VP SECURITIES A/S

June 2018

CSDR IMPLEMENTATION

CSDR AND THE CONSEQUENCES FOR MARKET PARTICIPANTS

CSDR and the consequences for the market participants
Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories will not only impact CSD's, but also market participants. CSDR applies to all market infrastructures, banks, brokers and operators involved with securities settlement and all transferable securities as defined under the Markets in Financial Instruments Directive (MiFID).

The intention of CSDR is to harmonise the market for CSD services and to improve settlement security. For market participants, this provides for more extensive cross-border issuance and settlement, as CSDs will be competing on equal terms.

As one of the first CSDs in Europe, VP SECURITIES has been granted an authorisation from the Danish FSA (Finanstilsynet), with effect from 3 January 2018.

VP's CSDR project takes both internal and external consequences of the CSDR into consideration as well as compliance, business and technical concerns. VP will facilitate an understanding of the regulatory regime, and inform stakeholders during the implementation process to ensure timely and orderly compliance with the CSDR requirements.

In general, the CSDR implications for participants is a two steps process – the first part primarily concerning Account Segregation and Record Keeping; the second part is focusing on Settlement Discipline.

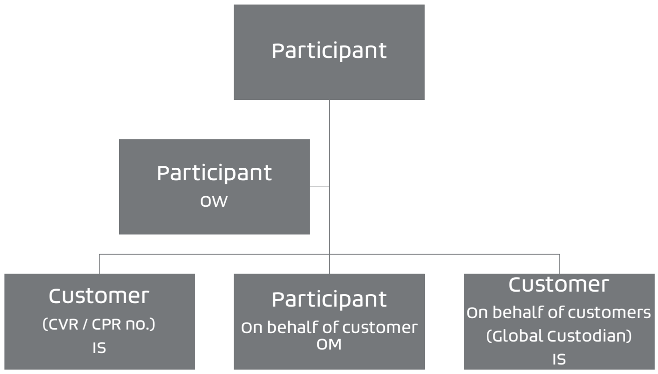
The main focus of this service sheet is to provide an overview of:

a. Participants' reporting requirements (Position records (stock) and transaction / Transfer order records (flow));
b. Settlement Discipline regime

Static data on securities accounts
Securities accounts must indicate the level of segregation. Hence, securities accounts must be marked with respect to ownership types:

- Own account (OW): Participant's own securities account
- Client omnibus account (OM): Participant´s account on behalf of customers (omnibus client segregation)
- Client individual account (IS): Securities account belonging to one of the participant's clients (individual Client segregation). The customer can be an end-investor or a customer's securities account on behalf of customers (Global Custodian).

The different ownership types and their use are illustrated in the figure below:



VP has ensured that all securities accounts have been marked in accordance with CSDR and our customers' specifications.

Changes to ownership type on securities accounts may be reported to VP (CSD Services). Please also note that it is mandatory for customers to indicate an ownership type when opening a new securities account.

Static data on participantss/issuers
LEI: all legal entities shall be identified by a unique code through the use of Legal Entity Identifiers, i.e. it is mandatory to report LEI for participants/issuers, including collective investment funds issuing securities. Reporting of LEI for securities accounts is optional.

IBAN
On cash accounts used by issuers to pay out Corporate Actions.

Domiciliation
Country of incorporation of the issuers of each securities issue.

Jurisdiction
The law under which the securities recorded by the CSD are constituted. To be used on each individual issuance.

Transaction data
New fields to be included in the transfer orders at the time of implementation of the new Settlement Discipline regime.

- Place of trading (MIC)
- Place of clearing
- Type of transaction

Settlement Discipline regime
CSDR includes several measures to address settlement fails.

Penalty mechanism
Cash penalties: CSD customers will be subject to cash penalties calculated and applied for each transfer order that fails to settle on the intended settlement date either due to lack of cash or lack of securities.

Cash penalty rates are defined in the EU Commission delegated regulation of 11 November 2016, (C(2016) 7154 final). See annex A below. An example of the calculation of a penalty is shown in Annex B.

Reporting: The penalties are computed and reported for each business day. Hence, the CSDs will provide a daily report detailing the penalties computed for the previous business day (new and modified penalties). The CSDs will report the penalties to both the failing (i.e. party imposed with the penalty) and the non-failing party (i.e. party entitled to receive the penalty).

Collection & distribution: In line with the requirements of CSDR, the collection and distribution of penalties will be performed once a month.

