Central Securities Depositaries Regulation ("CSDR")

Settlement Discipline

Contents

- Documenting the CSDR Settlement Discipline Requirements
  - *Summary*
  - *Transaction traded on venue cleared by a CCP*
  - *Transactions traded on venue but not cleared by CCP*
  - *Transaction not traded on venue and not cleared by a CCP*
- Buy-in process for transactions
  - *Transaction traded on venue cleared by a CCP*
  - *Transactions traded on venue but not cleared by CCP*
  - *Transaction not traded on venue and not cleared by a CCP*

Documenting the CSDR Settlement Discipline Requirements - Summary

- CSDR compliant CSD rules => Need to impose a contractual obligation on the participants to comply with the CSDR Settlement Discipline provisions as though they directly applied to the participants
- CSDR compliant CCP rules =>
  - Need to impose a contractual obligation on the CCPs and clearing members to comply with the CSDR Settlement Discipline provisions as though they directly applied to the CCPs and clearing members
  - Need to set out the buy-in process and procedures
- CSDR compliant trading venue rules =>
  - Need to impose a contractual obligation on the trading venues and trading venue members to comply with the CSDR Settlement Discipline provisions as though they directly applied to the trading venues and trading venue members
  - Need to set out the buy-in process and procedures
- CSDR compliant trading agreement/industry rules =>
  - Need to impose a contractual obligation on the counterparties to comply with the CSDR Settlement Discipline provisions as though they directly applied to the counterparties
  - Need to set out the buy-in process and procedures
- CSDR compliant sub-custody agreements and custody agreements =>
  - In respect of clients that are an intermediary, need to impose a contractual obligation on such clients to (A) comply with the CSDR Settlement Discipline provisions as though they directly applied to such intermediary; and (B) ensure their sub-custody agreements and custody agreements with their own clients impose a contractual obligation on such clients to themselves establish the necessary contractual arrangements with their own clients to ensure that the buy-in requirements are enforceable against such clients in all relevant jurisdictions as though the CSDR Settlement Discipline provisions directly applied to such clients (effectively passing on Article 25(4) of the RTS down the custody chain)
  - In respect of all other clients, need to impose a contractual obligation on such clients to comply with the CSDR Settlement Discipline provisions as though they directly applied to the clients

Documenting the CSDR Settlement Discipline Requirements - Transaction traded on venue cleared by a CCP

- 'CCP' for the CSDR means a CCP as defined in point (1) of Article 2 of EMIR. The definition is jurisdiction agnostic so a DIRECT regulatory obligation on the CCP to comply with the CSDR Settlement Discipline provisions cannot be assumed as the CCP could be outside the jurisdiction of the European Union, notwithstanding that the resulting settlement was in-scope for the CSDR.
- Under the CSD rules between the CSDs and the CCPs, the CSDs will impose a contractual obligation on the CCPs to comply with the CSDR Settlement Discipline provisions as though they directly applied to the CCPs (discharging the CSDs' obligation under Article 7(2) CSDR to "establish procedures").
- As a result, whether via a DIRECT regulatory obligation under Article 25(1), 25(2) and 25(3) of the RTS or an INDIRECT contractual obligation under the CSD rules, the CCP rules should contain all necessary provisions to implement the buy-in.
- Provided that the CCP rules are legally enforceable in the jurisdiction of the CCPs and the CCPs' clearing members (see Article 25(2) of the RTS), all necessary contractual arrangements, processes and procedures to implement the buy-in can be discharged by CSDR compliant CCP rules and CSD rules.

Documenting the CSDR Settlement Discipline Requirements - Transactions traded on venue but not cleared by CCP

- 'Trading venue' for the CSDR means a trading venue as defined in point (24) of Article 4(1) of MiFID II. The definition is jurisdiction agnostic so a DIRECT regulatory obligation on the trading venue or the trading venue members to comply with the CSDR Settlement Discipline provisions cannot be assumed as the trading venue or the trading venue members could be outside the jurisdiction of the European Union, notwithstanding that the resulting settlement was in-scope for the CSDR.

- Under the CSD rules between the CSDs and the settlement agents acting on behalf of the broker/trading venue members, the CSDs will impose a contractual obligation on the settlement agents to comply with the CSDR Settlement Discipline provisions as though they directly applied to the settlement agents (discharging the CSD's obligation under Article 7(2) CSDR to "establish procedures").

