

CSD Regulation

The main effects of the new Central Securities Depositories Regulation

An overview of the CSD-R

The CSD-R (Central Securities Depositories Regulation) is the European Regulation No. 909/2014, that regulates securities settlement services and, more generally, the activities of Central Securities Depositories (CSDs), which has been published in the Italian Official Gazette on 28 August 2014 and entered into force on 17 September 2014.

The new Regulation constitutes a fundamental milestone in the process of harmonising post-trade activities in Europe:

- enhancing the safety and efficiency of CSDs, identified as critical market infrastructures
- harmonising the applicable regulatory framework and defining common rules for all CSDs
- introducing a standardised framework for dealing with settlement fails.

The concrete applications of the primary rules established by the Regulation are then detailed in the provisions of the delegated regulations, the so-called Technical Standards.

The legislation applies to all European CSDs, in addition to the Central Depositories of Iceland, Lichtenstein and Norway.

With the entry into force of the CSD-R, all CSDs operating in Europe have filed an application with their respective Supervisory Authorities to be re-authorised to act as a Central Depository under the new European regulation and documenting their compliance with the new legislation.

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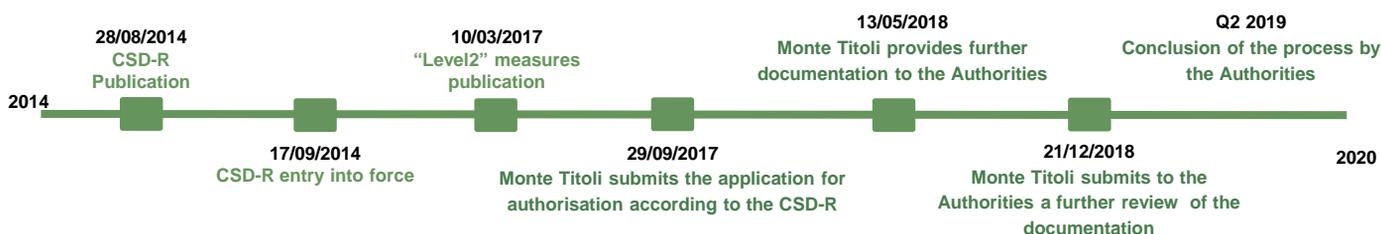
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1. Introduction

1.1. Purpose of this document

The purpose of this document is to provide an overview of the main points involving clients in relation to the implementation of the CSD-R by Monte Titoli.

The document has informative nature and is not intended as a reference for analysis and interpretation of the regulations.

For further details, see to the appropriate references and contacts at the end of this document.

1.2. Interim management

Monte Titoli has always operated in accordance with the applicable regulatory framework and international best practice, and is therefore already aligned with most of the CSD-R provisions, which identifies the CSD as a critical market infrastructure, able to ensure maximum security and operational transparency.

With this in mind, Monte Titoli has decided to focus its offer on asset servicing and value-added services that best support the operations of its Participants.

While the authorisation process is in progress, Monte Titoli continues to operate in accordance with current rules and is evaluating the possibility of immediately implementing some of the measures envisaged by the CSD-R, in order to achieve a more gradual adjustment process.

In this context, Monte Titoli maintains a constant flow of communication with its Clients through the appropriate channels, in particular through the several working groups that continue to support interaction with the market, including during the adjustment process.

2. Main impacts for participants

2.1. Reconciliation process (Article 37 CSD-R - Article 65 RTS Reg. 2017/392)

With the objective of ensuring the integrity of issuance, CSDs must verify that the number of securities constituting an issuance (or part of it) is equal to the sum of the securities recorded in the accounts of Clients.

To this end, when performing the process of daily reconciliation of the account balances in which financial instruments are recorded, the CSD must perform two key controls, checking that:

- the sum of the balances in Client securities accounts coincides with the balance of the Issuer's securities account with reference to each financial instrument issued;
- the end-of-day balance in the securities accounts of each Participant coincides with the balance on the previous accounting day, including all accounting movements recorded on that day with respect to the issued financial instrument in question.

In event of discrepancies, the CSD must activate the necessary settlement procedures.

In this regard, Article 65 of Delegated Regulation no. 392/2017 provides that if the reconciliation process reveals an undue creation or deletion of securities and the CSD fails to solve this problem by the end of the following business day, the CSD must suspend the settlement of transactions in those securities until the account records are properly realigned.

In the event that the settlement of transactions in a security is suspended, the CSD must inform Participants and the competent Authorities.

It should be remembered that Clients are also required to perform a similar reconciliation process internally on a daily basis, with reference to the accounting sent by Monte Titoli with its Daily Statement.

