SPARKASSE
Bank Malta plc

Central Securities Depositories Regulation (CSDR) – Settlement Discipline Regime (SDR)

Q&A:

1. What is CSDR?

The Central Securities Depositories Regulation 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 ('CSDR') is one of the key regulations adopted to harmonise certain aspects of the settlement cycle, to instill settlement discipline and to provide a set of common requirements for Central Securities Depositories ('CSDs') operating securities settlement systems across the EU. It provides for:

- Shorter settlement periods;
- Settlement discipline measures (mandatory cash penalties and 'buy-ins' for settlement fails, settlement 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.

A major change that is being introduced by CSDR is the 'Settlement Discipline Regime (SDR)' which is outlined in the regulatory technical standards Commission Delegated Regulation 2018/1229 supplementing CSDR and which comes into force on 1st February 2022.

2. What and who does CSDR apply to?

- Participants

  CSDR affects all market participants, wherever located, which are active in securities that settle within a European CSD (including ICSDs). It will affect both direct and indirect CSD participants (including Central Clearing Counterparties 'CCPs' and settlement agents) and both buy and sell-side institutions.

- Instruments

The following instruments will be in scope of the Settlement Discipline Regime (as per Article 5(1) of CSDR):

- transferable securities
- money-market instruments
- units in collective investment undertakings
- emission allowances

For clarification, SBM will continue to provide settlement services for the following instruments:

- Transferable instruments
- Money market instruments
- ETFs

- Transactions

Transactions in scope:

Transactions cleared by a central counterparty (CCP)
Transactions not cleared by a central counterparty (CCP) but executed on a trading venue
Transactions not cleared by a central counterparty (CCP) and not executed on a trading venue

The Bank provides settlement services for the following transactions:

- Trade (purchases and sales)
- Securities lending and borrowing
- Repo
- Portfolio transfer
- Collateral transactions

3. Does it have impact on the customers of Sparkasse Bank Malta?

Currently, the Bank has identified the following areas that have or will have an impact on customers:

- Custody payments (for income proceeds) – IMPLEMENTED

  Custody and income proceeds are no longer advanced to customers on an unsecured basis, i.e. the payment is only effected once it has been confirmed by the issuer CSD/agent.

- Option for segregated account at the market level – IMPLEMENTED

  The Bank already allows customers to open segregated accounts at a level of CSD - with justification and as is reasonably required (e.g. tax services, market rules, etc.)

- Settlement discipline regime (as of 1st February 2022)

  Settlement discipline regime (SDR) affects all market participants. It harmonises aspects of the settlement cycle and introduces new rules for cash penalties and buy-ins.

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4. What measures will be introduced by the Bank to minimize settlement fails?

Under SDR, a settlement fail means the non-occurrence of settlement, or partial settlement of a securities transaction on the intended settlement date, due to a lack of securities or cash and regardless of the underlying cause. Under CSDR, the Bank has an obligation to minimize settlement fails and is therefore introducing certain changes to the current process for dealing with customer settlement instructions. These changes will also help customers reduce the amount of settlement penalties they will incur and the need of a buy-in.

4.1 Allocation and confirmation

The customers will be required to send written allocation and confirmation electronically by close of business on the same day on which the transaction has taken place or by 12.00 CET on the following business day (if the order is executed after 16:00 CET).

Any instructions received will be electronically acknowledged by the Bank within two hours.

4.2 Matching and population of settlement instructions

The customers would be required to use additional matching fields in settlement instructions to ensure consistency across securities settlement systems (e.g., trade participant identifiers, transaction type, place of clearing/trading, etc) and provide full, accurate and correct information on an ongoing basis.

As a result, the Bank will be introducing a template instruction form to cater for the additional fields.

4.3 Monitoring settlement fails (settlement efficiency)

Customers are encouraged to analyse their settlement behaviour including fail reasons patterns and late matching situations.

If a problem is detected, the CSD or sub-custodian (if applicable) will advise the Bank, and the Bank will attempt to resolve the issue prior to the contractual value date; which may involve contacting the customer or the counterparty, if necessary. To this affect, the Bank will also be offering Failed Settlements Reports that the customers will be able to subscribe to.

4.4 Addressing settlement fails

Incorrect securities details and standing settlement instructions (SSIs) are a common cause of mismatching or late matching. The Bank will be increasing its due diligence and monitoring of the counterparties selected by customers for trade purposes and with whom the Bank acts as settlement counterparty on customers' behalf. Consideration will also be given to those counterparties which are consistently inefficient in their settlement process leading to frequent settlement fails. Such circumstances may lead the Bank to terminate its arrangements with that counterparty. Please refer to correspondence already sent in this regard.

