SETTLEMENT INTERNALISER AND ITS REPORTING
REQUIREMENTS IN THE CENTRAL SECURITIES
DEPOSITORIES REGULATION

OVERVIEW OF THE SETTLEMENT INTERNALISER IN THE CSDR

The main objective of Central Securities Depository Regulation is to harmonize settlement process and systems across Europe. Article 9 of the regulation sets rules on how to report trades settled outside the formal settlement system, Central Securities Depositories (CSDs) and Central Clearing Counterparties (CCPs). This will allows regulators to manage risks and improve security in the markets.

OVERVIEW

CSDR refers to the European Regulation n. 909/2014 that entered into force on 17th September 2014. It regulates the strengthening of the securities regulation and governing activity of Central Securities Depositories (CSDs) in the European Union. This Regulation was adopted after the financial crisis and it is part of the European regulatory reform plan that includes also EMIR and MIFID II.

The Regulation concerns CSD and Settlement Internaliser: **CSD** is an organization that holds financial securities in physical or virtual form in order to facilitate property exchange while **Settlement Internaliser** is any institution that settles a transaction without submitting the contract to a regulation system.

The purpose of the Regulation includes:

- strengthening the security and efficiency of CSDs;
- harmonizing the applicable regulatory framework in order to have rules common to all CSDs;
- creating an integrated market for securities settlement without distinction between national securities and cross-border securities.

In particular, this paper regards the Settlement Internaliser regulation that requests reports quarterly to the Supervisory Authority. The report must relate to all securities transaction settled outside the securities settlement system as following:

- aggregated by volume and value differentiated by financial instrument, type of transaction, type of client, identification of issuer CSD, failed transaction;
- the code of the country where the Settlement Internaliser is established;
- the period which report refers;
- a single LEI (Legal Entity Identifier) code.

Settlement Internalisers must send the report within 10 working days after quarterly end. The main step date of the reporting obligation for the Settlement Internaliser are the following:

DATE	DESCRIPTION	DETAILS
10th March 2019	Enter into force RTS on Settlement Internaliser	☑
12th July 2019	First Settlement Internaliser report due to national competent authority (NCAs)	☑
1st January 2023	Certified securities will be transferred into book entry from for transferable securities issued after that date	☒
1st January 2025	All transferable securities will be transferred into book entry after that date	☒

SETTLEMENT INTERNALISER

Internalised settlement reporting guidelines are documented within article 9 of the CSDR. The definition of a Settlement Internaliser describes it as any institution, including one authorised in accordance with Directive 2013/36/EU or with Directive 2014/65/EU, which executes transfer orders on behalf of clients or on its own account other than through securities settlement system[1].

A Settlement Internaliser is such if:

- It receives a settlement instruction from a client regarding settlement of a securities transaction which is not forwarded as whole to another entity along the holding chain;
- A settlement instruction results or is supposed to result in a transfer of securities from one securities account to another in the books of the Settlement Internaliser, without any external parallel securities movement along the holding chain.

On 28th March 2018, ESMA published its guidelines on Settlement Internaliser reporting under article 9 of CSDR in which describes the type of transactions and operations that must be considered in the report of the Settlement Internaliser.

Type of transaction and operations in scope of the report are the following:

- purchase or sale of securities (including primary market purchases or sales of securities);
- collateral management operations (including triparty collateral management operations or auto-collateralizations operations);
- securities lending or securities borrowing;
- repurchase transactions;
- transaction subject to netting;
- transfers of securities between accounts of different funds;
- transfers of securities between two securities accounts of the same client;
- title transfer financial collateral arrangement;
- corporate action on flows represented by transformation.

---

[1] *REGULATION (EU) No 909/2014 OF THE EUROPEAN PARLIAMENT, Title 1, Article 2 – Paragraph 11*

REPORTING

Settlement Internalisers must send a report to the competent authorities in their place of establishment, on a quarterly basis, with the aggregated volume and value of all securities transaction that they settled outside securities settlement system.

RTS (EU) 2017/391 of 11th November 2016 supplementing Regulation (EU) N. 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards further specifying the content of the reporting on Settlement Internaliser.

