



CSDR CENTRAL SECURITIES DEPOSITORIES REGULATION

CSDR – SEGREGATION AT CSD LEVEL
(ART 38)

The European Regulation applicable
to Central Securities Depositories

INTRODUCTION

The Central Securities Depositories Regulation (the so called CSDR)¹ is an European regulation that defines the European CSD regulatory framework for central securities depositories meanwhile requiring several measures to improve the settlement of financial securities and to reinforce the investor protection.

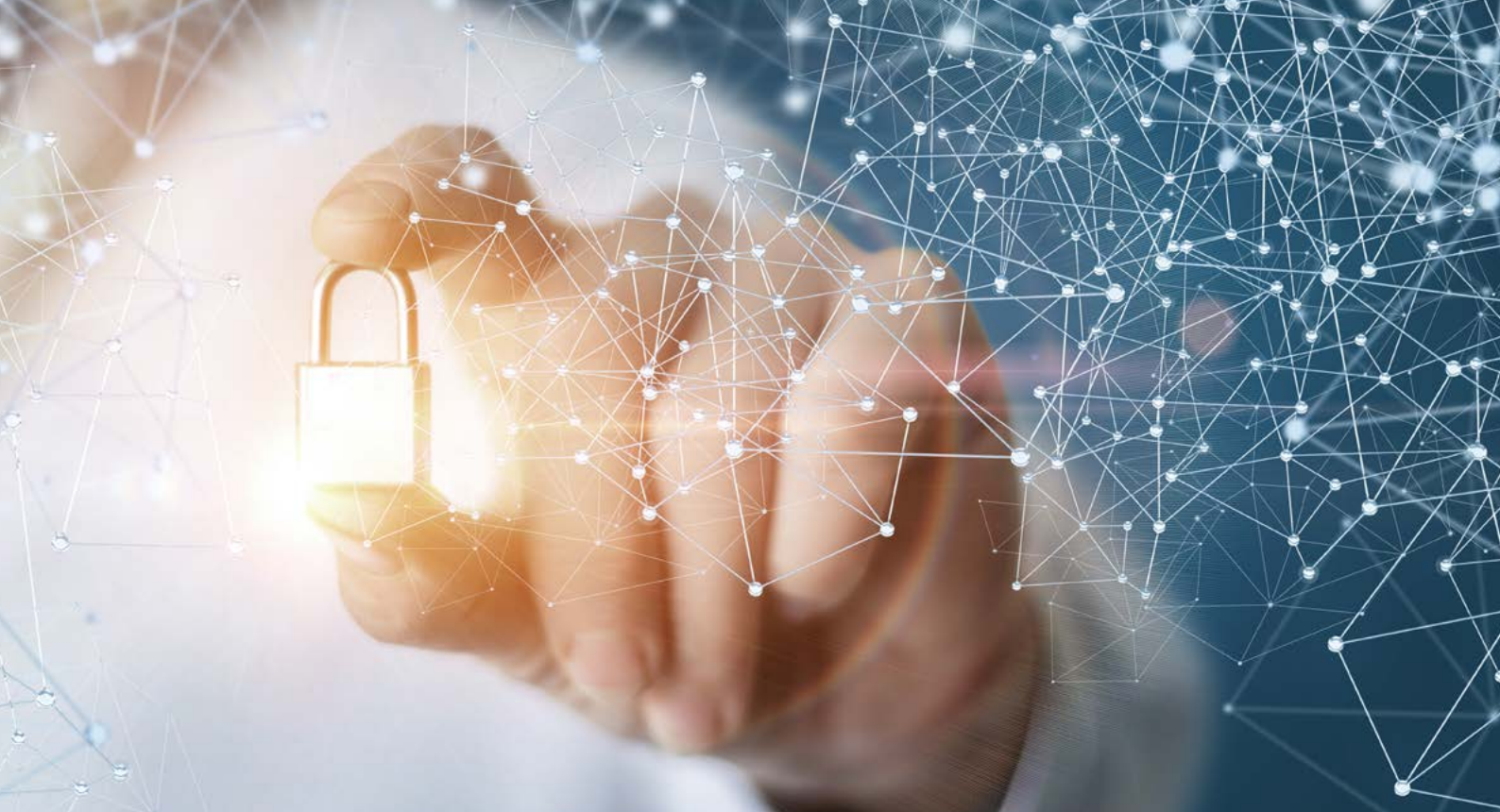
CSDR impose to participants of a CSD the new obligation to offer their clients the possibility to segregate their assets within the book and records of the Central Securities Depositories. More precisely, its article 38 requires that a participant to a CSD (SGSS SpA) offers its clients the choice between “omnibus client segregation and “individual client segregation” and inform them of the costs and risks associated with each option.

