



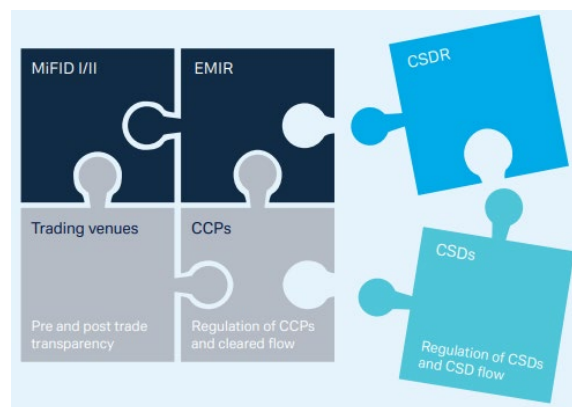
# Scotiabank

## Central Securities Depositories Regulation

### Introduction

The Central Securities Depositories Regulation (“**CSDR**”) is an EU regulation which aims to increase the safety and efficiency of securities settlement and settlement infrastructure in Europe. CSDR was introduced in 2014 in response to the global financial crisis and intends to harmonise the timing and standards of securities settlements, alongside other EU regulations such as the European Market Infrastructure Regulation (“**EMIR**”) and the Markets in Financial Instrument Directive (“**MiFID II**”).

CSDR has phased activation dates for various requirements. The upcoming go-live date is 1 February 2022 for the Settlement Discipline Regime in Articles 6 and 7.



Having already implemented a T+2 settlement cycle across European markets ahead of Target2-Securities, CSDR now progresses with measures to further strengthen and protect the CSDs, their participants and investors and to achieve consistency and standardisation across the CSDs in Europe

Measures include a new central securities depository (“**CSD**”) licence, asset protection requirements including reconciliation and account segregation and a comprehensive set of requirements to enhance the efficiency and transparency of securities settlement in Europe including a new settlement discipline regime.

## CSDR: Settlement Discipline



With CSDR covering a wide range of requirements, getting to grips with it might be difficult. Below is an overview of major categories and their respective requirements from a settlement discipline regime.

The headline requirements are to PREVENT, ADDRESS and MONITOR.

1. Measures to *prevent* settlement fails by improving matching and settlement rates
2. Measures to *monitor* and report
3. Measures to *address* settlement fails cash penalties and mandatory buy-ins

The CSDR Settlement Discipline Regime will go-live from **1 February 2022**, introducing a set of common requirements and business standards for authorised CSDs and market participants in relation to securities settlement.

The requirements in the Settlement Discipline Regime are broadly characterised into two themes:

- Measures to prevent settlement failure (CSDR Article 6)
- Measures to address settlement fails (CSDR Article 7)

These measures include timing requirements for allocation and confirmation messaging, cash penalties for late matching and settlement fails, and mandatory buy-ins for certain transaction types

The settlement discipline rules will enter into force 01 **February 2022**

### CSDR Impact and Scotiabank approach to CSDR

The CSDR Settlement Discipline Regime will impact all parties in the settlement chain involved in transactions in European securities, including trading parties who are not located in the European Economic Area (EEA).

In addition to building the relevant processes to comply with regulation, Scotiabank is committed to reducing settlement fails ahead of the 01 February 2022 activation date. We strongly encourage our clients to stay up to date on the latest regulatory guidance and to consider how their business activities and processes may be impacted by the CSDR Settlement Discipline Regime.

## Frequently Asked Questions

### General

#### 1. What is a CSD?

A Central Securities Depository (CSD) is an entity which:

- Operates a securities settlement system (“settlement service”);
- Records newly issued securities in a book-entry system (“notary service”);  
and
- Provides and maintains securities accounts at the top tier level (“central maintenance service”).

#### 2. What is the Settlement Discipline Regime?

The Settlement Discipline Regime (“SDR”) introduces new regulatory requirements for securities settlement, including:

- Measures to prevent settlement fails (Article 6), such as timely allocation and confirmation messages between investment firms and professional clients
- Measures to address settlement fails (Article 7), imposing cash penalties and mandatory buy-ins for late matching and settlement fails.

#### 3. Who is impacted by the CSDR settlement discipline regime?

- All parties in the settlement chain involved in transactions in European securities may be directly or indirectly impacted by the settlement discipline regime, including where the trading parties are not located in the EEA

#### 4. When does the CSDR settlement discipline regime need to be complied with?

- 1 February 2022

#### 5. How has Brexit impacted the CSDR settlement discipline regime?

- The UK onshored the CSDR as part of its departure from the EU, however excluded the settlement discipline regime. This was confirmed by the Chancellor of the Exchequer on 23 June 2020 in the UK Treasury’s Written Ministerial Statement. Therefore, there is a UK CSDR regulation in addition to EU CSDR. UK CSDR is applicable to financial instruments and activities of CSDs in the UK.
- Notwithstanding, UK trading parties involved in the settlement chain of transactions that settle on a European CSD will be indirectly impacted by the CSDR settlement discipline regime.

