



Information

On the re-authorization of KELER Ltd. under CSDR

13 November 2017

Dear Clients,

Please find below the summary of information related to [CSDR](#), the European Union regulation governing the operation of central securities depositories. The document includes the guide on the impacts of CSDR on our clients published in mid-September, and also contains important additional details on factors that do not impact the clients of KELER directly, but influence KELER's operation.

In line with the provisions of CSDR, KELER is required to acquire repeated authorization for both central securities depository services and banking-type ancillary services.

KELER reached an important milestone in terms of CSDR compliance: on 29 September 2017 it submitted the re-authorization request to the competent authority, the National Bank of Hungary (MNB).

CSDR states that the MNB has 6 months to decide on the request, this period starts after the authorization request is validated in terms of format; therefore, KELER is expected to receive the new license in the spring of 2018. As competent authority, the MNB expected KELER to comply with the requirements of CSDR as much as possible at the time of submitting the authorization request; however, certain regulatory documents of KELER, such as the General Business Rules and Fee Schedule, including the applicable provisions of CSDR, enter into force at the time the license is provided. Accordingly, the majority of the effects described, if these result in any change to the current practice, take force at the time the license is acquired. The applicable deadline is stated for the provisions that the regulation requires to be introduced after the date of the license.

Some of the provisions of CSDR will impact the clients of KELER Ltd., or state requirements for the clients of KELER also. Therefore, we recommend our clients to follow the news relating to CSDR, as KELER will provide information continuously on the changes impacting the clients or the operation of KELER.

In order to assist our clients in following the developments regarding CSDR, we created a new dedicated menu item on the KELER website that includes all the information published on the subject. The page is available at english.keler.hu/Strategy/CSDR.

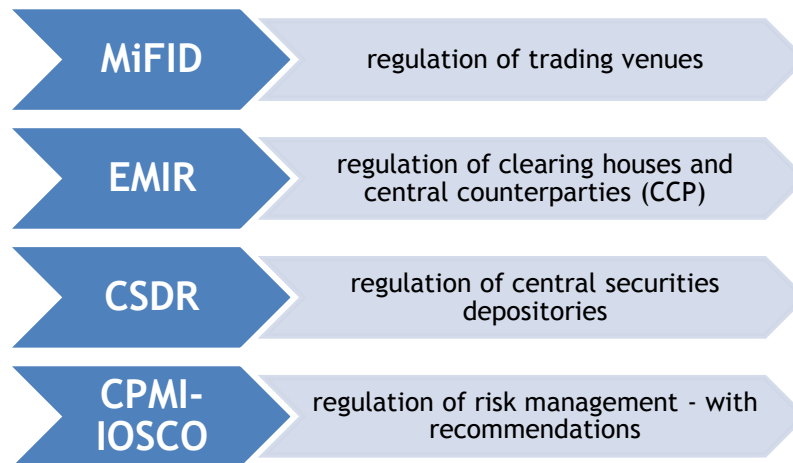
Sincerely,
KELER Ltd.

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I. CSDR

After the 2008 crisis, European regulators sought to cover the entire capital market value chain with European-level rules. This coverage is completed with CSDR (or CSD Regulation by its longer name) in force since 2014.



The 30 securities depositories located in 28 EU member states and 2 additional securities depositories in the European Economic Area are required to comply with the requirements of CSDR.

The main goal of CSDR is to improve the security of settlements by facilitating the creation of a European securities market subject to uniform regulations, and to increase the security of central securities depositories. The regulation defines in detail the terms of central securities depository authorization and the activities that can be authorized, the rules of operation, and defines separate rules for the competent authorities also.

The rules were laid down in the text of the regulation or in the technical standards describing detailed rules (Regulatory Technical Standard - RTS, or Implementing Technical Standards - ITS). The majority of technical standards was already published and is available at:

[Regulation \(EU\) 2017/389 on the parameters for the calculation of cash penalties for settlement fails and the operations of CSDs in host Member States](#)

[Regulation \(EU\) 2017/390 on regulatory technical standards \(RTS\) on prudential requirements](#)

[Regulation \(EU\) 2017/391 on regulatory technical standards \(RTS\) on internalised settlements](#)

[Regulation \(EU\) 2017/392 on regulatory technical standards \(RTS\) on CSD authorisation](#) [Regulation \(EU\) 2017/393 on implementing technical standards \(ITS\) on internalised settlements](#)

[Regulation \(EU\) 2017/394 on implementing technical standards \(ITS\) on CSD authorisation](#)

The final text of the last technical standard, the so-called Settlement Discipline RTS, probably the most important standard for securities market participants, has not been published yet. Please refer to Point 1. of Chapter III. for more details on this topic.

