Central Securities Depositories Regulation (CSDR)

Frequently Asked Questions (FAQs) for HSBC Clients

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HSBC

Table of contents

Background

1. What is CSDR?

The Central Securities Depository Regulation Settlement Discipline Regime (CSDR) is European Union (EU) legislation, developed by the European Securities and Markets Authority (ESMA). The aim of CSDR is to harmonise certain aspects of the settlement cycle and settlement discipline and to provide a set of common requirements for CSDs operating securities settlement systems across the EU. CSDR plays a pivotal role for post-trade harmonisation efforts in Europe, as it enhances the legal and operational conditions for cross-border settlement in the EU.

The main objective of CSDR is to increase the safety and efficiency of securities settlement and settlement infrastructures (CSDs) in the EU by providing, among others, for the following:

- Shorter settlement periods;
- Settlement discipline measures (mandatory cash penalties and 'buy-ins' for settlement fails, settelement fails reporting);
- An obligation regarding dematerialisation for most securities;
- Strict prudential and conduct of business rules for CSDs;
- Strict access rights to CSD services; and
- Increased prudential and supervisory requirements for CSDs and other institutions providing banking services ancillary to securities settlement.

Further information on CSDR can be found on ESMA's website.

2. When is CSDR coming into effect?

The third phase of the CSDR, the Settlement Discipline Regime (SDR) has been delayed to February 2022. The industry is in consultation with EU Commission/ESMA to discuss key roadblocks to implementation around buy-ins and other items. The announcement that the UK will not implement SDR signals a divergence in rule making between the EU and the UK.

3. How is CSDR preventing settlement failures?

With the introduction of:

- Allocation and Confirmation requirements within 2 hours for EEA domiciled clients,
- Matching and population of settlement instructions (mandatory fields such as transaction type, trade venue and MIC Code),
- Settlement tolerance level changes,
- Bilaterally agreed Cancellation facility,
- Hold and Release and
- Partial Settlement

Scope

4. Who is impacted by CSDR and are we in scope?

CSDR and its settlement discipline regime are extraterritorial in nature since all market participants, regardless of domicile, are impacted when trading and settling securities issued and held in EEA CSDs

5. What instruments are in scope?

The CSDR settlement discipline regime apply to transferable securities, money-market instruments, units in collective investment undertakings and emission allowances.

Transferable securities include:

- Shares in companies (whether listed or unlisted, admitted to trading or otherwise), comparable interests in partnerships and other entities and equivalent securities. (Cash Equities, Notes, ETFs).
- Bonds and other forms of securitised debt;
- Depositary receipts in respect of the instruments above;
- Securities giving the right to acquire or sell transferable securities (E.g. warrants, convertible bonds)

- Securities settlement stemming from derivatives contracts

N.B. – OTC derivatives concluded by a confirmation under an ISDA master agreement do NOT amount to transferable securities (FCA Handbook).
Essentially any Financial instrument physically settling at an EU CSD should be considered as an in scope product for the CSDR settlement discipline regime.

6. Are derivatives in scope of CSDR?

Exchange traded and OTC derivatives are not included within the list of in-scope financial instruments, however they are impacted where:

- Physically settled OTC and exchange traded derivatives – OTC and exchange traded derivatives that are physically settled by the delivery of cash in one or more currencies are not in scope
- Margin transfers – the transfer of margin where the relevant margin consists of in-scope financial instruments.

There are a number of outstanding open questions with the European Commission which may affect certain nuances of this, and we await the response to these.

7. How does CSDR impact Prime Brokerage clients?

CSDR SDR is applicable to all markets participants settling on EEA CSDs, and covering prime brokerage clients also.

Trade Settlement and Messaging

8. Settlement instruction fields: What has changed?

Counterparties may be required to populate two additional fields within their settlement instructions. These are:

- Transaction type (mandatory)
- Place of trade and place of clearing (in some instances). 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. 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.

9. How would you communicate discrepancies on settlements to Client?

HSBC Debt Securities or Equities Operations will contact Client via email/ phone to convey any settlement discrepancies – same as current processes.
We will continue to leverage on the BAU Process and BAU contacts if no response from our chasers is received. Client trades are confirmed on electronic platform CTM, and normally trade economic discrepancies are identified prior to Intended Settlement Day.

10. What is the Fails reporting mechanism that you have in place and would the report include Trade matching reference (CTM ID) and CSDR clarification for each trade?

We do not send any specific fails reports. We will continue to leverage on BAU process for items managed and confirmed in CTM. We have no plans to include the CTM ID or any CSDR clarification.

11. Do you have a Global coverage model for EMEA Market settlements?

We do not have a follow the sun process, however our settlement teams cover European settlement from around 8am to 6pm each day. These timelines should cover all European settlements and capture any issues in good time

12. How would you notify Client when a CCP is involved in the chain of the transaction?

Notification relating to these trades will be completed on a case by case basis with the email and phone queries. Please also refer to item 1

13. **In the instance of a trade fails due to your liability (e.g. short of securities, etc.), would you be flipping the trade to "Hold" before the market close at the end of extension period to avoid deliveries in the overnight batch?**

No, HSBC will not flip its trade on hold

14. **What are the concrete measures taken by you to avoid fails/settlement (eg SSI/PSET review)?**

We will continue to ensure our SSIs are properly updated in Alert. We will activate auto-partial settlements to improve our settlement efficiency. We are conducting internal reviews to identify and remediate fails root causes

15. **What industry tools you are looking to leverage to help improve the settlement workflow? E.g. AccessFintech, Taskize or other?**

We will improve the settlement workflow using extisting BAU processes and systems

Partial settlement

16. **What are the CSDR requirements for partial settlements?**

CSD's are required to enable partial settlement on client accounts, on the final day of the extension period. However participants could still split/partial trades manually

17. **What will be your approach on partial settlement? Do you intend to automate it?**

We will activate auto partial settlement. Auto partial settlement monitoring has been automated.