SGSS SpA is a participant of some Central Securities Depositories within the European Union. As such, accounts are opened in the books of CSDs in the name of SGSS SpA in which SGSS SpA holds the financial securities of its clients (omnibus clients segregation, applicable by default). In accordance with CSDR, SGSS SpA offers its clients the possibility to have their securities registered in an individualized account with the CSD (individual client segregation).

The individualized account is still open in the name of SGSS SpA, but only records the securities of the client.

Though this document does not constitute legal advice, it will give you an overview of the additional regulatory requirements.

⁽¹⁾ Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 Text with EEA relevance



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1. CSDR SEGREGATION POLICY SCOPE

This new CSDR requirement applies to direct participants of a CSD (CSD Central Securities Depositories or I-CSD International Central Securities Depositories).

SGSS S.p.A., offers safekeeping services in the following CSDs and ICSDs across EEA.

List of CSDs where SGSS S.p.A. is direct participant:

CSD	Monte Titoli (Italy) CBF (Germany)	OeKB CSD (Austria) SIX SIS (Switzerland ²)
I-CSD	Euroclear Bank	Clearstream Banking Luxembourg

This document summarizes the main pros and cons of the individual segregation at the CSD's level and gives you an overview of the implementation details and costs.

² SIX SIS will not apply for a CSD license under CSDR since it is not an EU CSD. However, it is targeting recognition by ESMA as a third-country CSD according to Art. 25 CSDR. In order to obtain such a recognition, SIX SIS is dependent on a positive assessment by the EU Commission with regard to the regulatory regimes of Switzerland and the EU. Since SIX SIS is also the CSD for Liechtenstein, which is part of the European Economic Area (EEA) and must therefore fulfil the regulation enacted by the EU, it submitted the application for recognition as a third-country CSD for Liechtenstein in September 2017.

2. ACCOUNT STRUCTURE: CURRENT SITUATION VS NEW CSDR REQUIREMENT

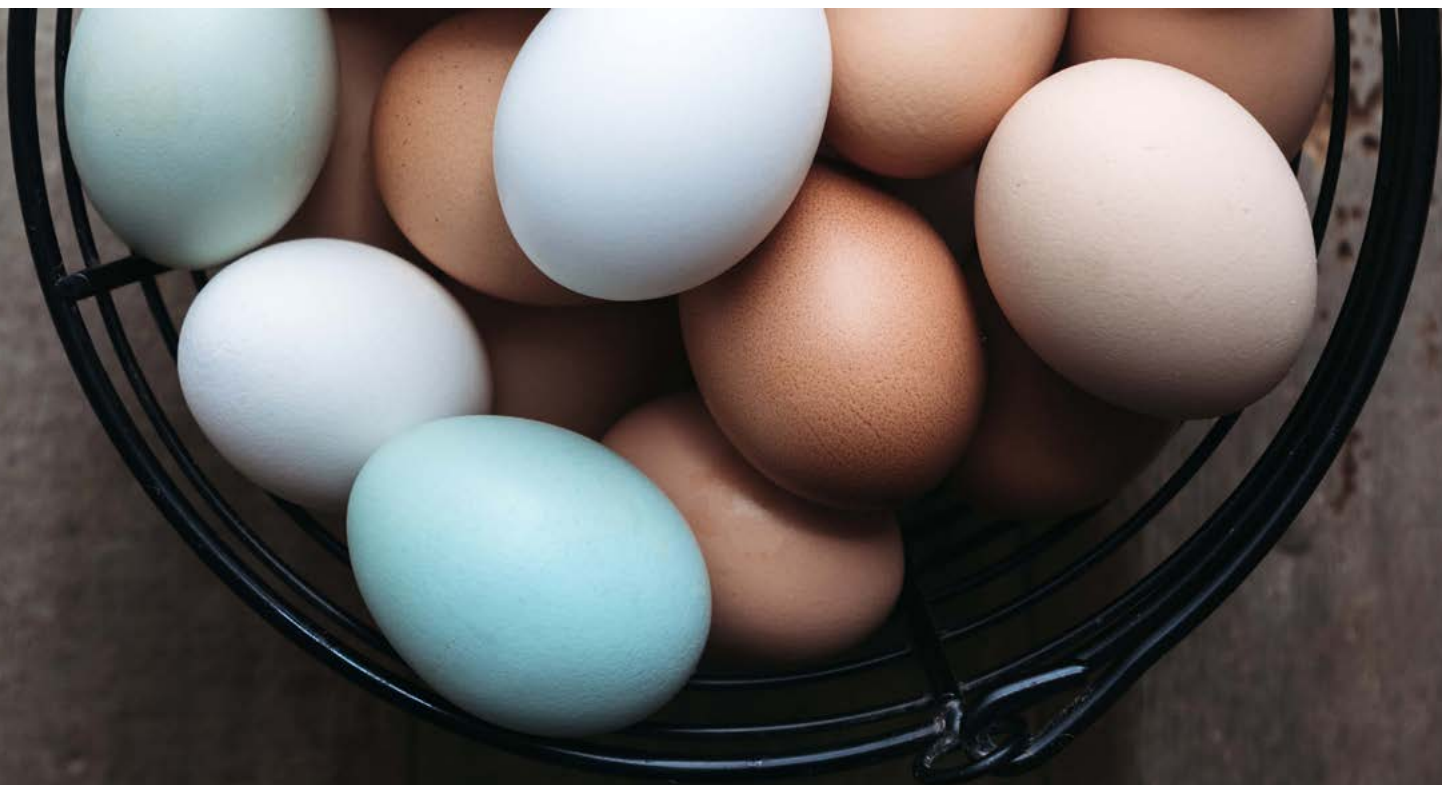
To better understand what individual client segregation means, let's recall what exists today.