#### 6. Which CSD Markets are in-scope for CSDR?

- All EEA CSD Markets are in-scope for the settlement discipline regime:
- Austria / Belgium / Bulgaria / Croatia / Cyprus / Czech / Denmark / Estonia / Finland / France / Germany / Greece / Hungary / Ireland / Italy / Latvia / Lithuania / Luxembourg / Malta / Netherlands / Poland / Portugal / Romania / Slovakia / Slovenia / Spain / Sweden / Iceland / Norway / Euroclear bank (ICSD) / Clearstream Lux (ICSD)
- Please refer to the [ESMA register](#) for a list of authorised CSDs

#### 7. How is Scotiabank preparing for CSDR and who should I contact if I have any questions?

Scotia has a dedicated team preparing our businesses for the CSDR settlement discipline regime. If you would like to discuss CSDR further, please contact your Business Relationship Manager.

## Allocations

### 1. What are the key requirements for Allocations?

Article 6(2) of the CSDR requires investment firms to take measures to limit the number of settlements fails. It specifies that these measures should at least consist of arrangements with their professional clients ensuring prompt communication of an allocation of securities to the transaction, confirmation of that allocation and confirmation of the acceptance or rejection of the terms in good time before the intended settlement date. This requirement is further specified in Article 2 of the regulatory technical standards (RTS) on settlement discipline, in respect of the content of this allocation message and deadlines for sending these messages.

For more information, please refer to Regulatory Technical Standards (RTS) on the settlement discipline regime

### *Scope of Allocations*

The following products are in-scope for CSDR Allocations, to the extent they settle on an EEA CSD:

- Transferable securities
- Money-market instruments
- Units in collective investment undertakings (UCITs)
- Emission allowances
- Transactions in any of the products listed above are in-scope for CSDR Allocations to the extent they settle on an EEA CSD.
- Derivative transactions may also in scope to the extent that:
  - they are physically settled derivatives where the underlying instrument is one of the products listed above which settled on an EEA CSD, or
  - margin delivery includes one of the products listed above which settled on an EEA CSD.

### *Impact of Allocations to clients*

Scotiabank's professional clients will need to ensure they provide us with the relevant allocation and confirmation messages within the timeframes specified under CSDR, to ensure timely settlement.

Professional clients will need to ensure that they provide Scotiabank with the confirmation message, and with all required information in an allocation message within specified timeframes. Scotiabank should receive the confirmation and allocation messages by close of business on the business day that 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.

## Tolerance Level & Additional Field Requirements

### 1. What are the new settlement Tolerance Levels?

The matching tolerance levels for settlement amounts on against payment instructions.

- a. EUR 2.00 for settlement amounts  $\leq$  EUR 100,000 equivalent
- b. EUR 25.00 for settlement amounts  $>$  EUR 100,000 equivalent

### 2. What are the key requirements for the new settlement instruction fields?

CSDs are required to provide functionality to participants with fully automated, continuous real-time matching of settlement instructions.

CSDs require their participants to populate additional fields in their settlement instructions, including:

- Transaction Type
- Place of Trade and Place of Clearing

#### ***Impact of new settlement fields to clients***

Clients should ensure that they provide all relevant details to ensure timely settlement. The Transaction Type should always be populated, and we recommend that the Place of Trade field is also populated as a matter of good practice. The Place of Clearing should be completed for transactions settling with a CCP

## Bilateral Cancellation

### 1. What are the key requirements for Bilateral Cancellation?

CSDs are required to operate a bilateral cancellation facility that requires participants to bilaterally cancel matched settlement instructions

Many EEA CSDs already operate with bilateral cancellation functionality and the remaining markets are currently updating their processes

### 2. What is the impact of Bilateral Cancellation to clients?

Clients will need to ensure that both parties to a matched settlement instruction will need to instruct a cancellation of the settlement instruction in order to prevent the transaction from settling

## Partial-Settlement

### 1. What are the key requirements for Partial Settlement?

CSDs are required to provide participants with functionality to partially settle transactions.

Early partial settlement (between intended settlement date (ISD) and buy-in deadline date - 1) can reduce the penalty fines payable by the delivering party.