In particular, Settlement Internalisers have to send the report to the National Competent Authority that transmits the information to ESMA within 5 working days.

The report must contain all securities transactions settled outside the securities settlement system, as follows:
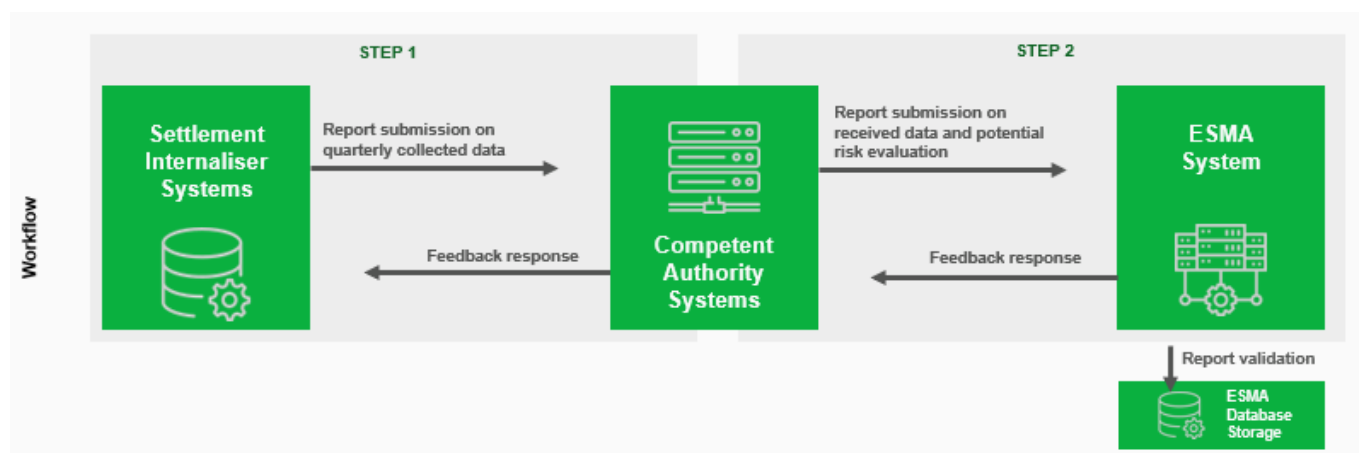
- aggregated by volume and value differentiated by financial instrument/type of transaction/type of client/identification of issuer CSD/ failed transaction;
- the code of the country where the Settlement Internaliser is established;
- the period which report refer;
- a single Legal Entity Identifier (LEI code) of client.

The type of reports in scope of the Settlement Internaliser are:

- 1 report for internalised operations from entities established in the country;
- 1 report for internalised operations from branches established in the other EU country;
- 1 report for internalised operations from branches established in Extra-EU country.

Settlement Internalisers must report this information quarterly - due 10 business days after quarter end. The first report is due between 1st and 12th July 2019 to cover the transactions internalized in quarter 1st April – 30th June 2019.
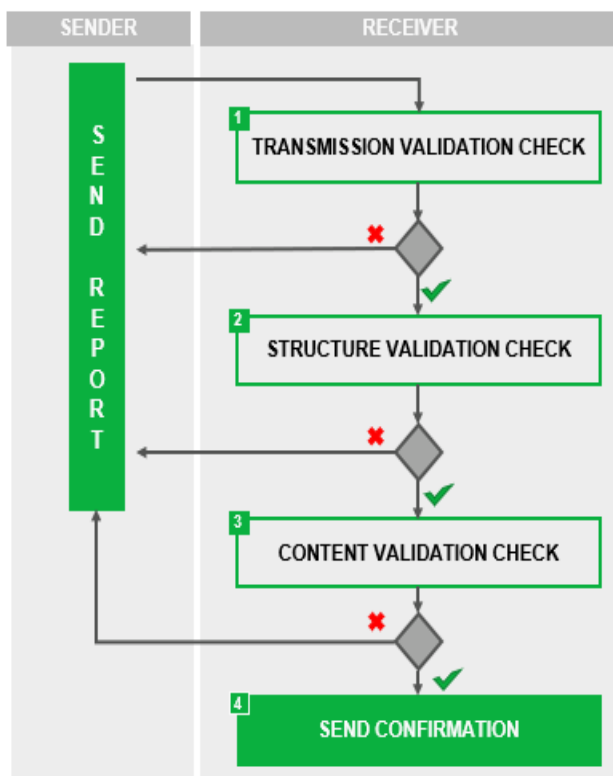
REPORTING PROCESS