The current situation is largely the result of the European directive on markets in financial instruments ⁽³⁾ (the so-called MIF Directive).

Indeed, MIF (and now MIF II) requires a custodian:

- to maintain internal accounts to identify at any time the securities account holder to whom the securities belong and to distinguish assets held for one client from assets held for any other client and from its own assets;
- when it deposits clients' assets to a third party (for example a CSD or a sub custodian) to take the necessary steps to ensure that any client's financial instruments are identifiable separately from the financial instruments belonging to the CSD or the sub custodian itself. To this extent, the custodian shall open several accounts within the books of this third party. Externally the account structure is essentially an omnibus client account structure, where securities are grouped by large categories of holders: securities held by the custodian clients, securities held for the own account of the custodian, securities held for the own account of the sub custodian;
- to conduct regular reconciliations between the internal and the external accounts, to avoid any loss or accounting mistake (a shortfall on a given security appears when the total quantity recognized internally is not exactly the same as the total quantity recognized externally, meaning the custodian does not recognize to its clients the whole quantity of securities its clients have deposited in its books).

⁽³⁾ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance





3. WHAT WILL CHANGE WITH CSDR?

As a reminder, like MiFID (now MiFID II), CSDR requires CSDs to maintain records and accounts that allow a participant to hold financial securities in the books of the participant separately from securities deposited with other participants and from any assets the CSD itself may hold as well as to segregate the securities held by the participant from those held by the participant's clients.

But CSDR goes also a step further by requiring custodians when they are participant of a CSD (i.e. the third party mentioned above is a CSD) to offer their clients the choice between:

- an omnibus client segregation (individual client account in the books of the custodian and omnibus client account in the books of the CSD) and
- individual client segregation at CSD level (the individual client account in the books of the custodian is replicated at the level of the CSD) while that account still remains opened in the name of the custodian.

This possibility to choose the segregation level goes with the reauthorization of each CSD under CSDR (expected in Q1/Q3 2019)⁽⁴⁾.

4. WOULD THE NEW MODEL BRING MORE PROTECTION TO YOUR ASSETS?

As mentioned, MiFID (now MiFID II), already contains requirements to ensure the safeguarding of clients' assets:

- a custodian shall not use the securities of a given client for its own account or for any other person or client without the prior consent of that given client;
- a custodian shall take appropriate measures to prevent the unauthorized use of a given client financial instruments for its own account or for the account of any other person or client.

