Central Securities Depositories - Regulation

December 4th 2018

CRÉDIT AGRICOLE
CORPORATE & INVESTMENT BANK

Contents

CONTEXT

Some piece of History

- **As soon as 2004,** European Commission performed some workshops on the need to provide some rules on CSDs and globally on the European post trading
- No reason at that time to speed up the process and **crisis 2007-2008** proved the relative "good health" of CSDs which were viewed like "safe" for many actors. CSDs were followed closely under domestic law
- **G20 decisions on OTC Clearing** for Derivatives products
  - The G20 was instrumental in establishing the core elements of a new global financial regulatory framework that should make the financial system more resilient
- **MIFID 2008** aims at harmonizing rules among the European market (trading platforms)
- **EMIR 2013** -> in respect of CCPs and Trade repository
  - => Fixed Income Settlement & Custody functions were missing in the scope
- **CDSR** should be seen as complementary to both EMIR and MIFID regulation

Who's concerned

- **Who's concerned?**
  - CSDR applies to European **Central Securities Depositaries (CSD's)**
  - CSDR applies as well to any entities being participants on those CSDs (result of the requirements imposed on CSDs themselves)
    - **Issuers** that issue securities in EU CSDs
    - **Participants to CSDs**
    - **Banks** that offer banking services to CSDs

What's the aim

- **To set up some common rules** for CSDs through European Markets
  - Need of harmonizing settlement infrastructures obvious since T2S implementation
- **To increase the safety & efficiency of securities settlement**
  - Raise & tackle the "Failed topic" which was highlighted during & after the Financial crisis
- => To improve operational efficiency and asset protection

Contents

TIMELINE

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020

2011 :

First text issued by European Commission on this topic

August - September 2014:
- Entry into force of CSDR, 20 days after publication in the Official Journal of the EU

March 2017:
- Publication of Level 2 measures (excluding settlement discipline) in the Official Journal

September 2017:
- Deadline for CSDs to apply for re-authorization

September 2020, 14th:
- Entry into force Settlement discipline

EU CSDs

- **New operating license**
- **Organizational requirements**
- **Prudential requirements**

CSD Customers

- **Wider requirements**
- **New account segregation rules**
- **Daily reconciliation processes**
- **Book entry form of securities**
- **Using of Legal Entity Identifier code (LEI)**

CSD Customers

- **New settlement discipline regime**
- **T+2 settlement cycle**
- **New systematic buy ins**
- **Penalties**

Contents

SUMMARY OF IMPACTS

New operating License	• **CSD Passport**
Organizational requirements	• CSDR changes the CSD landscape by reducing the number of CSD operating currently around 40 • Concentration of CSD
Prudential requirements (LIVE)	• **CREDIT** • Credit lines, custody advances or Bank guarantees need to be collateralized • **COLLATERAL** • New rules for collateral valuation or haircuts • Review/set up of concentration limits • **LIQUIDITY** • Debit interest at a minimum threshold • **RISK MANAGEMENT** • Comprehensive risk management framework covering legal, operational and business risks

Stakes for final clients	• Syndicated new issues :
	  • To check we have sufficient collateral the day of the peak
	  • Revisit our current process for all syndicated issues where we are the issuer or lead manager
	• Custody advances : To use proceeds prior to payments confirmations, we ll need :
	  • A sufficient Credit line by the CSD/ICSD
	  • Sufficient collateral associated with the credit line

SUMMARY OF IMPACTS

Wider Requirements

- **ACCOUNT SEGREGATION**
- CSD customers to offer to their clients choice between
- Omnibus client segregation or not
- CSDs and customers to disclose levels of protection and cost associated

- **RECONCILIATION**
- CSD Customers to reconcile their records with the information received by the CSD on a daily basis

- **BOOK ENTRY FORM**
- End of paper securities (dematerialization)
- Securities transferable or admitted on trading venues

- **MANDATORY LEI**
- Unique 20 character code that identifies legal entity
- CSDs to collect LEIs from CSD customers or issuers
- Should facilitate record keeping

Contents

SETTLEMENT DISCIPLINE

Key changes

Global Target	• The aim is to set up one single rule package for all European Markets. • CSDs will require its customers to ensure smooth settlement on the intended settlement date • Individual settlement performance will be reviewed by CSDs and reported to regulators • Sanctions for non-compliance may apply
Failed prevention	• **Extended settlement period** • Following the liquidity of products, we have extended period s of settlement from 3-7-15 days before some penalties apply • **Partial settlement** • CSD-R open the door to partial settlement. • The aim is to force the partial settlement as soon as counterparty hold part of the nominal traded • => Should lead to further use of standardized settlement messaging services by participants • => May impact market liquidity
Buy In	• Trading parties or CCPs will be required to initiate buy ins and report the outcome details to the CSDs • Fails matched however failing due to lack of securities will be taken into account as well

Penalties	• Beyond this period, CSDs are required to play a "new" role to facilitate such process
	  • To calculate, report the amounts due on a daily basis
	  • To collect & redistribute money back to counterparties concerned
	• **ICSDs** (Clearstream, Euroclear Bank) will follow this new process
	• It will take place at least monthly

CONFIRMATIONS / SETTLEMENT DISCIPLINE

What is at stake for final customers like CACIB

Confirmations

- The aim is to ease confirmations process following the requirements (deadlines) of ESMA
- => We have to define new market practices -> discussed in groups like AFTI
- Standardization of data exchanged, allocation 2 hours after trade is executed

Penalties processes

- One target : to limit penalties
- From a CIB view, we closely monitor Failed trades, including short positions
  - Workshops with our Front Office
  - Use of RPA to have real time status of trades
  - Systematic chasing of our counterparties
  - => Improve our settlement efficiency

Buy In Management

- Workload and current process to define following the regulation some process & market practices allowing to deal with Buy In in an easier way than today

Contents

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NEXT CHALLENGES

Challenges

- Represents a big structural change in market practices
- Significant technical changes for CSDs to make the necessary adaptations
- Capacity for domestic CSDs to innovate in an environment of change
- National protectionism

Benefits expected

- Securities infrastructures linked with common EU rules
- Solving the costly fragmentation of securities market infrastructure => final phase of T2S?
- Stimulates competition between actors