- Whether via a DIRECT regulatory obligation under Article 25(4) of the RTS or an INDIRECT contractual obligation under the CSD rules, the settlement agents acting on behalf of the broker/trading venue members should ensure their sub-custody agreements with the broker/trading venue members impose a contractual obligation on the broker/trading venue members to comply with the CSDR Settlement Discipline provisions as though they directly applied to the broker/trading venue members. If there are any intermediaries in the custody chain, the settlement agents should ensure their sub-custody agreements with such intermediaries impose a contractual obligation on such intermediaries to (A) whether via a DIRECT regulatory obligation under Article 25(1), 25(2) and 25(3) of the RTS or an INDIRECT contractual obligation under the aforementioned sub-custody agreements, comply with the CSDR Settlement Discipline provisions as though they directly applied to such intermediary; and (B) ensure their custody agreements and sub-custody agreements with their own clients impose a contractual obligation on such clients to themselves establish the necessary contractual arrangements with their own clients to ensure that the buy-in requirements are enforceable against such clients in all relevant jurisdictions as though the CSDR Settlement Discipline provisions applied to such clients (effectively passing on Article 25(4) of the RTS down the custody chain).

- Whether via a DIRECT regulatory obligation under Article 25(1), 25(2) and 25(3) of the RTS or an INDIRECT contractual obligation under their sub-custody agreements with the settlement agents, the broker/trading venue members should ensure the trading venue rules with the trading venues impose a contractual obligation on the trading venues to comply with the CSDR Settlement Discipline provisions as though they directly applied to the trading venues.

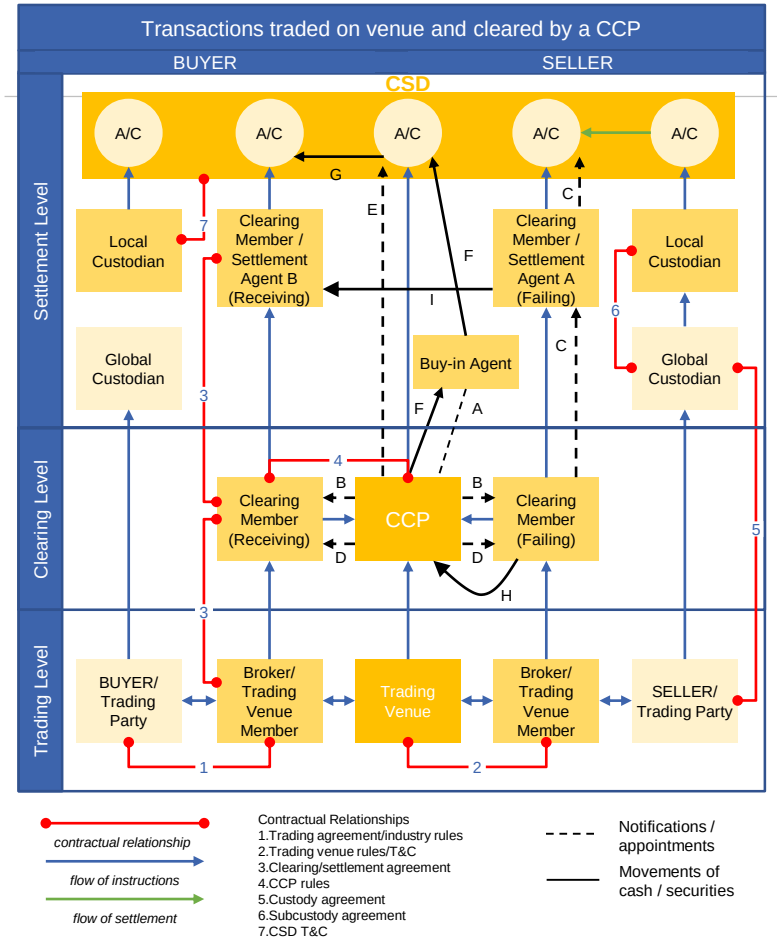
- As a result, whether via a DIRECT regulatory obligation under Article 25(1), 25(2) and 25(3) of the RTS or an INDIRECT contractual obligation under the trading venue rules, the trading venue rules should contain all necessary provisions to implement the buy-in.

- Provided that the trading venue rules are legally enforceable in the jurisdiction of the trading venue and the broker/trading venue members (see Article 25(2) of the RTS) and the sub-custody agreements and custody agreements are legally enforceable in the jurisdiction of the relevant parties thereto, all necessary contractual arrangements, processes and procedures to implement the buy-in can be discharged by CSDR compliant trading venue rules, sub-custody agreements, custody agreements and CSD rules.