Therefore, **the protection of your assets will not increase due to the choice of an individual client segregation at the CSD level.**

⁽⁴⁾ https://www.esma.europa.eu/sites/default/files/library/esma70-151-889_csd_register.pdf

5. WHAT ARE THE BENEFITS OF THE INDIVIDUAL CLIENT SEGREGATION?

On a day-to-day basis, the main consequence for you will be to have all your settlement instructions processed by the CSD in a dedicated account apart from the settlement of instructions of other custodian's clients.

The individual client segregation model is often seen as a mean to avoid the use of your assets by another client. Indeed, it avoids any misuse, but in fact the protection of your assets from any misuse is firstly handled by the custodian itself rather than by the CSD: it is the custodian that is given access right and manages settlement instructions.

A control of the client's provision is performed, irrespective of the segregation set up, before sending any instruction to the CSD. Should there not be sufficient provision on the client's account in the custodian book, then the instruction is either retained or sent but its settlement is blocked ("hold and release") so that other client's assets cannot be used. This process goes on until the provision becomes sufficient.

Should a shortfall happen (when the custodian recognizes to its clients more than it actually holds at the CSD's level), the custodian shall buy or borrow the missing quantity or give a cash compensation to cover the shortfall (when the buyback of financial securities is impossible due to insufficient liquidity).

6. WHAT ARE THE CONSTRAINTS OF THE INDIVIDUAL CLIENT SEGREGATION?

The setting up of an individual segregation at the CSD level will generate an increase of information flow and an increase of transactions daily matching:

- The individual client segregation will imply the creation and the processing of a dedicated account in the books of the CSD, thereby increasing the costs for the client (for further details, please see in appendix).
- To have your settlement instructions settled on time (and avoid any penalty / buy-in that CSDR will impose as of September 2020) you will have to clearly inform all your counterparties to a transaction and request them to update your SSI in their database so that they will deliver to / receive from the right new account at the CSD level

Some constraints and processes will apply for each CSD with which individual segregated accounts are opened.



7. WHAT ARE THE CONSEQUENCES IN CASE OF INSOLVENCY (BANKRUPTCY)?

In case of insolvency of an Italian custodian, insolvency proceedings would take place in Italy and would be governed by Italian law.

Under Italian Law on Finance, the financial instruments of individual customers held by a custodian are separate assets from those of the bank and from those of other customers, so such assets would not be part of its estate on insolvency for distribution to creditors, rather, they would be deliverable to clients in accordance with each client's proprietary interests in the securities. Consequently, actions in respect of such assets may not be brought by creditors of the custodian nor by creditors of the sub-custodian, if any.

In respect of the separation of financial instruments of individual customers from those of Italian banks/custodian, the Bank of Italy has supervisory and regulatory powers. Under Italian regulation, the financial instruments of each client, held on deposit by custodians, must result from specific records relating to that client, as illustrated in the above paragraphs.

Accordingly, where an Italian custodian holds securities in custody for clients and those securities are correctly registered in its books as belonging to those clients rather than being its own property, the clients will be protected from the insolvency or resolution of the Italian custodian. This applies whether the securities are held in an omnibus client segregation or in an individual client segregation.

8. WHAT ARE THE CONSEQUENCES IN CASE OF INSOLVENCY (BANKRUPTCY)?

As far as the Italian CSD is concerned, the receiver or liquidator, appointed by the Bank of Italy, once it has checked the correctness of the registration within the books of the defaulting custodian, shall verify, for each financial security, that the quantity of securities held in an account with a CSD or with another intermediary on behalf of the defaulting custodian, regardless of the nature of the accounts opened with them, is sufficient to enable the custodian to meet its obligations towards its clients. Accordingly, in our opinion, the nature of clients' interests in omnibus client segregation or of individual client segregation is not different. In relation to individual client segregation, each client may not be beneficially entitled to all of the securities held in this account. This conclusion applies *pari passu* to the foreign EU CSD we are dealing with. In fact there is no difference in terms of protection of clients' assets in case of default of the CSD between individual segregated accounts and omnibus accounts, being both segregated from the CSD assets.

The whole of any shortfall benefiting of individual client segregation would not be attributable to the client for whom the account is held and would be shared with other clients for whom the custodian holds securities. Similarly, the client would be exposed to a shortfall on an account held for another client or clients.