Buy-in
Buy-in process: If a failing participant does not deliver the financial instruments to the receiving participant within four business days after the intended settlement date (extension period), a buy-in process will be initiated, delivering the financial instruments to the receiving participant. To ensure the smooth and orderly functioning of the financial markets, the extension period may be increased from four business days up to a maximum of seven business days, depending on the asset type and liquidity of the financial instruments. Penalties are calculated each day until the buy-in is finalized.

Buy-in agent: The buy-in process will be handled by an independent buy-in agent.

Mandatory partial settlement: Should part of the relevant financial instruments be available for delivery to the receiving participant on the last business day of the extension period, the transfer order should be partially settled.

Cash compensation: If the buy-in fails or is not possible, the receiving participant can choose to be paid a cash compensation or to defer the execution of the buy-in to an appropriate later date (deferral period). If the relevant financial instruments are not delivered to the receiving participant at the end of the deferral period, a cash compensation shall be paid.

Suspension of a Participant
A procedure for suspension of a participant considered to be failing consistently and systematically, is part of the CSDR Settlement Discipline regime. Suspension is an extreme measure that can only be used as a last resort solution for a serious problem and can only be executed after careful consideration of the circumstances in each case and in close consultation with the respective competent authority.
In order to comply with the rules specified in CSDR, VP has to establish a procedure of suspension, i.e. monitoring and sanctioning participants who do not meet the established benchmarks.

VP has to:

- Establish procedures to suspend any participant that fails consistently and systematically to deliver the financial instruments
- Have objective and transparent procedures for the suspension
- Deliver information concerning disciplinary actions, including suspension with a specification of the period of suspension and the reason for suspension
- Monitor consistent and systematic fails – i.e. monitor all the participants' activity and determine if at least 10 per cent of the settlement days of each participant is 15 per cent or more below the average settlement ratio during a period of 12 months
- Set up working relationship with the most relevant participants: establish a dialogue regarding settlement fails as part of the broader efforts to improve settlement efficiency

On 25 May 2018, the European Commission published the regulatory technical standards (RTS) to the Central Securities Depositories Regulation (CSDR) on settlement discipline.
The Council and the Parliament have a 1-3 months objection period, possibly extended by another 1-3 months. The RTS will enter into force 24 months following its publication in the Official Journal of the European Union. Full compliance with the legislation is therefore expected in H2 2020.

Annex A: Penalty Rates applicable to settlement fails

	Type of fail	Rate
1.	Settlement fail due to a lack of shares that have a liquid market, excluding shares referred to in point 3	1.0 bp
2.	Settlement fail due to a lack of shares that do not have a liquid market, excluding shares referred to in point 3	0.5 bp
3.	Settlement fail due to a lack of financial instruments traded on SME growth markets, excluding debt instruments referred to in point 6	0.25 bp
4.	Settlement fail due to a lack of debt instruments issued or guaranteed by: a. a sovereign issuer b. a third country sovereign issuer c. a local government authority d. a central bank e. any multilateral development bank referred to in Articles 117(1) and 117(2) in the CSDR Level 1 text f. the European Financial Stability Facility or the European Stability Mechanism	0.10 bp
5.	Settlement fail due to a lack of debt instruments other than those referred to in points 4 and 6	0.20 bp
6.	Settlement fail due to a lack of debt instruments traded on SME growth markets	0.15 bp
7.	Settlement fail due to a lack of all other financial instruments not covered in points 1 to 6	0.5 bp
8.	Settlement fail due to a lack of cash	Official interest rate for overnight credit charged by the central bank issuing the settlement currency with a floor of 0

Annex 1 to the supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council as regards the parameters for the calculation of cash penalties for settlement fails and the operations of CSDs in host Member States (EF342).

Annex B: Example - calculation of penalty

Failing settlement of a matched equity trade will result in a penalty of 1 basis point of the market value of the trade, for each day the settlement is postponed from the intended settlement date. The market value is calculated based on the closing price each day. The exact calculation of the penalty to be paid would be as shown below.

In the example the following applies:

A trade of 10,000 shares has been matched but not settled due to a lack of securities at the intended settlement date. This continues for two days. The market price (closing) for day one is DKK 150 and for day two DKK 175.

- Penalty, day 1: 10,000 shares * DKK 150 *0.01% = DKK 150
- Penalty, day 2: 10,000 shares * DKK 175 * 0.01% = DKK 175
- Total penalty amount: DKK 150 + DKK 175 = DKK 325

The penalty is to be paid by the party failing to deliver the securities. VP will facilitate the payment of the penalty between the failing and non-failing parties.

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