Documenting the CSDR Settlement Discipline Requirements - Transaction not traded on venue and not cleared by a CCP

- A DIRECT regulatory obligation on the trading party or the broker to comply with the CSDR Settlement Discipline provisions cannot be assumed as the trading party or the broker could be outside the jurisdiction of the European Union, notwithstanding that the resulting settlement was in-scope for the CSDR.
- Under the CSD rules between the CSDs and the settlement agents/local custodians acting directly or indirectly on behalf of the trading parties or the brokers, the CSDs will impose a contractual obligation on the settlement agents/local custodians to comply with the CSDR Settlement Discipline provisions as though they directly applied to the settlement agents/local custodians (discharging the CSD's obligation under Article 7(2) CSDR to "establish procedures" and Article 7(10)(c)).
- Whether via a DIRECT regulatory obligation under Article 25(4) of the RTS or an INDIRECT contractual obligation under the CSD rules, the settlement agents/local custodians acting directly or indirectly on behalf of the trading parties or the brokers should ensure their sub-custody agreements with the global custodians acting directly or indirectly on behalf of the trading parties/trading parties or the brokers impose a contractual obligation on the trading parties or the brokers to comply with the CSDR Settlement Discipline provisions as though they directly applied to the trading parties or the brokers. If there are any intermediaries in the custody chain, the settlement agents should ensure their sub-custody agreements with such intermediaries impose a contractual obligation on such intermediaries to (A) whether via a DIRECT regulatory obligation under Article 25(1), 25(2) and 25(3) of the RTS or an INDIRECT contractual obligation under the aforementioned sub-custody agreements, comply with the CSDR Settlement Discipline provisions as though they directly applied to such intermediary; and (B) ensure their custody agreements and sub-custody agreements with their own clients impose a contractual obligation on such clients to themselves establish the necessary contractual arrangements with their own clients to ensure that the buy-in requirements are enforceable against such clients in all relevant jurisdictions as though the CSDR Settlement Discipline provisions applied to such clients (effectively passing on Article 25(4) of the RTS down the custody chain).
- Whether via a DIRECT regulatory obligation under Article 25(1), 25(2) and 25(3) of the RTS or an INDIRECT contractual obligation under their sub-custody agreements with the settlement agents/global custodians, the trading parties or the brokers should ensure their trading agreement/industry rules impose a contractual obligation on their counterparty to comply with the CSDR Settlement Discipline provisions as though they directly applied to the counterparty.
- As a result, whether via a DIRECT regulatory obligation under Article 25(1), 25(2) and 25(3) of the RTS or an INDIRECT contractual obligation under the trading agreement/industry rules, the trading agreement/industry rules should contain all necessary provisions to implement the buy-in.
- Provided that the trading agreement/industry rules are legally enforceable in the jurisdiction of the trading parties or the brokers (see Article 25(2) of the RTS) and the sub-custody agreements and custody agreements are legally enforceable in the jurisdiction of the relevant parties thereto, all necessary contractual arrangements, processes and procedures to implement the buy-in can be discharged by CSDR compliant trading agreement/industry rules, sub-custody agreements, custody agreements and CSD rules.

Buy-in process for transactions - Transaction traded on venue and cleared by a CCP



Documentational amendments
- A. – H. - CCP rules (4.) pursuant to Art. 25(1), (2) and (3) RTS
- I. - CSD rules (7.) pursuant to Art.7(2) and (6) CSDR

Transaction cleared by a CCP

Assumptions:

> There is a settlement fail between the Clearing Member/Settlement Agent A and CCP

> CCP has verified that a buy-in is possible and such buy-in is successfully executed in full

> The price of the shares paid as part of the buy-in is higher than the price agreed at the time of the trade

Steps:

Procedures

A. CCP appoints a buy-in agent on the business day following the expiry of the extension period [Art 27(1)]

B. CCP notifies the failing and receiving Clearing Members of appointment of buy-in agent [Art 27(1)]

C. Failing Clearing Member puts on hold any relevant instruction relating to the settlement fail upon receipt of notification in B [Art. 27(2)]

D. CCP notifies the results of the buy-in to the failing and receiving Clearing Members (including information as to the quantity and price of bought in instruments) [Art. 27(4) and (5)]

E. CCP notifies the results of the buy-in to the CSD (including information as to the quantity and price of bought in instruments) [Art. 27(4) and (5)]