In conclusion, the shortfall would be shared among the clients wherever benefiting from omnibus client segregation or of individual client segregation. Therefore, a client may be exposed to a shortfall even where securities have been lost in circumstances which are completely unrelated to that client. The risk of a shortfall arising is, however, mitigated in certain situations to cover shortfalls identified during the reconciliation process of our records with those of the CSDs with which securities are held. In the event of the quantity of securities held being insufficient, an allocation of securities shall be made among the clients in proportion to the securities made available.

APPENDIX

You will find here below links to CSD's disclosures and a synthesis dashboard of individual segregation account impacts, by markets.

TABLE OF INSTITUTIONS DISCLOSURES ON CSDR ARTICLE 38:

INSTITUTION	LINK
ESMA	Follow up of CSDs CSDR licenses: https://www.esma.europa.eu/sites/default/files/library/esma70-151-889_csd_register.pdf
ECSDA	CSDs published disclosures: https://ecsda.eu/disclosures-csdr-art-38
Clearstream Banking Frankfurt (Germany)	http://www.clearstream.com/clearstream-en/about-clearstream/regulation--1-/central-securities-depository-regulation--csdr-
OeKB (Austria)	https://www.oekb-csd.at/en/about-oekb-csd/the-five-functions-of-oekb-csd.html
Euroclear Bank (International)	https://www.euroclear.com/about/en/business/Disclosuresandquestionnaires.html
Clearstream Banking Luxembourg (International)	https://www.clearstream.com/clearstream-en/about-clearstream/regulation-1-/central-securities-depository-regulation-csdr-/csd-r-faqs/frequently-asked-questions-european-central-securities-depositories-regulation--1275164
Monte Titoli (Italy)	https://www.lseg.com/markets-products-and-services/post-trade-services/monte-titoli/monte-titoli/about-us/csdr/what-means-csdr-our-clients
SIX SIS (Switzerland)	https://ecsda.eu/wp-content/uploads/CH_SIX_SIS.pdf

APPENDIX

SYNTHESIS DASHBOARD

CSD or ICSD	Impacts of an individual client segregation account*		Re authorization date
	On a day to day basis*	On assets protection	
Clearstream Banking Frankfurt (Germany)	<ul style="list-style-type: none"> • Implementation delay of some weeks. • SGSS S.p.A. transactions costs may be slightly higher and a set up fee may be required depending on your activity. • A monthly maintenance fee is applied by SGSS S.p.A. for each segregated account open with the CSD. 	No increase of protection of investor assets	Refer to ESMA - follow up of CSDs CSDR licenses
OeKB (Austria)			
Euroclear Bank (International)	<ul style="list-style-type: none"> • Implementation delay of some weeks. • SGSS S.p.A. transactions costs may be slightly higher and a set up fee may be required depending on your activity. • A monthly maintenance fee is applied by SGSS S.p.A. for each segregated account open with the CSD. 		
Clearstream Banking Luxembourg (International)			
Montetitoli (Italy)			
SIX SIS (Switzerland)	<ul style="list-style-type: none"> • Implementation delay of some weeks. • SGSS S.p.A. transactions costs may be slightly higher and a set up fee may be required depending on your activity. • A monthly maintenance fee is applied by SGSS S.p.A. for each segregated account open with the CSD. 		

*to which should be added CSD costs if any (e.g 150€/month per account in iberclear)

Contact your client relationship manager for further details

SGSS IS SOCIETE GENERALE'S BUSINESS UNIT DEDICATED TO SECURITIES SERVICES

Established in 27 locations worldwide with 4,000 employees*, SGSS provides a full range of securities services that are adapted to the latest financial markets and regulatory trends: clearing services, custody and trustee services, retail custody services, liquidity management, fund administration and asset servicing, fund distribution and global issuer services.

SGSS is among the top ten global custodians and the 2nd largest European custodian with EUR 4,011 billion of assets under custody*. SGSS provides custody & trustee services for 3,538 funds and the valuation of 4,153 funds, representing assets under administration of EUR 609* billion. SGSS ranks among the European leaders in stock option management.

*Sources: SGSS internal report and Competitor Annual Reports Greensted. Data as of 12.31.18

CONTACT US

email: sgss.com@socgen.com

web: securities-services.societegenerale.com



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B 552 120 222 RCS PARIS - APE 651C - N° SIREN : 552 120 222 000 13

REGISTERED OFFICE : 29 BOULEVARD HAUSSMANN, 75009 PARIS



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