

Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH
Explanatory note: Our approach to the CSDR
settlement discipline rules



LLOYDS BANK

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1 Introduction to the CSDR Settlement Discipline Regime

- 1.1** This note aims to provide you with a summary of the CSDR settlement discipline rules, including mandatory buy-in rules for relevant uncleared over-the-counter ('OTC') transactions under the EU Central Securities Depositories Regulation (2014/909/EU) ('**CSDR**')¹. We're implementing this change by updating our Terms of Business with the Terms of Business CSDR Annex ('**Annex**') which you should read together with this note.
- 1.2** In addition, any trades you make with us which are centrally cleared by an EU central counterparty ('**CCP**') and any uncleared OTC transactions with us which are on an EU trading venue are also subject to the settlement discipline rules.
- 1.3** This note isn't legal advice and you should seek your own independent legal advice.
- Please read this note carefully and make sure you understand the requirements for both failing and receiving trading parties. We've updated our Terms of Business to take into account these requirements.
- 1.4** CSDR is an EU regulation which came into force on 17 September 2014. It removes some existing barriers to cross-border settlement, harmonises the timing and conduct of securities settlement in Europe, and introduces rules to make CSDs more robust. Some of these rules are already in place. The main settlement discipline measures will come into effect on **1 February 2022**. However, the mandatory buy-in obligation may be delayed by the European Commission before the end of 2021.
- 1.5** You'll see these new measures when we transact with you. These measures aim to reduce settlement fails and resolve them quickly and efficiently. The two primary measures are:
- (a) Daily penalties for any settlements and/or unmatched instructions that happen after the intended settlement date. Please read Section 6 below for more details.
 - (b) Mandatory buy-ins² for certain transactions in:
 - (i) Transferable securities (e.g. shares and bonds)
 - (ii) Money-market instruments
 - (iii) Units in collective investment undertakings
 - (iv) Emission allowances³where each of these are either:
 - (A) Admitted to trading or traded on a trading venue located in the European Economic Area ('**EEA**') or
 - (B) Cleared by a CCP located in the EEA ('**Relevant Financial Instruments**') and
in all cases, settle on a CSD located in the EEA.
- 1.6 Third country principal trading venue exemption**
- The mandatory buy-in rules for delayed settlements don't apply when the shares' principal trading venue is located in a third country outside of the EU, including the UK.
- 1.7 Securities financing transactions ('SFTs')**
- SFTs such as repos and securities lending transactions in Relevant Financial Instruments, where the second leg is intended to settle in an EU CSD more than 30 business days after the first leg, are in scope of the settlement discipline regime. If the second leg happens less than 30 business days after the first leg, such SFTs' settlements are out of scope.

¹ Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R0909>).

² These are set out in Articles 7(3) – (13) CSDR and Articles 21 – 38 Commission Delegated Regulation (EU) 2018/1229 of 25 May 2018 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline (<https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1579691857526&uri=CELEX:32018R1229>).

³ Each of these terms is defined in accordance with its meaning under Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (<https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1579693409800&uri=CELEX:32014R0600>).

2 Settlement Discipline – mandatory buy-in rules

2.1 The mandatory buy-in rules are triggered when settlements fail to deliver Relevant Financial Instruments (rather than fail to deliver cash) following a grace period after the intended settlement date.

The rules mean that when settlements fail, the receiving trading party is no worse off financially than if the settlement hadn't failed. The 'receiving trading party' (the trading counterparty whose Relevant Financial Instruments have failed to deliver due to a settlement fail) receives:

- (i) Financial instruments equal in value to those that have failed to settle, including reimbursement for any increase in price when compared to the agreed price for the Relevant Financial Instruments under the original trade; or
- (ii) Cash compensation if the Relevant Financial Instruments can't be delivered.

2.2 Depending on the transaction, you'll either be:

- The 'receiving trading party' where your trading counterparty has failed to deliver the Relevant Financial Instruments to you; or
- The 'failing trading party', where you've failed to deliver the Relevant Financial Instruments to your receiving trading counterparty.

Buy-in rules scope

2.2.1 The mandatory buy-in rules apply to:

- Transactions cleared by an EU CCP
- Transactions executed on an EU trading venue
- Transactions executed on an over-the-counter basis,

where a settlement fail occurs at an EU CSD to any Relevant Financial Instruments. Please also refer to Section 2 above and Section E of the FAQs for additional information on the scope and any exemptions from the buy-in rules.

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.

During this period, the receiving trading party can't commence a buy-in and the failing trading party has a further opportunity to deliver the Relevant Financial Instruments.

Mandatory partial settlement

2.2.2 If some of the Relevant Financial Instruments are available for delivery on the last business day of the extension period, the receiving trading party must accept the partial settlement and pay the failing trading party for the part of Relevant Financial Instruments delivered to it. The failing trading party is obliged to deliver the remaining Relevant Financial Instruments subject to the transaction.

Verification of whether a buy-in is possible

2.2.3 If none, or only some, of the Relevant Financial Instruments have been delivered by the end of the extension period, the receiving trading party must verify whether a buy-in is possible (see paragraph 2.2.2 above).

2.2.4 If a buy-in isn't possible, the receiving trading party must tell the failing trading party and the failing trading party must:

- (i) Pay cash compensation to the receiving trading party based on the difference between the original settlement price (or market value on the trade date for free of payment settlements) and the market value of the equivalent financial instruments the day before payment of the cash compensation; and
- (ii) Reimburse the receiving trading party for all costs related to the buy-in process.

3 Buy-in procedure

3.1 If a buy-in is possible, the receiving trading party must appoint a buy-in agent on the business day after the end of the extension period and tell the failing trading party. The buy-in agent must act in the best interests of the failing trading party (rather than the receiving trading party that appointed it) and must not have any conflict of interest in the execution of the buy-in.

