
BNY SECURITIES FINANCE

SETTLEMENT FAIL PENALTIES UPDATE

The following communication details topics relating to all securities lending programmes that lend securities that may incur settlement fail penalties pursuant to the Central Securities Depositories Regulation (“CSDR”).

1. TREATMENT OF SETTLEMENT FAILS PENALTIES PURSUANT TO CSDR

By way of reminder, the CSDR settlement discipline regime took effect on 1st February 2022 and introduced cash penalties (both credits and debits) for settlement fails in transactions in securities settling via a European Economic Area (“EEA”) Central Securities Depository. The CSDR settlement discipline regime therefore applies to parties who are located within or outside of the EEA and now will affect both the receiving and delivering parties in a given failing transaction.

CSDR requires EEA CSDs to charge their participants cash penalties for each business day on which a settlement fail in securities has occurred and remains outstanding. On a monthly basis, EEA CSDs collect penalty debits from “failing” participants and distribute those amounts as penalty credits to “receiving” participants (who were on the other side of the settlement fail).

2. WHAT DOES THIS MEAN FOR YOUR SECURITIES LENDING PROGRAMME, SPECIFICALLY WITH SALES AND SALE NOTIFICATION?

The Bank of New York (“BNY”) may receive CSDR penalty credits and debits arising from loan and loan return instructions. For example: (i) a CSDR penalty credit where the borrower fails to return the loaned securities in time following a recall; or (ii) a CSDR penalty debit where securities are not delivered to the borrower on time at the beginning of a loan. BNY will receive all CSDR penalty credits as revenue to BNY and will pay all CSDR penalty debits arising from loan and loan return instructions given by BNY as agent lender which subsequently fail on your account as part of your lending activity.

Where the loaned security is not returned in time to cover a client sale which results in a CSDR penalty debit, a debit equal to the CSDR penalty arising on the failing client sale will be allocated to your account. Subject to the 'Mitigation-Partial Settlement' paragraph below, where you have provided BNY agency lending with a sale notification in accordance with the deadlines outlined below, BNY will transfer and re-allocate the CSDR penalty debit amount from you to BNY agency lending.

This means that BNY will absorb the economic impact of CSDR cash penalties (both debits and credits) arising on your account as part of your lending activity, including cash penalty debits arising on your failing client sales as described above, provided that you have (i) provided BNY agency lending with a sale notification in accordance with the deadlines outlined below; and (ii) arranged for the partial settlement of trades when required. However, in accordance with paragraph 5 of this communication, where you fail to provide such notification(s) in accordance with relevant deadlines or fail to arrange for partial settlement of trades when required, BNY may not re-allocate the relevant cash penalty debit amounts from you to BNY agency lending.

3. DEADLINES – EQUITIES

- Notification of sales should be received by BNY before the underlying market cut off time, on the **trade date** of any sale.
- Notification after this will be deemed T+1 and could result in a cash penalty if the recall and subsequent sale fail to settle on ISD of the sale.

4. DEADLINES – FIXED INCOME

- Notification of sales should be received by BNY, by 1pm CET on **trade date + 1** of any sale.
- This is in line with current market practice, but should that change, we reserve the right to amend this timescale in line with the equities' deadlines above.

5. MITIGATION - PARTIAL SETTLEMENT

- All clients will be expected to arrange for the partial settlement of trades when required, to minimise the costs of failing under the new regime. As your agent lender, where you fail to arrange for partial settlement, BNY may, at our discretion, either re-allocate: (i) the portion of the CSDR penalty debit amount caused by the outstanding recalled securities from you to BNY agency lending; or (ii) the CSDR penalty debit incurred for the entire sale failure from you to BNY agency lending.

We will continue to evaluate the impact of any settlement fail penalty regime or practice on the securities lending market and will keep you updated of any further developments as they arise.

In the event of any inconsistency between this communication and any other previous communication from BNY on this topic, this communication shall prevail.

Please direct inquiries to your relationship manager.