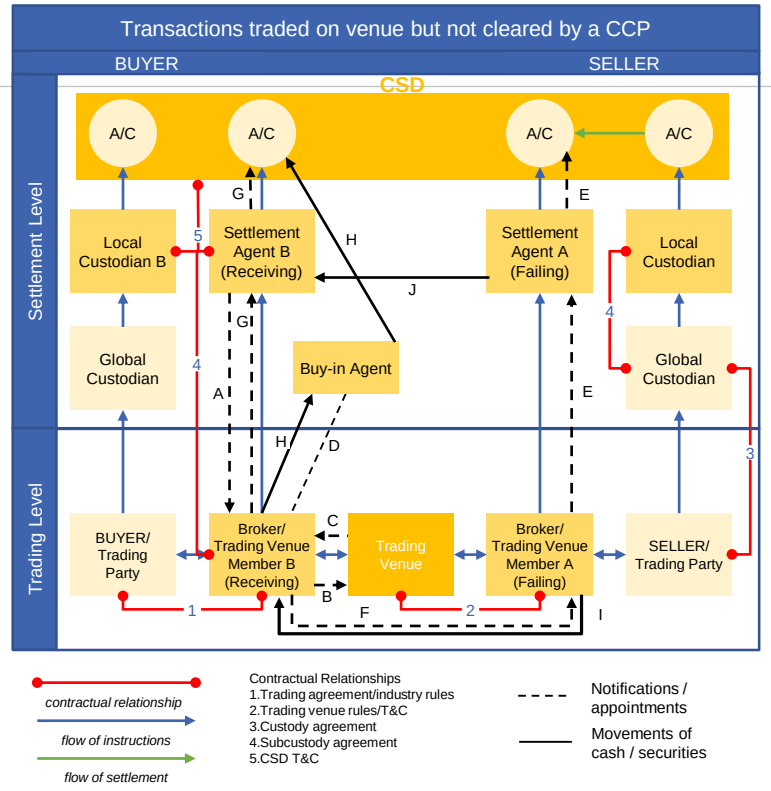
F. CCP accepts and pays for the bought in financial instruments [Art. 27(10)]

G. CCP ensures that the bought in financial instruments are delivered to the receiving Clearing Member at the end of each business day on which the CCP receives those financial instruments [Art.27(10)(a)]

H. Failing Clearing Member pays (i) price difference to CCP and (ii) reimburses the CCP for all amounts paid pursuant to the buy-in, including execution fees [Art. 25(3)]

I. [Clearing Member/Settlement Agent A pays amounts in H, to the extent not paid by the Failing Clearing Member. This payment shall be made no later than the second business day after the financial instruments have been delivered following the buy-in.] [Art. 7(6) CSDR Level 1]

Buy-in process for transactions - Transactions traded on venue but not cleared by CCP



Documentational amendments

- A. - CSD T&C (5.) pursuant to Art.7(2) CSDR
- B. - Sub-custody agreement (4.) pursuant to Art. 25(4) RTS and trading venue rules (2.) pursuant to Art. 25(1) RTS
- C. - Trading venue rules (2.) pursuant to Art. 25(1) RTS
- D. – I. - Trading venue rules (2.) pursuant to Art. 25(1), (2) and (3) RTS
- J. - CSD T&C (5.) pursuant to Art. 7(2) and (6) CSDR

Venue trade not cleared by CCP

Assumptions:

> Broker/Trading Venue Member A and Broker/Trading Venue Member B are trading on venue as principal and there is a settlement fail between Settlement Agent A and Settlement Agent B

> The receiving Broker/Trading Venue Member B has verified that a buy-in is possible and such buy-in is successfully executed in full

> The price of the shares paid as part of the buy-in is higher than the price agreed at the time of the trade

Steps:

Process

A. Settlement Agent B notifies Broker/Trading Venue Member B of the settlement fail without undue delay [Art. 28(1)]

B. Broker/Trading Venue Member B notifies Trading Venue of the settlement fail [Art. 28(2)]

C. Trading venue discloses to Broker/Trading Venue Member B the name of Broker/Trading Venue Member A on request [Art. 28(2)]

Procedures

D. Broker/Trading Venue Member B appoints a buy-in agent on the business day following expiry of the extension period [Art. 29(1)]

E. Broker/Trading Venue Member A puts on hold any relevant instructions relating to the settlement fail [Art. 29(2)]

F. Broker/Trading Venue Member B notifies the results of the buy-in to Broker/Trading Venue Member A (including notification of the quantity and price of the bought in instruments) [Art. 29(4) and (5)]