On the deadline date of the buy-in extension period (e.g. ISD +4 for liquid securities) the regulation states that any available stock must be used to partially settle, unless the settlement instruction is on hold.

### 2. How is Scotiabank managing Partial Settlement?

Where possible, Scotiabank will be opting-in to auto-partial functionality at EEA CSDs.

### 3. What is the impact of Partial Settlement to clients?

Clients have the ability to opt-in for the auto-partial functionality for in-scope CSD markets

## CASH PENALTIES

### 1. What are the key requirements for CSDR Cash Penalties?

CSDR requires EEA CSDs to impose cash penalties to CSD participants if a trade does not settle by the intended settlement date. Penalties accrue daily and are debited on a monthly basis from the participant causing the settlement failure and credited to the participant impacted by the settlement fail. There are separate penalties for late matching and failed settlement.

### 2. What are the products are in-scope for Penalties?

The following types of financial instruments are considered in-scope:

- Transferable securities;
- Money market instruments;
- Units in collective investment undertakings; and
- Emission allowance

IF the instrument is admitted to trading or traded on a trading venue ("EU ToTV") OR cleared by an EEA CCP AND where the parties intend to settle on an EEA CSD

### 3. Which transactions are in-scope for Penalties?

Any transactions conducted on own account or on behalf of clients in an in-scope product. CSDR does not define the term "transaction" but the RTS indicates a broad interpretation, as the relevant transaction types identified in the RTS are:

- purchase or sale of securities;
- collateral management operations;
- securities lending or borrowing operations;
- repurchase transactions (Article 22 RTS further indicates that each of the outward and return legs of a securities lending or borrowing or repurchase transaction should be treated as a separate 'transaction');
- 'other' transactions

### 4. Which transactions are out-of-scope for Penalties?

Penalties do not apply for transactions where:

- the failing participant is a CCP;
- insolvency proceedings are opened against the failing participant; or
- the principal venue for the trading of shares is located in a third country

### 5. What are the different types of Penalties?

There are two types of cash Penalties:

- Late Matching Fail Penalty (LMFP) - applies when matching taking place after the Intended Settlement Date (ISD). The CSD will apply the fine to the final amending party.
- Settlement Fail Penalty (SEFP) - applies due to the non-settlement of a matched transaction after the ISD.

## 6. How are Penalties calculated?

CSDs calculate daily cash penalties from the Intended Settlement Date (ISD) until the trade settles or cancellation of the instruction (e.g. if the trade goes to Buy-In). Penalties accrue daily till the 14th of each month, when the CSD debits and credit the CSD participants.

## 7. Will Scotia Pass Penalty costs onto Clients?

Yes, for specific scenarios where it is clear a client is responsible for late matching or settlement fail (e.g. if a client provides incorrect SSIs).

Scotia are currently assessing a suitable pass-on and dispute process, which we will communicate to clients in due course

## 8. When will CSDs report and collect Penalties?

Cash penalties will be reported by CSDs to CSD participants daily, using MT 537 SWIFT messaging. This will be reported at a transactional level allowing us to align the costs to specific transactions. The overall net impact of cash penalties will be reported by CSDs monthly and then debited from / credit to our agreed cash account on the 14th of each month

## 9. What are the CSDR Penalty Causes and Rates?

<b>Settlement Fail Penalty Rates</b>		
<b>#</b>	<b>Cause Of Fail</b>	<b>Penalty Rate</b>
1	Settlement fail due to a <b>lack of shares that have a liquid market</b>	1 Basis Point
2	Settlement fail due to a <b>lack of shares that do not have a liquid market</b>	0.5 Basis Point
3	Settlement fail due to a <b>lack of financial instruments traded on SME growth markets</b> , excluding debt instruments	0.25 Basis Point
4	Settlement fail due to a lack of debt instruments issued or guaranteed by: (a) a sovereign issuer as defined in Article 4(1)(60) of Directive 2014/65/EU; (b) a third country sovereign issuer; (c) a local government authority; (d) a central bank; (e) any multilateral development bank (f) the European Financial Stability Facility or the European Stability Mechanism.	0.10 Basis Point
5	Settlement fail due to a <b>lack of debt instruments other</b> than those referred to in points 4 and 6	0.20 Basis Point
6	Settlement fail due to a <b>lack of debt instruments traded on SME growth markets</b>	0.15 Basis Point
7	Settlement fail due to a lack of all <b>other financial instruments</b> not covered in points 1 to 6	0.5 Basis Point
8	Settlement fail due to a <b>lack of cash</b>	Official interest rate for overnight credit charged by the central bank issuing the settlement currency with a floor of 0

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