Penalties

18. **How will Penalties work?**

Where a trade fails to settle on the ISD, cash penalties for late matching and settlement failure will be imposed. The degree of penalty is dependent on the type of asset:

Type of Security	Penalty
Liquid Shares	1 basis point (bp)
Illiquid Shares*	0.5 bp
SME Growth Market	0.25 bp
Corporate Bonds	0.2 bp
SME Growth Market Bonds	0.15bp
Government and Municipal Bonds	0.1 bp
Cash**	European Central Bank Discount Rate

**Includes other financial instruments such as ETFs, Certificates and Derivatives*
***Applies when the settlement fails due to a lack of cash*

19. **How is the cash penalty calculated?**

- For late matching fail penalties: retrospectively from the ISD until the actual matching date.
- For settlement fail penalties: Either the ISD or matching date (whichever is earliest) to the date of actual settlement or cancellation of the instruction. These will be imposed daily and collected monthly by the CSD, until the trade is settled, cancelled or mandatory buy-in takes effect. Net amounts should be calculated in the settlement currency.

For further information on penalties calculation please refer to the ECSDA CSDR Penalties Framework.

20. Cash penalties: Which type of instructions will be subject to cash penalties?

- Settlement instructions settling at an EU CSD either matched on/after their ISD or failing to settle on/after their ISD will be subject to cash penalties.
- Redemptions (i.e REDM), corporate actions on stock (i.e. CORP) and technical instructions will not be in scope for cash penalties.

21. How are you preparing yourself to handle this new activity ?

We will ensure we match on time and follow market practise guidelines for penalties

22. Are you planning to introduce a threshold level (Euro 500 for instance) below which no penalties/bonuses will be claimed ?

We will follow AFME Market Practises for claims thresholds. For further details please refer to AFME's website.

23. For penalties, what will happen with instructions already failing before the go live(activation date) of the SDR?

CSDs will start collecting/re-distributing penalties as from 1 February 2022, so any penalty which calculation date is on or after 1 February 2022 is included in the global net amount due in March 2022. There is no retro-active effect.

24. Do you expect any changes in our current contractual agreements?

There is no requirement to update documents for penalties.

Allocation and Confirmation

25. How does the Allocation and Confirmation process address settlement fails?

Under the CSDR, in an attempt to ensure prompt settlement and to prevent a settlement fail, investment firms executing client orders are required to collect certain information concerning clients' transactions. This includes an allocation by the client of securities to the transaction, confirmation of that allocation and confirmation of the acceptance or rejection of the terms of the transaction before the intended settlement date.

This requirement applies to any transaction settled in a CSD if that transaction concerns transferable securities, money-market instruments, units in collective investment undertakings or emission allowances. This requirement does not apply in respect of other transactions including, for instance, derivative contracts. The firm's clients (although not market counterparties) must then provide certain prescribed information to the investment firm executing their order as well as the client's written confirmation of acceptance of the terms of the underlying transaction.

CSDR puts the focus on the confirmation process to prevent settlement fails and ensure transactions can settle in intented settlement date.

26. What are the CSDR requirements during the Allocation and Confirmation process?

Clients are requested to confirm Investment banks transaction details (including SSI). This can be avoided if financial details were agreed at negociation level and if Standard Settlement instructions have been provided ahead of the transaction negociation (SSIs have been provided at onboarding level or are made available via a central database such as Alert). In case of allocations, CSDR is encouraging the use of electronic allocations and confirmations platforms (electronic channels) were both transactions details and SSI can be acknowledged.

27. When do confirmation and allocation messages need to be received?

Confirmation and allocation messages are required to be received by the investment firm by close of business on the business day 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.

28. It is seems that the consequence of not meeting this deadline is unclear. Do you have more information on this topic ?

There are no punitive sanctions if we are not meeting this aspect of the regulation. However, HSBC plans to comply with the regulation.

29. Are you taking any specific measures to align your process to meet this requirement?

We will ensure Standard Settlement Instructions are given by the client at onboarding or made available in Alert.
Considering the regulation makes it mandatory to offer the capacity to confirm transaction details via electronic channel, we will welcome all clients initiatives willing to confirm via TRAX, CTM or FIX.

30. Do you envisage any changes to your systems or processes affecting your counterparties as a result of CSDR trade allocation and confirmation requirements?

Some changes have been delivered in HSBC’s confirmation electronic platforms to improve matching rate, such as including some place of settlement fields and improving tolerance levels.

Documentation

31. Would there be a requirement for any additional legal documentation between Client and yourself for CSDR?

Our approach is to set the new principles at the Terms of Business (ToB) level, leaving to the operational teams the flexibility to organize the way they collect the necessary information before trades to avoid the affirmation/confirmation requirement. We can confirm there will be no further change in the trades documentation.