4.5 Will the Bank allow partial settlement?

The Bank already supports partial settlement for eligible transactions. Partial settlement can only be triggered in the case of a lack of securities on the delivering customer's account. Partial settlement is not triggered in the case of a lack of cash on the receiving side.

5. Settlement Fails – Are there any Penalties?

Currently, there are no penalties for late matching and/or settlement if customers or their counterparties do not deliver securities or do not have sufficient cash. Under the new SDR, CSDs will apply cash penalties for settlement instructions that fail to settle on their intended settlement day (ISD) and when the financial instrument is in scope.

Customers are encouraged to analyse their settlement processes, including the practice of instructing back-dated trades, prior to SDR entering into force.

5.1 What are the Penalty rates?

Penalty rates and calculation formulas vary according to liquidity, the transaction type and cause of fail.

There are two types of cash penalties:

- Late Matching Fail Penalties (LMFP) - **penalty that applies due to the matching taking place after the ISD**
- Settlement Fail Penalties (SEFP) - penalty that applies due to the non-settlement of a matched transaction on or after its ISD

The below is a summary of the cash penalty rates applicable to LMFP and SEFP:

Type of Settlement Fail	Security Type	Penalty rate applied
Settlement fail due to lack of securities	Shares that have a liquid market	1.0 bps
	Shares that do not have a liquid market and other financial instruments (Including ETFs, and certificates).	0.5 bps
	Financial instruments traded on SME growth markets (Excluding SME growth market bonds)	0.25 bps

	Government and municipal bonds	0.10 bps
	Corporate bonds	0.20 bps
	SME growth market bonds	0.15 bps
	Other financial instruments not covered above.	0.5 bps
Settlement fail 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.

Penalties will be calculated from the ISD of the failed settlement instruction onwards, irrespective of the settlement instructions actual matching date, i.e. instructions that are entered and matched into the CSD settlement system after their ISD will be subject to "late matching penalties".

5.2 When and how Penalties will be applied?

The penalties will be calculated by the CSD based on a daily reference price of the financial instrument to be identified by the CSD; the securities and the daily reference price data must be sourced from suppliers and/ or maintained by CSDs on ISIN level based on MiFID II/ MiFIR rules. The Bank intends to pass on penalties to its customers, as calculated and reported by the CSDs, upon final settlement of the transaction.

Penalties will be collected in EURO only and debited to the customer's default cash account.

Penalties only apply to matched instructions.

5.3 Will there be additional charges to cover administrative costs of the penalty mechanism?

Yes, details are yet to be determined and will be reflected in a revised fee schedule which will become effective with the introduction of SDR in February 2022.

5.4 Is there an appeal process for penalties charged?

Customers may address appeals regarding their penalties to the Bank within 5 working days from the day the penalty is applied by the Bank, by creating an appeal request. A specific form for lodging an appeal will be provided by the Bank in due course. The Bank will appeal to the CSD, on behalf of the customer, within the CSD's timeframe. If the appeal is accepted by the CSD, and the CSD reverses/refunds the penalty, then erroneous fees will be reversed from the customer's account.

6. Settlement Fails – Mandatory Buy-Ins

The SDR provides that a buy-in process shall be initiated if a failing participant does not deliver the financial instruments to the receiving participant within a set number of business days after the intended settlement date (the 'extension period') depending on the asset type, liquidity or whether the security is quoted on a Small and Medium Enterprise (SME) Growth Market. The extension period for initiating a buy-in process will be as follows:

- 4 business days after the intended settlement date for liquid securities
- 7 business days after the intended settlement date for illiquid securities
- 15 business days after the intended settlement date for securities quoted on a Small and Medium Enterprise (SME) Growth Market.

The buy–in needs to be effected at the level where the contractual obligations to buy and sell securities have been created and it aims for obtaining the failed-to-deliver securities from the market via an auction or buy-in agent to deliver them to the receiving party and thus to settle the transaction within a defined time frame.

Customers' instructions should include the correct transaction type that most accurately reflects the underlying economics of the transaction. It is important for customers to instruct the correct transaction type as this determines if a buy-in is applicable.

Customers shall establish contractual arrangements with their relevant counterparties that incorporate the buy-in process requirements as defined in SDR and inform the Bank once buy-in is initiated so that the original instructions can be put on hold to prevent settlement. Once the buy-in is completed and the securities are received, the original instructions will be bilaterally cancelled.

7. Will there be changes with regard to contractual arrangements?

The Bank's General Terms and Conditions for Investment Services and the Service Level Agreement (where applicable) will be updated accordingly.

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