II. CSDR compliance by KELER – timeline

Compliance with CSDR is mandatory for all EU central securities depositories. The requests for re-authorization had to be submitted until the end of September 2017. KELER met this requirement on 29 September 2017, that is to say the re-authorization of KELER started and is expected to be closed in the spring of 2018.

With respect to compliance, the following dates are highlighted:

- the General Business Rules and Fee Schedule complying with the requirements of CSDR enter into force simultaneously with the receipt of the new license (for details please refer to the website of KELER: english.keler.hu/KeyDocuments/RegulatoryDocuments),
- the provisions on internalized settlement apply as of 10 March 2019 (for details please refer to Point 4. of Chapter III.),
- based on currently available information, the provisions of the Settlement Discipline RTS are expected to be applied as of Q4 2019 (for more details please refer to Point 1. of Chapter III.),
- mandatory dematerialization and immobilization will be introduced as of 1 January 2023 and 1 January 2025 respectively (for more details please refer to Point 8. of Chapter III.).

III. Provisions impacting Clients

1. Measures to improve settlement discipline

Settlement Discipline is one of the key measures of CSDR, and is expected to apply in Q4 2019. Based on the Settlement Discipline, it will be mandatory to impose financial penalties if trades fail and introduce mandatory buy-in procedures to encourage securities account holders to settle trades until the intended date.

Impacted client groups

- Investment firms keeping securities accounts with the depository

In line with Article 6 of CSDR, investment firms keeping securities accounts with KELER are required to take measures to limit the number of settlement fails.¹ Such measures at least consist of arrangements between the investment firms and certain of its clients that ensure trade settlement at the latest on the intended settlement date (e.g. prompt communication of an allocation of securities to the transaction, confirmation of allocation and confirmation of the acceptance or rejection of terms in good time before the intended settlement date). In light of the above, investment firms are required to introduce measures with respect to their clients also.

The final technical standards including the detailed rules have not yet been published, based on information currently available to KELER the final technical standards are expected to be published in the autumn of 2017. Detailed rules and the applicable provisions of CSDR are to be applied 2 years after publication. After the publication of the final standards, KELER plans to set up a working group to inform market participants on the impact of the provisions and consult market participants on the issues arising related to the application of the provisions. KELER will invite to the working group the representatives of the User

¹ Article 6 (2) of the CSDR

Committee, the Settlement Committees of the Government Debt Management Agency and the Budapest Stock Exchange, and the representatives of its clients with the highest turnover. All Clients will be informed on the results of the consultation.

2. Protection of the securities of system participants and clients

CSDR requires central securities depositories to allow segregation at the following levels: the account of securities account holder („participant own account”), single client account („individual client segregation”) or the account related to several clients („omnibus client segregation”). KELER offers the possibility of segregation at these levels; the provision does not mean any change in the current situation.

Impacted client groups

- Investment firms keeping securities accounts with the depository

Also in line with Section 336 (3) of Act CXX of 2001 on the Capital Market, from the time of obtaining CSDR license, the holders of securities accounts with KELER “are required to offer their clients at least the choice between omnibus client segregation and individual client segregation and inform them of the costs and risks associated with each option.”².

3. Reconciliation

Reconciliation, i.e. comparing of the end-of-day central securities depository portfolio to the records of central securities depository account holders is part of the current market practice. The account statements that KELER provides electronically (KID or SWIFT) or on paper for the clients without electronic access allow reconciliation to be performed. CSDR requires the holders of securities accounts with KELER to compare at least daily their own records to the daily information provided by KELER .³

Impacted client groups

- Holders of securities accounts with the depository

In view of the above, our clients need to pay particular attention to the following information provided by KELER when performing reconciliation:

- aggregate balance of the securities account at the start of the trading day concerned;
- individual securities transfers in the securities account on the trading day concerned;
- aggregate balance of the securities account at the end of the trading day concerned.

Detailed rules related to reconciliation can be found in Chapter IX (Articles 59-65.) of [the regulatory technical standards on authorization, supervisory and operational requirements](#).