1) Settlement Internaliser shall report to the Competent Authority in their place of establishment. It shall use the template provided by Regulation to submit the report within 10 working days from the end of each quarter of a

calendar year;

2) Competent Authority transmits the information received by Settlement Internaliser to Supervisory Authority (ESMA) within 5 working days from the day of the receipt of each report using the template provided by Regulation and inform Supervisory Authority of any potential risk resulting from the Settlement Internaliser activity within 30 working days from the end of each quarter of a calendar year;

3) Supervisory Authority check the report and generates a feedback. Each received report is validated against completeness and soundness of message and submitted data;

4) Once the report is validated, Supervisory Authority generates a feedback file as response to Competent Authority;

5) Competent Authority receives feedback file from Supervisory Authority and sends it to Settlement Internaliser;

6) Settlement Internaliser receives feedback file from Competent Authority and if one or more problems have been identified the respective data, which do not comply with Supervisory Authority's validation rules, must be corrected and the report must be sent again.

There is no minimum threshold, so even single settlement operation internalised per quarter is sufficient to activate the report obligations.

REPORTING VALIDATION. The first series of checks are **syntactic controls**:

1) If an error is identified during file validation then the process is stopped, thus all records contained in the submitted file are rejected. In that case a feedback message that explaining the reason for rejection is sent to the submitting entity, through a feedback file generated by the system;

2) After the successful transmission validation, the System will perform XML validation of the received file against the commonly agreed XSD schema. If an error is identified, the processing stops, all records contained in the file are rejected and a feedback message explaining the reason for rejection is sent to submitting entity. The submitting entity will have to fix the errors and resubmit the full file for reprocessing.

Successively, there are the **semantic controls**:

3) During content validation, if at least on error is identified, the corresponding file (i.e. the complete Settlement Internaliser report) will be rejected. The System will send a feedback (through a feedback file generated automatically) to the submitting entity on the full list validation checks that failed, reporting error. The submitting entity will have to fix the errors and resubmit the full file for reprocessing.

The last step is the **validation** process:

4) If data content validation is completed identifying no errors, the system sends a confirmation of data receipt to the submitting entity, through a feedback file generated automatically and stores the received records included in the submitted file in the database.

REPORTING TECHNICAL INFORMATION. Settlement Internaliser sends a message to NCAs. The name of report of Settlement Internaliser follows this format:

<Sender>_<FileType>_<Recipient>_<Key1>_<Key2>.xml

In particular:

- **<Sender>** is prefix "NCA" followed by the Country Code of the submitting entity;

- **<FileType>** is the standard text **"DATISR"** standing for "Data for Settlement Internaliser";
- **<Recipient>** is the standard text "CSDR9";
- **<Key1>** contains the following elements delimited by "-":
  - The Country Code (ISO Country Code or the special value "TS") that report concern;
  - The LEI code of Settlement Internaliser;
  - The year for which the content of the report relates to;
  - The Quarter for which the content of the report relates to, it can be "Q1", "Q2", "Q3", or "Q4".
- **<Key2>** is a four-digit number indicating the version of the report, which is a positive integer values indicated by 4 numeric characters where the value must be preceded by one or more zeros. For example, for the first submission the version must be filled by "0001" and for each subsequent report sending this number increased by 1 (for example 0002).

The Authority produces a feedback file containing information on the outcome of the report sent by Settlement Internaliser. The name of the feedback file is:

<Sender>_<FileType>_<Recipient>_<Key1>_<Key2>.xml

In particular:

- **<Sender>** is the standard text "CSDR";
- **<FileType>** is the standard text **"FDBISR"** standing for "Feedback for Settlement Internaliser";
- **<Recipient>** is the standard text "NCA" followed by the Country Code of the entity;
- **<Key1>** and **<Key2>** are the same of the name convention of report file.

