C3 Post Trade CSDR - Compliance controls and expertise you can count on

CSDR Explained

The CSDR Settlement Discipline Regime is due to come into force on the 1st February 2022. CSDR's goal is to improve the safety and efficiency of securities settlement systems across the European Economic Area (EEA). The location of the settling party is not relevant and therefore firms that are based outside the EEA with trades settling in EEA CSDs and ICSDs are impacted. UK firms will be impacted where their transactions are settling in EEA CSDs and ICSDs.

There are three pillars:

1. Measures to **prevent** settlement fails
2. Measures to **address** settlement fails
3. Measures to **monitor** settlement fails

"We estimate that over 10,000 firms globally will be directly impacted by the measures to address settlement fails: the introduction of cash penalties and a mandatory buy-in framework. This includes both buy-side and sell-side firms."
- Paul Gill, Partner & CPO, C3 Post Trade.

Settlements in the UK CSD (Euroclear UK) will not be subject to the regime. Again, the location of the settling party is not relevant. Settlement Discipline is included in the current EC consultation on CSDR. The outcome is not yet known but current industry consensus appears to be:

- Interest penalties: **these will happen**
- Mandatory buy-ins: **likely to happen so we urge firms to plan for the worst and hope for the best**

What is the impact of CSDR?

The regime has a firm-wide impact, including on the front office and especially if mandatory buy-in requirements don't change.

"Examples of issues buy-side firms need to consider include tracking indexes, lending costs, cash compensation, hedge transactions, pr=oving best execution, and accounting for interest penalties. Sell-side firms need to ensure they validate and process interest penalties and buy-ins in line with client agreements and regulatory obligations". - Rob Denham, Founder & CEO, C3 Post Trade.

- Firms will receive their first fails penalties reports on 2nd February 2022
- Those with multiple CSD or custodian relationships will receive a report from each of them
- These reports will show the debit or credit interest associated with each fail
- Interest will then need to validated and allocated appropriately, in line with internal policies and external regulatory and contractual obligations (such as MiFID)
- Monthly summaries need to be checked back to item level daily reporting
- For a firm with 250 fails a day this means at least 20 reports and 5,000 interest debits and credits every month
- Few will be individually material, but all need to be processed

The first mandatory buy-ins are due a few days later. The timescales for these vary according to the instrument type, liquidity, and trading venue but will usually be after 4 business days (liquid shares) or 7 business days (most other transactions).

"Processing buy-ins will be hard to track and control. For example, the initiator needs to check that buy-in is feasible, select the agent, issue the instruction, process the result, cancel the original failed instruction, and keep their counterparty informed".

- Paul Gill, Partner & CPO, C3 Post Trade.

How should firms prepare?

The starting point should be an impact assessment based on an analysis of the expected penalty interest, potential buy-ins, their causes, the impact on clients and the front office, and regulatory and contractual considerations. This will give the basis for determining the size and scope of the project needed and ensure that resources are appropriately allocated across the various workstreams.

Planning and preparation activities can be categorised as:

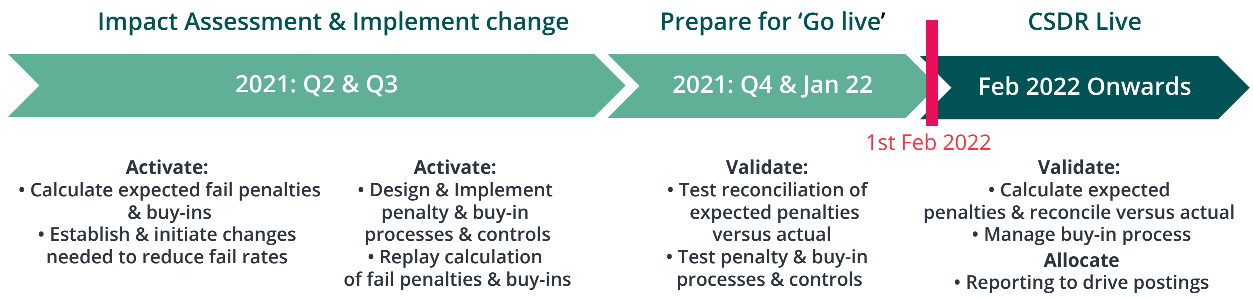
1. **Reducing fails across all impacted business activities** (cash trading, repo, stock lending, etc) – fewer penalties, fewer mandatory buy-ins. A trade that settles on ISD (intended settlement date) won't ever be penalised or bought in. What changes are needed to improve settlement rates and reduce the time to resolve fails?
2. **Front office preparation** – counterparty/broker performance needs to be reviewed, client impact including contractual changes assessed, etc. How will this be monitored and managed?
3. **Processing penalties** – we conservatively estimate c.€1.5bn pa total debit and credit interest. These are significant new flows. How are they going to be validated and allocated? How will queries be resolved? Who is going to do this?
4. **Processing mandatory buy-ins** – these impact a lot of business areas: front office, middle office / fund accounting, settlements, etc. Who will own these and coordinate across the firm?