Any discrepancies must be immediately reported to Monte Titoli.

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2.2. Communication standards (Article 35 CSD-R)

Pursuant to Article 35 of the CSD-R, in their communication procedures with their Clients, CSDs must use international open communication and messaging procedures, identified as "Communications Standards" in order to facilitate efficient recording, payment and settlement of securities transactions.

On 23 March 2018, The European Securities and Markets Authority (ESMA) published an update of its [CDSR Q&A](#) document containing further details on the scope and interpretation of Article 35 CSD-R. In the document, ESMA clarified that the standard refers only to communication procedures concerning automated interactions (A2A, machine/machine), not manual interactions (U2A, i.e. man/machine).

2.3. Links with other CSDs (Article 84 RTS Regulation (EU) 2017/392)

The CSD-R requires that, before establishing a link, the CSDs concerned must identify, assess, control and manage all potential sources of risk for the protection of their Participants and take appropriate measures to mitigate them.

Specifically, the link must provide adequate protection for linked CSDs and their Participants, particularly with regard to protection of the financial instruments held through the link.

To this end, linked CSDs must have robust reconciliation procedures in place to ensure the accuracy of their records.

Monte Titoli's operating procedures are already substantially compliant with the CSD-R's requirements.

In this regard, on 23 March 2018, ESMA updated its [CDSR Q&A](#) and clarified that links between two CSDs in T2S must be considered as "interoperable links". As a consequence these type of links are subject to additional requirements relating to the alignment of certain operational aspects and required procedures to be followed in case an insolvency event affecting participants occurs.

2.4. Settlement discipline (Articles 7- 8 CSD-R)

The CSD-R provides for the introduction of a set of measures

designed to ensure the orderly and timely execution of settlement processes (the so-called "Settlement Discipline").

In particular, the measures that have been introduced are intended to:

- prevent settlement fails, with particular reference to the transactions hold & release mechanism;
- monitor settlement fails, with particular reference to the reporting of fails that CSDs must provide to the supervisory authorities in aggregate form;
- managing settlement fails, with particular reference to:
 - i. the regulation of penalties, i.e. when
 - a transaction is not settled on the intended day (or following days), or when
 - a settlement instruction is matched after the settlement date
 - ii. the standardisation of the buy-in procedure.

It should be noted that the CSD-R guarantees a reasonable period of time for the implementation of the "Settlement Discipline" equal to 24 months starting from the publication of the Technical Standards for the Settlement Discipline, thus enabling all operators to adapt to the new processes.

Monte Titoli is an active member of the task force set up within T2S for the creation of a centralised Settlement Discipline solution, supporting the implementation of a single procedure for penalties managed in T2S, as the most efficient solution in economic and operational terms.

The European Commission has adopted the Technical Standards on 25 May 2018. The Parliament and the European Council have a 3-months period (plus 3 additional months in case of objections) to examine the documents.

Consequently, the entry into force of the new Settlement Disciplines should be placed in August or November 2020.

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2.5. LEI code (Articles 4 and 11.5 RTS Regulation (EU) 2017/394)

The Legal Entity Identifier Code, or LEI, is a unique code defined according to the ISO 17442 standard that identifies legal entities operating in the financial markets. The CSD-R requires CSDs to record the LEI code of all clients (issuers and intermediaries) in their databases.

Issuers and intermediaries are therefore required to obtain a LEI code and report it to the CSD. The LEI code will be recorded in the CSD's databases and used in the context of reporting obligations to the supervisory authorities.

Although Monte Titoli already requires LEI code into its databases, as of today the same code is not mandatory for the admission of new clients and no relevant implementation have been yet defined. However, it is recommended that clients apply for their own LEI code and report it to Monte Titoli as soon as possible.

Monte Titoli will provide further information as soon as the adaptation modalities have been defined.

3. Risk Management

3.1. Identification of Key Participants

In order to ensure the proper and efficient functioning of the settlement system, the CSD-R requires that the CSD monitors potential risks arising from clients whose operations, within the settlement system, are particularly significant on the basis of the following elements:

- number of settlement instructions sent (volumes)
- countervalue handled (value)
- dependencies between the clients of the CSD and their respective clients, if they are known to the CSD.

On the basis of these criteria, Monte Titoli will produce a list of "Key Participants" which will be regularly updated. Those included in the list will be promptly informed by Monte Titoli.

In accordance with the contractual provisions common to all participants, those identified as "Key Participants" are required to promptly notify the CSD of any organisational and/or technological change that could potentially impact their interaction with Monte Titoli.

Monte Titoli is developing a specific risk indicator based on the system's settlement efficiency to monitor the operations of Key Participants.