In detail, a Settlement Internaliser report contains:

- One **Report Header part** containing metadata for the report comprising: creation data time, reporting date, currency, report status;
- One Settlement Internaliser part containing:
  - Identification data of the Settlement Internaliser (LEI code, contact details, head-office country code);
  - Data for overall total, financial instruments, transaction types, client types and total cash transfer of the Settlement Internaliser for the quarter and specified country;
- One or **more Issuer CSD parts** containing:
  - Identification data of the issuer CSD: LEI of the issuer CSD (if know), the first two characters of the ISIN code, country code of the issuer CSD (if know);
  - Data for the overall total, financial instrument, transaction types, client types and total cash transfer of the Settlement Internaliser for the quarter, specified country and specific issuer CSD.

All **Business Data** are reported under two core data structure:

- The Aggregate Structure containing:
  - Settled data (volume, value);
  - Failed data (volume, value);
  - Total data (volume, value).
- The Failed Rate Structure containing:
  - Volume percentage;
  - Value percentage;

The **status**[2] of each report can be:

- New report (**RptSts=NEWT**) when a submitting entity first reports for a given reporting period for a given country

---

or when a submitting entity reinstates a previously cancelled report. If the file is successfully validated, the system will store a respective "IS entry" (Internalised Settlement) in the DB, flagging it as a "valid" record;

- Update report (**RptSts=AMND**) when a submitting entity wishes to update data of a valid "IS entry". If the file is successfully validated, it will be stored in the DB as a "valid" report, while its previous version will be fragged as "invalid";
- Cancel report (**RptSts=CANC**) when a submitting entity wishes to cancel a valid "IS entry". If the file is successfully validated, it will "invalidated" the "IS entry". The cancelled data will be marked as cancelled and maintained in the DB.
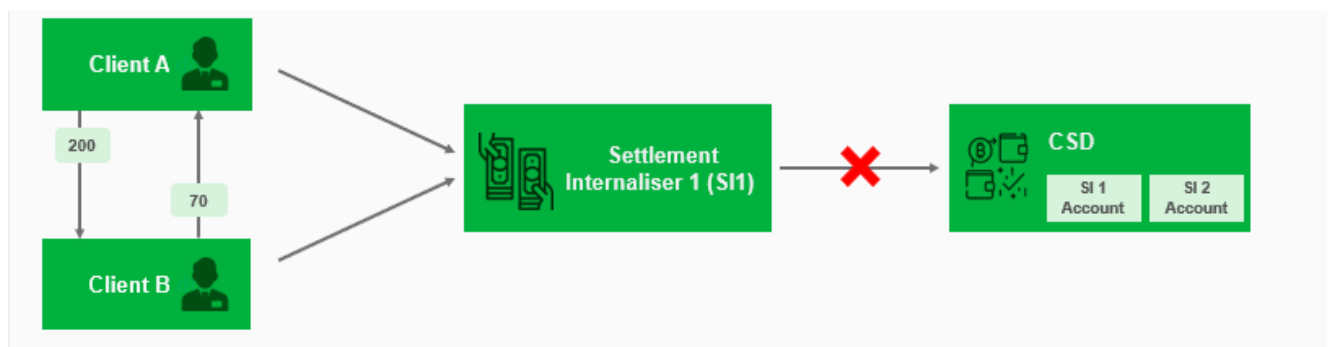
The status of the feedback can be:

- <u>Corrupted</u> **(CRPT):** the Settlement Internaliser report is flagged as corrupted when zip file cannot be opened or decompressed;
- <u>Rejected</u> (**RJCT**): the Settlement Internaliser report is flagged as rejected in the following cases:
  - one or more of the expected XML files is not contained in the zip folder;
  - the contained XML file does not have the same filename as the container zip file;
  - the report does not use the same XML schema as the one used by the system;
  - the report uses exactly the same file name previously used or the report relates to a country that is not recognised in EEA country;
  - the report cannot be validated against the XML schema;
  - the content of the report violates any of the Data Content Validation rules in which case Record Status elements will be included in the feedback file, detailing the exact records violating Data Content validation rules, all having the status "RJCT");
- <u>Accepted</u> (**ACPT**): the Settlement Internaliser report is flagged as accepted when it passes successfully all validation checks

REPORTING EXAMPLES

This paragraph shows some examples regarding type of reporting that must be sent by Settlement Internaliser as reported in the Guidelines of ESMA of 28th March 2018.

