

Client information on KELER CCP compliance under SDR

CSDR (909/2014/EU Regulation) places a particular emphasis on ensuring and maintaining the settlement discipline of securities transactions. In order to reach its main goal the Regulation not only sets requirements for central securities depositories (CSDs), but for central counterparties (CCPs) as well. CSDR is complemented by various Implementing Technical Standards (ITS) and Regulatory Technical Standards (RTS), in particular 2017/389/EU Regulation contains the detailed rules of the cash penalty requirements for settlement fails, while the 2018/1229/EU Regulation sets requirements for the buy-in mechanism. These three regulations are commonly referred to as the settlement discipline regime (SDR).

According to our current information, the SDR requirements are expected to be applied by the market participants from 1st of February 2022¹.

KELER CCP has carried out significant preparatory work and is also currently working very hard for its compliance. As several cases the compliance of KELER CCP is affected by the cooperating securities settlement system operated by KELER CSD Ltd. (hereinafter KELER CSD or CSD), thus KELER CSD's SDR compatibility is essential to ensure the full and automatic compliance on the CCP side as well. For this reason KELER Group still works in close cooperation with the market on the developments, and expects to implement the necessary IT developments within the framework of the KELER CSD Service Development Program (hereinafter KELER Program). The KELER Program is planned to go live early December 2021. This technical background will ensure the possibility of full compliance not only for KELER CSD but for KELER CCP, too, however please note that KELER CCP intends to go live with its own rules and regulations and all SDR related changes in its operations in line with the deadline applicable by the law (01.02.2022).

KELER CCP makes every effort in order to implement all the necessary changes in its procedures and rules, however currently there are several outstanding issues and requests for clarification suggested by industry participants, which are still waiting for answers from the EU authorities, and thus brings challenges for industry participants to comply with the regulation on time.

Despite of these uncertainties KELER CCP considers it important to continuously inform its clients about the changes in details as much as possible for the time.

Hereinafter in this Questions&Answers KELER CCP would like to provide information about the most important identified changes in its rules and regulations to be made, which have impact on our Clearing Members as well.

¹ <https://www.esma.europa.eu/press-news/esma-news/esma-proposes-further-postpone-csdr-settlement-discipline>

This Questions&Answers document will always contain the most up-to-date SDR related information, in case any new information/clarification becomes available by the EU authorities, KELER CCP will update it and will notify its Clearing Members accordingly.

- 1. Has KELER CCP got a complete detailed CSDR Settlement Discipline framework?**

2021.07.27

Yes, it is developed and available, however can not be shared in its entirety with Clearing Members before approval process completed.

- 2. Are there any IT developments needed by Clearing Members of KELER CCP?**

2021.07.27

It is very important to note that KELER CCP designed its compliance in such a way that does not need any IT developments from its Clearing Members. All technical changes occur solely on the CSD side from the perspective of our clients.

- 3. Will be the extension period different per product- or market type?**

2021.07.27

Please note that KELER CCP intends to apply uniformly 4 days as extension period regardless of the product- or market type (ie. 4 days also for BSE Xtend SME market and also for illiquid products).

- 4. How variation margin will be calculated during the extension period?**

2021.07.27

KELER CCP will calculate and collect negative variation margin from the defaulting Clearing Member for the missing amount of securities during the 4 days extension period in order to cover any unfavorable price movements daily.

5. Will partial settlement be allowed during the extension period?

2021.07.27

Partial settlement will be allowed for the defaulting Clearing Member on each day within the extension period, and penalties will be calculated only for the non-delivered quantities at each COB, daily.

In accordance with Article 27 of the RTS, after the original settlement cut-off time, 14:00 CET on SD, KELER CCP creates a DVP transaction against the defaulting Clearing Member and a DVP transaction against the selected non-defaulting Clearing Member(s) and will continuously try to settle until extension period ends (settlement until SD+4 COB, 10 minutes before CSD COB). Thereafter these DVP transactions will be put on hold, and the extension period ends.

6. Who will initiate instructions after declaring the default?

2021.07.27

No instructions are sent by clients, all instructions after declaring the default will be initiated by KELER CCP.

7. How buy-in mechanism will be applied on spot capital markets?

2021.07.27

KELER CCP highlights that after the entry into force of the regulation, KELER CCP will only apply buy-in rules according to the SDR on spot capital markets, which means that the currently applied buy-in mechanism will be amended in accordance with the SDR.

8. How will KELER CCP communicate with its Clearing Members during its default management procedure and the buy-in mechanism?

KELER CCP will notify the Clearing Members of each step of the buy-in process (and the whole default management process) via e-mail.

9. What happens on SD+5?

2021.07.27

Following the expiry of the extension period, a buy-in process initiated and KELER CCP will appoint a buy-in agent at 9:00 CET on SD+5. The process of the buy-in itself will remain the same as it is applicable today.

According to the SDR requirements, after the receipt of the buy-in notification (regarding initiating the buy-in procedure), the failing participant cannot directly fulfill its obligation to the CCP anymore, only through a buy-in agent.

10. Who can be a buy-in agent?

2021.07.27

The process of the buy-in itself will remain the same as it is applicable today, hence the institution of buy-in agent will not be a new role in the buy-in process, only in its name. A buy-in agent will be a Clearing Member with trading right in line with 8.4.3.1. of the current General Business Rules, a Clearing Member in line with 8.4.4. of the current General Business Rules.