3.2. Segregated accounts (Article 38 CSD-R)

Article 38 of the CSD-R pays particular attention to the protection of Client assets, establishing a set of rules for the structure and segregation of accounts, together with some transparency rules regarding the levels of protection and associated costs.

In particular, the CSD must allow its Participants to:

- segregate its own securities from those of its Clients
- hold the securities of various Clients in a single account
- segregate the securities of each Client, if and as requested by the Participant.

In accordance with these requirements, Monte Titoli will introduce the obligation to define the securities accounts of each Client at the level of master data configurations, selecting from:

- account for own securities
- account for omnibus third party securities
- account for third party securities individually segregated (or destined for a single client).

Third-party accounts can be used either for the registration of securities held by several Clients of a CSD Participant ("omnibus third party accounts"), or for the registration of securities held by an individual Client of a CSD Participant ("accounts segregated at the level of the individual client"). In the latter case, Participants in the CSD are not required to disclose the identity of the Client.

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Participants must define their securities accounts using the CLIMP platform. At the moment Monte Titoli has not set any deadline for the definition of individually segregated accounts.

In order to comply with the transparency requirements established by Article 38 of the CSD-R, Monte Titoli will publish a specific document on segregation which, in addition to describing the various types, will indicate the costs, as already published in the Monte Titoli Fees, and the main legal implications associated with each level of segregation.

3.3. Amendments to Service Rules

The introduction of the CSD-R has led to a general reorganisation of legislation governing centralised management and liquidation activities contained in Part III of the Consolidated Law on Finance which, in line with Community legislation, now establishes a single set of rules for the activities of central depositories.

Accordingly, the texts of the Regulations for the Settlement Service, the Centralised Management Service, and the X-COM service will be integrated into a single document, as follows:

- **PART I - Common Provisions:** containing provisions on access to services, rules of conduct, suspension and exclusion procedures
- **PART II - Discipline of the Centralised Account and of the ancillary services:** containing the specific rules for Centralised Administration and of related activities (including X-COM)
- **PART III - Rules for the Settlement Service and ancillary services,** containing the current rules for the settlement service and related activities, in particular the X-TRM service and the cross-border settlement service.

Instructions for the three services will remain separate.

The consultation process regarding regulatory changes concluded on 16 September 2017. The new regulations will

enter into force when Monte Titoli obtains authorisation from the CSD-R.

3.4. Contract

Given the revision of the structure of the general terms for the provision of services and the substantive amendment of some contractual provisions, it is expected that clients will need to sign a new Request for Services.

Specific communications will follow on this point.

4. Transparency & Governance

4.1. User Committee (Article 28 CSD-R)

Article 28 of the CSD-R provides that each CSD is required to establish a User Committee.

The Committee shall be entitled to submit non-binding opinions to the Board of Directors of the CSD on the most significant issues concerning the level of service, the price structure, and/or Italian market harmonisation practices. On the other hand, all technical and operational matters dealt with in the existing and/or future technical working groups are excluded from the Committee's mandate.

Monte Titoli has defined the following composition:

- Three (3) members representing Issuers.
- Six (6) members representing Participants in the settlement service.

Prior the expected time for completion of the authorisation process, Monte Titoli intends to commence working on the establishment of the User Committee in the first half of 2018.

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4.2. Organisational structure of the CSD

The provisions of the CSD-R pay particular attention to the internal organisation of CSDs and require the adoption of specific governance arrangements.

In particular, the following corporate positions must be created:

- CTO (Chief Technology Officer)
- CRO (Chief Risk Officer)
- CCO (Chief Compliance Officer)

In addition, the following Committees will be introduced to support the Board of Directors in their respective areas of responsibility:

- Risk Committee
- Audit Committee
- Remuneration Committee

4.3. Transparency (Article 34 CSD-R)

Under the CSD-R, CSDs are required to publicly disclose the prices and fees associated with basic services.

In particular, CSDs must publish the prices and fees of each service separately and provide their clients with all information that enables them to check invoices against published pricing lists.

Monte Titoli is compliant with these requirements and continues to ensure transparency in pricing and the services it provides.

For further information, see the [“Download Area/Fees”](#) section of the montetitoli.it website.

Monte Titoli is a leader in Post-Trade industry, with c. €3.3 trillion of assets under custody.

Monte Titoli offers pre-settlement, settlement, custody, asset servicing and collateral management services as Issuer and Investor CSD as well as issuer services to a large domestic and international client base of 184 banks, brokers, CCPs and stock exchanges and 2,400 issuers.

In 2017, Monte Titoli settled 44.6 million transactions with an increase of 3% over previous year and a settlement rate of 97,4%.

Monte Titoli is part of the London Stock Exchange Group.

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