The Clock is ticking – C3 CSDR is here to help:

Before the regime goes live: *Assess the impact, reduce fails & buy-ins, build the controls & MI needed*

After go-live: *Validate and allocate penalties, manage buy-ins, maintain reduced fail & buy-in rates*

CSDR Timeline



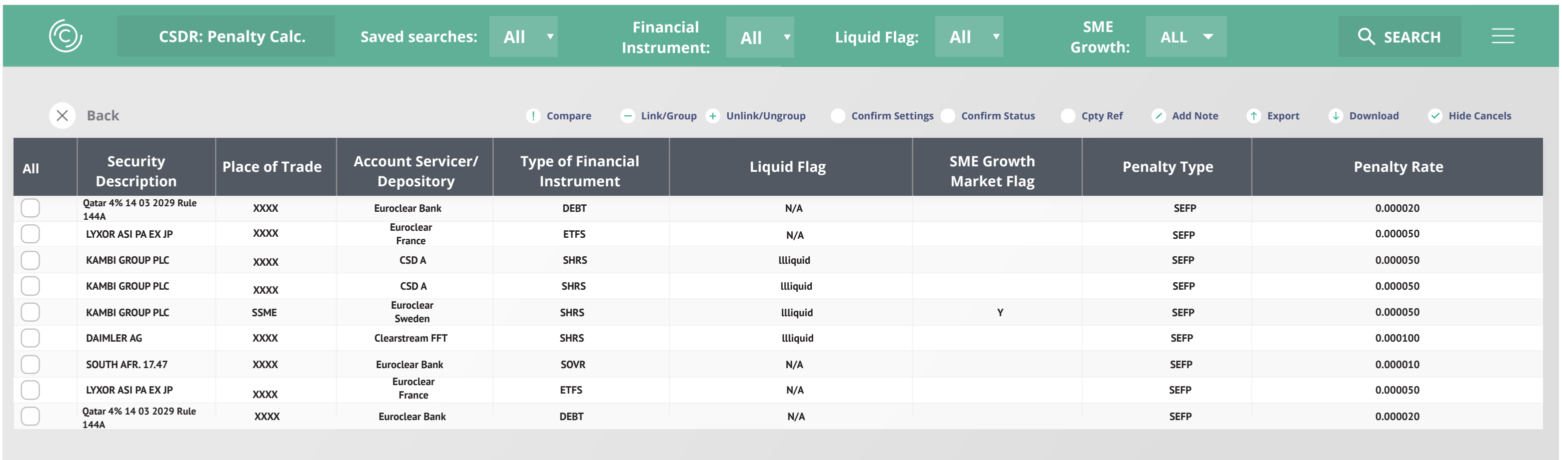
How can C3 help?

C3's CSDR fully managed service takes the worry out of compliance.

We help ensure fewer fails and buy-ins, enable validation and allocation of penalties, and offer a comprehensive audit trail to keep track of everything.

Calculation of the fail penalty rate:

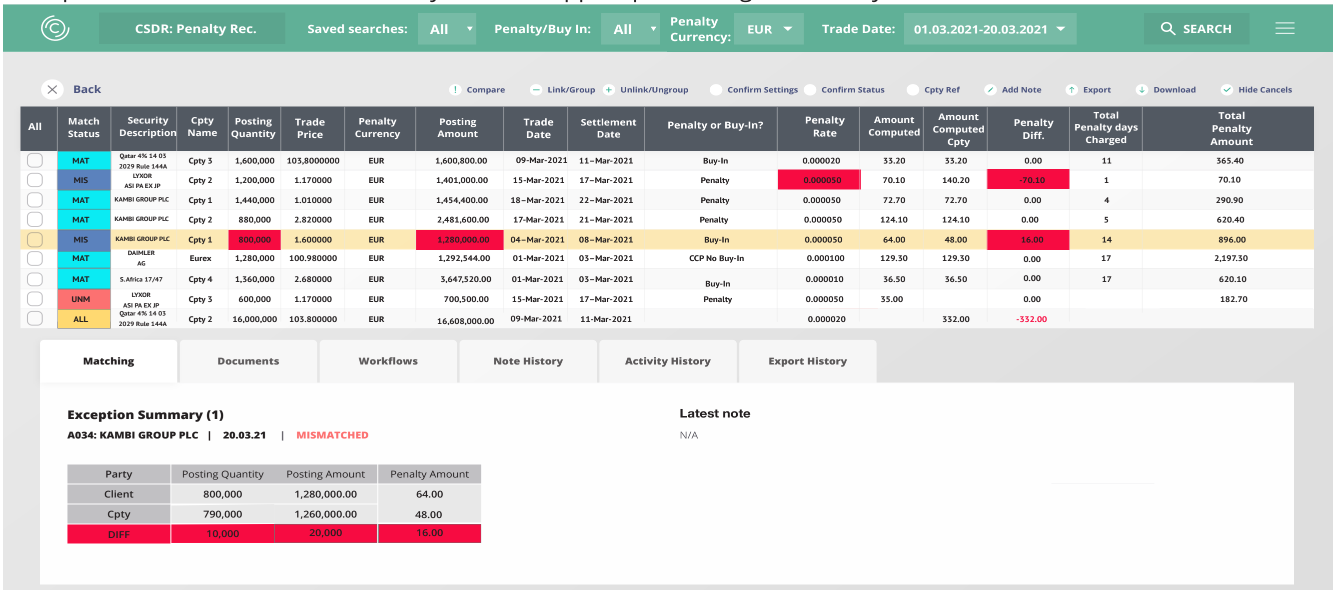
- **You** provide your security identifier.
- **We** calculate the settlement fail penalties as per the ECSDA CSDR Penalties framework.
- **We** manage data sources including the client's Failed Trade file and reference data including the ESMA FIRDS database, Financial Instrument Type from the CSDR SDR RTS Annex 1, Liquidity indicator from FITRS, SME growth market indicator from the ESMA website, the penalty rates published in the Delegated Regulation.



All	Security Description	Place of Trade	Account Servicer/ Depository	Type of Financial Instrument	Liquid Flag	SME Growth Market Flag	Penalty Type	Penalty Rate
	Qatar 4% 14 03 2029 Rule 144A	XXXX	Euroclear Bank	DEBT	N/A		SEFP	0.000020
	LYXOR ASI PA EX JP	XXXX	Euroclear France	ETFS	N/A		SEFP	0.000050
	KAMBI GROUP PLC	XXXX	CSD A	SHRS	Illiquid		SEFP	0.000050
	KAMBI GROUP PLC	XXXX	CSD A	SHRS	Illiquid		SEFP	0.000050
	KAMBI GROUP PLC	SSME	Euroclear Sweden	SHRS	Illiquid	Y	SEFP	0.000050
	DAIMLER AG	XXXX	Clearstream FFT	SHRS	Illiquid		SEFP	0.000100
	SOUTH AFR. 17.47	XXXX	Euroclear Bank	SOVR	N/A		SEFP	0.000010
	LYXOR ASI PA EX JP	XXXX	Euroclear France	ETFS	N/A		SEFP	0.000050
	Qatar 4% 14 03 2029 Rule 144A	XXXX	Euroclear Bank	DEBT	N/A		SEFP	0.000020

Calculation & reconciliation of the penalty:

- **You** provide failing trade details, we calculate the expected penalties
- **You** provide the CSD/custodian/etc. fail penalty reports, we reconcile against expected penalties
- **We** provide reporting to support internal and external allocation, posting, and reporting
- **We** provide MI to help minimise fails and potential buy-ins and maintain improved settlement rates
- **We** provide workflow to minimise buy-ins and support processing where they do occur



Posting & Reporting of fail penalties:

C3 will provide a formatted export of fail penalty data to automatically post data into the client's accounting system or to drive additional reporting.

C3 Summary Benefits:

- Calculate expected penalty interest and identify potential buy-ins
- Import and track penalty reports from CSDs/ICSDs, CCPs and custodians
- Experience a full audit trail of actions and approvals at your fingertips
- Leverage MI to monitor, manage and control your views

C3 Workstream	C3's CSDR Offering
Calculate	• An impact assessment covering expected penalty debit and credit interest, the number of buy-ins, the impact on clients and the front office, and regulatory and contractual considerations.
Reconcile	• Have complete visibility of daily fails and penalties per custodian, prime broker, CSD and CCP. • Calculate expected penalties & buy-ins. • Includes daily penalty reconciliation differences with a full audit trail of actions and approvals.
Post	• Generates postings – both agreed debit and credit interest, over/under, and other charges. • Our daily and monthly reporting features make management and control under CSDR so much easier. You'll have access to MI from historic data to identify and fix issues, receive alerts and be fully supported to validate penalties.
Additional Benefits	• Stay on top of files you've received and processed with our connectivity dashboard. • A comprehensive calculation of expected penalties. • Minimise buy-ins with countdown reporting. • Buy-in workflow management.

To discover more of our CSDR service offering, please email: Paul Gill, Partner & CPO, C3 Post Trade at: paul.gill@c3posttrade.com