11. How long the buy-in period will be?

2021.07.27

KELER CCP will apply a one day long buy-in period uniformly in all cases and does not intend to make use of the possibility to extend it.

If buy-in is successfully completed until SD+5 COB, KELER CCP deletes DVP on hold. If still partially not settled, then deletes DVP on hold and cash compensation is paid for the remaining part.

The amount of cash compensation is the difference between the market value of the financial instruments concerned at the clearing day before the cash compensation is paid and the market value of those financial assets at T-day if the market value of those financial instruments at T-day is lower than the market value on the clearing day before cash compensation. KELER CCP collects cash compensation from the default Clearing Members and transfers cash compensation to the non-defaulting Clearing Members.

12. How buy-in proceed if securities are non-existing?

2021.07.27

Buy-in is not possible only, when the securities are non-existing (ie. cancellation of securities), in this situation, KELER CCP will notify via e-mail both defaulting and selected non-defaulting Clearing Members and arrange for cash compensation.

13. How buy-in mechanism will be applied with regards derivative transactions with physical delivery?

2021.07.27

KELER CCP will unify its default management procedures including the extension period and buy-in mechanism with regards derivative transactions with physical securities delivery. As of the date of implementation (01.02.2022.) the same rules and processes will apply as in the case of default on the spot securities markets.

14. Will the existing sanctioning mechanism of KELER CCP change?

2021.07.27

Based on the SDR requirements and KELER CCP's interpretation, the settlement fails of securities transactions are subject to cash penalties which will be an additional new element and independently introduced beside the applicable sanctioning fees existing in the Fee Schedule of KELER CCP. This means the existing sanctioning mechanism of KELER CCP will co-exist with the CSDR penalty mechanism. The method of existing sanctioning mechanism of KELER CCP will remain as it is today.

15. At what level will penalties be calculated, reported and collected?

2021.07.27

Penalties will be calculated, reported and collected at Clearing Member level (see more information under following questions). Based on the Clearing Member's request the report can contain the NCM level for information purposes only as well.

16. Who will calculate the cash penalty amount for transactions settled through KELER CCP?

2021.07.27

The Regulation specifies in details the calculation methodology of the penalty amount and the collection of the penalties under SDR, pursuant to which KELER, the CSD, will calculate the penalty amount.

17. Who will report penalties for transactions settled through KELER CCP pursuant to SDR?

2021.07.27

Daily net penalty report shall be sent by KELER CSD to the securities settlement system users for information purposes only. This preliminary daily report WILL include the amount of the penalty for transactions cleared by the CCP. Each item shall be classified - CCP involvement is revealed.

Monthly net penalty report shall also be sent by KELER CSD on the 14th PBD (penalty business day according to standardized calendar of EU CSDs) in the next month. The Monthly Penalties Report will show the amount of the penalty to be paid.

Participants will get separated demand for payment monthly and shall settle both: one from KELER CSD related to OTC trades and trades executed on trading venues but not cleared by KELER CCP and one from KELER CCP related to CCP cleared trades.

Defaulting Clearing Members shall get the penalty collection notification of KELER CCP monthly on the 15th PBD in the next month via e-mail.

Penalty report templates of KELER CSD are available on KELER CSD's SWIFT MyStandards site, where the registered participants are able to download these templates. KELER CCP intends to communicate only via e-mail, no further reports will be developed.

18. Who will collect cash penalty for transactions cleared by KELER CCP?

2021.07.27

The CSD advises KELER CCP about the calculated penalty amount and KELER CCP will collect it from the defaulting Clearing Member and reallocate it fully to the earlier selected non-defaulting Clearing Member(s) (on the 17th PBD), and finally reports the result to the CSD.

19. Is there a need to open a designated cash account for the collection of penalties?

2021.07.27

KELER CCP will debit the account that the Clearing Member previously designated to collect the SDR penalties - please note that it must not be a new, exclusive account for this reason.

20. What happens if overnight holdings on KELER CCP account resulting in a mismatch of penalties incurred?

2021.07.27

Regarding potential late settlement, KELER CCP will set an earlier cut off time for the defaulting Clearing Member during the extension period in order to avoid any mismatch at end of business day (**10 minutes before CSD COB**). No recharge is planned by KELER CCP.

21. What happens if defaulting Clearing Member fails to pay penalties?

2021.07.27

In the event that Clearing Member fails to pay penalties, KELER CCP will consider it as a financial default against the CCP, consequences will be applied accordingly in line with KELER CCP's General Business Rules. No unpaid penalties will be distributed to other members.

22. What will be the way of appeal?

2021.07.27

Based on the Daily Penalty Reports, all KELER CSD customers will have the opportunity to appeal regardless of the items to be appealed are CCP-cleared or not. The appeal shall be sent by e-mail, in all cases addressed to KELER CSD, even if it is related to a transaction involving CCP. KELER CSD will judge its legitimacy. The reply by KELER CSD will also be sent by e-mail.

Appeals may be lodged no later than the 10th PBD of the following month.

Should you have any further questions, please do not hesitate to contact us at the e-mail address sales@kelerkszf.hu.