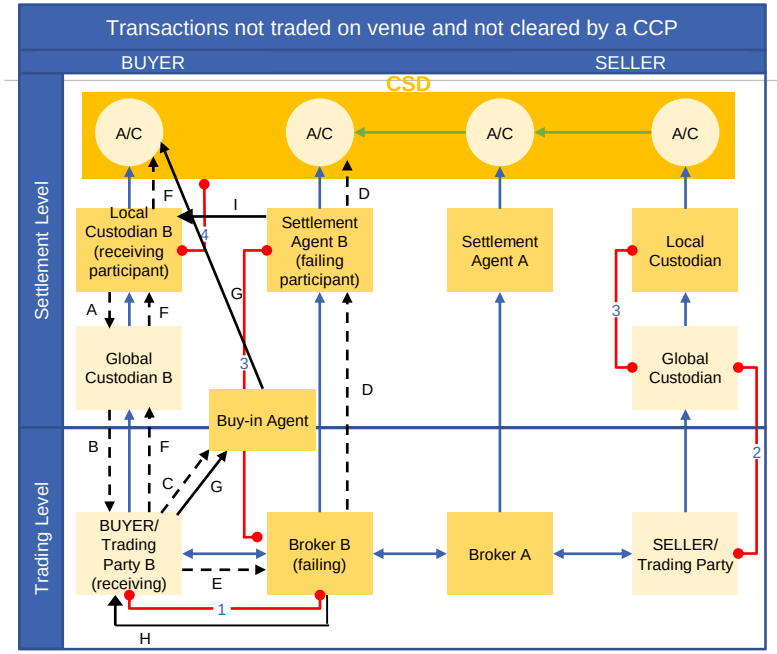
G. Broker/Trading Venue Member B notifies the results of the buy-in to Settlement Agent B which then notifies the CSD (including information as to the quantity and price of bought in instruments) [Art.29(4) and (5)]

H. Broker/Trading Venue Member B accepts and pays for the bought in financial instruments [Art. 29(10)]

I. Failing Broker/Trading Venue Member A pays (i) price difference to receiving Broker/Trading Venue Member B and (ii) reimburses the receiving Broker/Trading Venue Member B for all amounts paid prior to the buy-in, including execution fees [Art. 25(3)]

J. [Settlement Agent A (failing participant) pays amounts in I, to the extent not paid by failing Broker/Trading Venue Member A no later than on the second business day after the financial instruments have been delivered following the buy-in][Art. 7(6) CSDR Level 1]]

Buy-in process for transactions - Transaction not traded on venue and not cleared by a CCP



Documentational amendments

- A. - CSD T&C (4.) pursuant to Art.7(2) CSDR
- B. - Sub-custody agreement (3.) pursuant to Art. 25(4) RTS
- C. – G. - Custody agreement (2.) pursuant to Art.25(4) RTS or trading agreement (1.) pursuant to Art. 25(1), (2) and (3) RTS
- H. - Sub-custody agreement (3.) pursuant to Art.25(4) or trading agreement (1.) pursuant to Art. 25(1), (2) and (3) RTS
- I. - CSD T&C (4.) pursuant to Art. 7(2) and (6) CSDR

Uncleared OTC transaction

Assumptions:

> Broker B and Buyer/Trading Party B face each other as principal and there is a settlement fail between Settlement Agent B and Local Custodian B

> The BUYER/Trading Party B has verified that a buy-in is possible and such buy-in is successfully executed in full

> The price of the shares paid as part of the buy-in is higher than the price agreed at the time of the trade

Steps:

Process

A. Local Custodian B (receiving participant) informs Global Custodian B of settlement fail without undue delay [Art. 30(1)]

B. Global Custodian B informs Buyer/Trading Party B of settlement fail without undue delay [Art. 30(1)]

Procedures

C. Buyer/Trading Party B appoints buy-in agent on the business day following the expiry of the extension period and notifies Broker B of appointment [Art. 31(1)]

D. Broker/Trading Party B puts on hold any relevant instructions relating to the settlement fail [Art.31(2)]

E. Buyer/Trading Party B notifies results of buy-in to Broker B (including notification as to the quantity and price of bought in instruments) [Art. 31(4) and (5)]

F. Buyer/Trading Party B notifies results of buy-in to Global Custodian B, which notifies Local Custodian B and Local Custodian B notifies CSD [Art. 31(4) and (5)]

G. Buyer/Trading Party B accepts and pays for bought in instruments [Art. 31(10)]

H. Failing Broker B pays (i) price difference to receiving Buyer/Trading Party B and (ii) reimburses the receiving Buyer/Trading Party B for all amounts paid prior to the buy-in, including execution fees [Art. 25(3)]

I. [Settlement Agent B (the failing participant) pays amounts in H, to the extent not paid by failing Broker B] [Art. 7(6) CSDR Level 1]

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