SIMPLE SETTLEMENT INTERNALISER REPORTING. Settlement Internaliser (SI1) has one omnibus account at the CSD, including both client A's and B's securities. SI1 does not send any instruction to the CSD in relation to the instructions that SI1 has received from its clients.
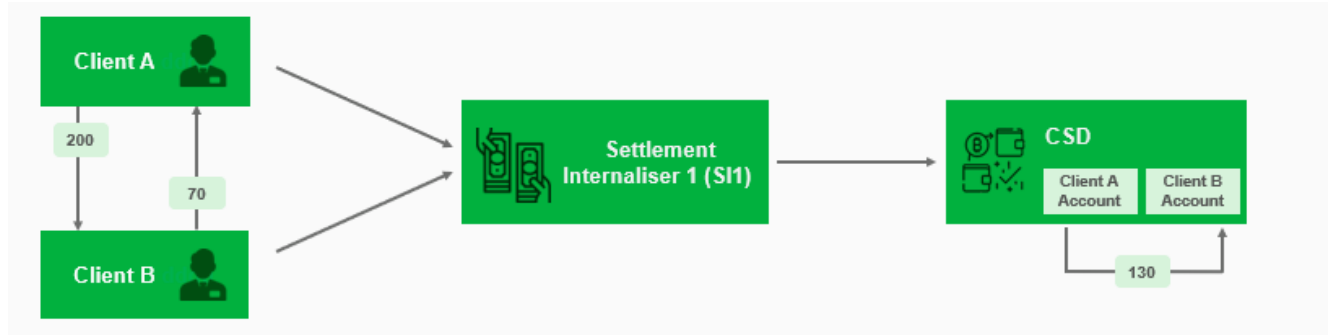

In relation to the report, Settlement Internaliser (SI1) must be sent 4 instructions:

- client A delivers 200 securities to client B;
- client B receives 200 securities to client A;
- client B delivers 70 securities to client A;

- client A receives 70 securities to client B.

PARTIAL SETTLEMENT INTERNALISER REPORTING. Settlement Internaliser 1 (SI1) has two securities accounts at CSD, one for client A's securities and one for client B's securities. SI1 sends instructions to the CSD for the settlement of the net difference in relation to the instructions the SI1 has received from the clients.
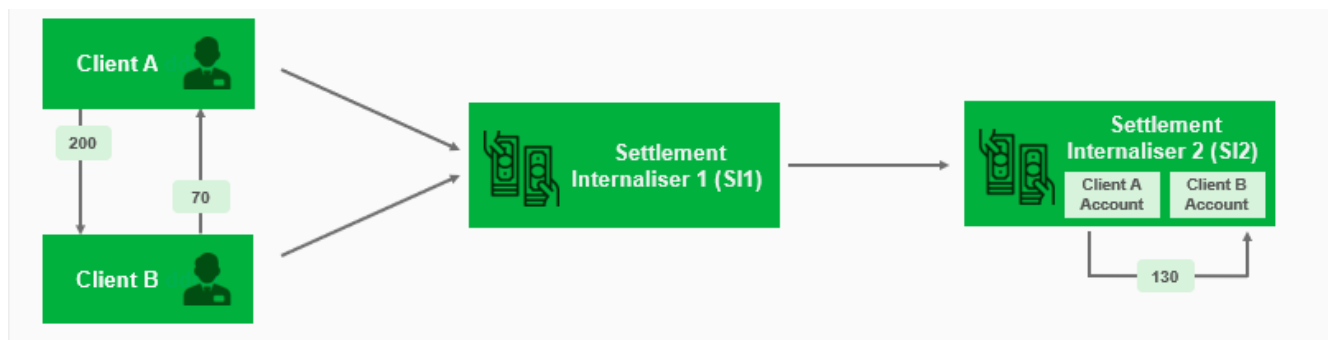

In relation to the report, Settlement Internaliser (SI1) must be sent 4 instructions:

- client A delivers 70 securities to client B;
- client B receives 70 securities from client A;
- client B delivers 70 securities to client A;
- client A receives 70 securities from client B.