3.2 The buy-in agent then has **4** business days to source liquid shares from the market and **7** business days for all other financial instruments.

3.3 The failing trading party can still deliver the Relevant Financial Instruments to the buy-in agent if the buy-in agent agrees.

3.4 The receiving trading party must notify the results of the buy-in to the failing trading party and:

3.4.1 **Where the buy-in is successful:** For each buy-in held, the financial instruments will be paid for and delivered to the receiving trading party. Any price increase compared to the price agreed in the original transaction will be paid by the failing trading party to the receiving trading party within 2 business days of the financial instruments being delivered, as well as all costs of the buy-in process, including execution fees. Unlike certain wholesale markets (namely fixed income), where the price decreases, the receiving trading party will not pay the price difference to the failing trading party; and

3.4.2 **Where the buy-in isn't successful (either in part or in full):** At the end of the initial buy-in period, the receiving trading party may defer the buy-in by a further **4** or **7** business days. At the end of this period, any further failure would mean cash compensation needs to be paid. If it doesn't defer, or if by the end of any deferral period the buy-in hasn't succeeded in full, the failing trading party must pay cash compensation to the receiving trading party. The failing trading party must also reimburse the receiving trading party for all costs of the buy-in process, including execution fees.

4 Buy-in contractual compliance rules

4.1 CSDR requires all parties in the settlement chain for transactions in a Relevant Financial Instrument to establish contractual arrangements with their relevant counterparties that incorporate the CSDR buy-in process requirements and procedures.

4.2 This is necessary to allow the flow of information, the enforcement of buy-in and the management of payment flows and their instruction through any intermediary chain, if applicable.

4.3 It also gives indirect extra-territorial effect to the CSDR buy-in regime, as it means that parties in the settlement chain located outside of the EEA will be under a contractual obligation to comply with the buy-in rules.

5 Settlement Discipline - Other requirements

Cash penalties

5.1 One of the main measures to prevent settlement failures to be implemented under the settlement discipline regime will be the imposition of daily cash penalties for each business day's settlement delay after the intended settlement date. Penalties are removed from the failing trading party's cash accounts held at their custodian by the relevant EU CSD. You'll need to keep enough money in the relevant settlement currency at your custodian to meet any cash penalties.

Daily penalty rates are below:

	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.

5.2 Penalties apply to unmatched instructions and settlements failing after the intended settlement date in EU CSDs for securities that are either:

- (a) Admitted to trading or traded on an EEA trading venue; and/or
- (b) Cleared by an EEA CCP.

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

- 5.4** Penalties will continue to be levied until the first to occur of settlement, transaction cancellation, the occurrence of a buy-in and/or the payment of cash compensation.

Hold and release and cancellation of instructions

- 5.5** The Commission Delegated Regulation (EU) 2018/1229 (the '**RTS**') requires CSDs to establish hold and release mechanisms and bilateral cancellation facilities for the instructing participants to block, release or cancel matched or pending instructions, as required in the RTS to deal with buy-ins and partial settlement, as applicable. If you're a CSD participant, you'll need to confirm you have the operational capability to send appropriate instructions/ take appropriate actions in line with the RTS requirements. If you're a custody client (i.e. an indirect participant at a CSD), you'll need to confirm you have the operational capability to instruct your direct custodian accordingly to comply with the RTS requirements, as applicable.

6 Impact of the UK's withdrawal from the EU

- 6.1** The UK Chancellor's announcement on 23 June 2020 confirmed that the settlement discipline regime would not be applied to settlement instructions/ settlements occurring at UK CSDs, such as CREST.
- 6.2** However, where we execute securities transactions with you that settle in an EU CSD, such settlements and the associated settlement instructions shall be subject to the settlement discipline regime.

7 Written allocations and confirmations

- 7.1.1** Under Article 2 of the RTS, we need to arrange with you, as a Professional Client, for certain information to be communicated between us within certain time limits.
- 7.1.2** These obligations apply when you trade the following financial instruments with us which settle on a CSD located in the EEA:
- Transferable securities (e.g. shares and bonds)
 - Money-market instruments
 - Units in collective investment undertakings or
 - Emission allowances.
- 7.1.3** As a Professional Client, our Terms of Business have been updated to exempt both you and us from being required to exchange this allocation and confirmation information where we deliver and settle securities to each of your securities custody accounts (per settlement currency) for which we hold/ have been provided in advance with the relevant co-ordinates (standard settlement instructions or '**SSIs**').
- 7.1.4** Where you usually alternate your securities transaction settlements to different securities accounts, such as to sub-accounts, you can also rely on this exemption, provided you provide to us (in writing, via an electronic platform or by SWIFT message) certain transaction specific information (including, trade price, trade notional amount, intended settlement date, your custodian LEI, your standard settlement instructions, etc..) by the specified cut-off times to comply with the RTS requirements. The Schedule to the Terms of Business CSDR Annex includes all required regulatory information you must give us.

Time limits

- 7.1.5** You must provide the required regulation allocation information and/or confirmation within the following time limits:
- (i) Where you and we are in the same time zone, by close of business on the business day of the transaction; or
 - (ii) Where there's a difference of over two hours between your and our time zones, or the orders have been executed after 16.00 CET on the business day within our time zone, by 12.00 CET on the business day following the transaction.

Method of communication

- 7.1.6** We'll provide you with the option of sending the written allocation and confirmation electronically and through other communication methods agreed between us in our contractual terms.

We'll let you know what means of communication may be used for allocations and confirmations. We will use international open communication procedures and standards for communication procedures (such as standardised messaging formats and data representation).