In particular, the transfer of 200 securities from A to B is split in two parties: the first one of 130 securities is covered at the level of CSD, and does not need to be reported as settlement internaliser. The remaining transfer of 70 securities is considered as settlement internaliser at the level of SI1 and, for this reason, must be reported by the SI1.

DOUBLE SIDE SETTLEMENT INTERNALISER REPORTING. Settlement Internaliser (SI1) has two securities account with another Settlement Internaliser (SI2), one for client A's securities and one for client B's securities. SI1 sends instructions to SI2 for the settlement of the net difference in relation to instructions that SI1 has received from its clients.

In relation to the report, SI1 and SI2 must be report 4 instruction each one.

Settlement Internaliser 1 (SI1) reports instructions for:

- client A delivers 70 securities to client B;
- client B receives 70 securities from client A;
- client B delivers 70 securities to client A;
- client A receives 70 securities from client B.

Settlement Internaliser 2 (SI2) reports instructions for:

- client A delivers 130 securities to client B;
- client B receives 70 securities from client A.

In particular, the transfer of securities of 200 from A to B is split in two: the first part of 70 securities is considered as Settlement Internaliser 1 instruction, while the net difference (130) will have to be reported by Settlement Internaliser 2.

CONCLUSION

According to Regulation (EU) n. 909/2014 (CSDR), the subjects that internally regulate transactions on securities, i.e. without transmitting them to a central depository, to a central counterparty or to another intermediary, should be considered **"settlement internalisers"**.

The regulation internalisers must communicate, within 10 working days from the end of each quarter (January-March; April-June; July-September; October-December), aggregated data on transactions internalized to the competent authority of the EU country in which they are based .

The settlement Internalisers that have their headquarters in Italy and the Italian branches of entities based in non-EU countries must therefore make the communications to Consob. The Italian branches of settlement internalisers established in other EU countries must communicate the data to the national authority of the EU country in which their head office is located.

As recalled in Communication n. 9 of 11 April 2019, the obligation enters into force on **1 July 2019** on the figures for the **April-June 2019 quarter**.

The content of the data is defined in the Delegated Regulation n. 2017/391 and in the Implementing Regulation n. 2017/393. Further clarifications are provided in the ESMA Guidelines of 28 March 2018, to which Consob will comply in its supervisory activity.

The data must be communicated using XML format files prepared according to an XSD scheme approved by the ISO (c.d. Schema Report), as required by the aforementioned ESMA Guidelines, and sent to Consob through an ad hoc data reception system.

In order to access the new system, the CSDR form attached to the Communication must be sent to Consob by 17 May 2019.

ABOUT AVANTAGE REPLY. With operations in Amsterdam, Brussels, Frankfurt, Lisbon, London, Luxembourg, Milan, Munich, Paris, Rome and Turin, Avantage Reply is the Reply Group financial services consulting practice employing more than 300 specialized consultants and drawing on the wider capabilities of Reply's 7,500+ people. Avantage Reply delivers advisory and management consulting services to financial services institutions with respect to Risk and Compliance, Finance (including Capital Management and Regulatory Reporting), and Treasury. Since its establishment in 2004, Avantage Reply has been committed to industry specialization (financial services) offering insights and in-depth experience. Avantage Reply works with board members, CROs, CCOs, COOs and CFOs, senior and mid-management finance and risk executives of leading financial services institutions across the Eurozone and the United Kingdom. We provide advisory and management consulting services to help financial institutions address the risk, finance and compliance challenges arising from changes in regulation and strategic and organizational change, including technology.