Although KELER does not expect that any event raising the suspicion of deviation would occur, KELER analyses all cases of non-compliance and controversy that may result from reconciliation and intends to solve them on the day of occurrence. If it can be concluded based on the reconciliation that the creation or cancellation of securities was unjustified, and KELER does not sort out the issue until the end of the following settlement day, KELER suspends the settlement of the securities series concerned until the unjustified securities creation or cancellation is remedied, and it requests the trading venue concerned to suspend it also. KELER informs its clients and the authorities involved without delay. After the correction of

² Article 38 (5) of the CSDR

³ Article 37 of the CSDR

any deviation, the suspension of the securities series is terminated, thus ensuring continuous trading of the securities concerned.

4. Internalized Settlement

CSDR requires the so-called Settlement Internalizers to report to their competent supervisor the aggregate volume and value of all their trades settled outside central securities depositories. The first report of this type is due to be submitted within 10 business days of the end of the first quarter after 10 March 2019 (until 12 April 2019 for the first time, as calculated by KELER).⁴ The applicable technical standards govern the content of reports.

KELER will provide the necessary data to the competent authorities in line with the requirements.

For detailed information on the trade data to be reported, please refer to the applicable technical standards of CSDR:

- [Commission Delegated Regulation \(EU\) 2017/391 on regulatory technical standards on internalized settlements](#)
- [Commission Implementing Regulation \(EU\) 2017/393 on technical standards with regard to internalized settlements](#)

Impacted client groups

- Settlement Internalizers: any institution executing securities transfers on behalf of clients or for own account, without the involvement of the central securities depository (e.g. KELER)

5. Legal Entity Identifier (LEI)

LEI, the unique identification code of legal entities of 20 characters became widely known due to the reporting requirement stated in EMIR ('European Market Infrastructure Regulation') for capital and energy market participants. The use of LEI has been expanding in the past years, and will continue to increase as LEI is a mandatory element of the MiFID II. reporting as of 2018.

It is mandatory for central securities depositories⁵ to collect and record the LEIs of their securities account holder clients and issuers. This requirement is to ensure that central securities depositories can meet their reporting obligations to domestic and European supervisory authorities with the use of standard forms, tables and procedures. Accordingly, all the securities account holder clients and issuer clients of KELER are required to have LEI.

In line with the expectations of ESMA, the European Securities and Markets Authority, after the license is received, KELER is also required to validate that the LEIs provided by issuer clients are the identifiers of the appropriate legal entities and the identifiers are valid.

Impacted client groups

- Holders of securities accounts with the depository
- Securities issuers

⁴ Article 1 (1) of [Commission Implementing Regulation \(EU\) 2017/393 of 11 November 2016 laying down implementing technical standards on internalized settlements](#)

⁵ Based on Article 29 of the CSDR and Article 11 (5) of the implementing technical standards on the licensing arrangements of central securities depositories

6. Provision of banking-type ancillary services

KELER will continue to provide banking services to clients as a special credit institution after its CSDR license is received. KELER submits the request of authorization to provide banking-type ancillary services to the MNB as part of the CSDR license request.

According to the provisions of CSDR, in the future KELER can offer banking services only to the participants of the securities settlement system, that is to say to its clients that have securities accounts also.

Impacted client groups

- Clients having cash accounts with KELER

7. Acceptance of clients, risk management

In line with the requirements of CSDR, KELER already has transparent eligibility terms for clients wishing to open securities accounts, available to the public in the General Business Rules. The client identification procedures comply with the requirements of CSDR and the valid regulations to prevent money laundering and other legal regulations, KELER regularly reviews these procedures. As part of compliance with the provisions of CSDR, KELER plans to introduce the Know-Your-Customer (KYC) questionnaire, the only new element and a condition of account opening and account management for securities account holders in order to be able to assess more efficiently the activity of securities settlement system participants and any related risks. KELER will provide detailed information on the questionnaire before it is introduced.

Impacted client groups

- Holders of securities accounts with the depository

KELER is required to determine, monitor and manage the risks that the activities of major securities account holders may mean related to its activity.⁶ The major securities account holders will be determined based on the following data: trade volumes and values, substantial interdependencies between account holders and their clients, impact of individual account holders on other account holders in case of any operational issues at KELER.⁷ KELER is required to identify the clients of account holders if they are known to KELER (e.g. their transactions are settled in dedicated accounts) and they represent a significant part of the transactions of KELER or the account holder concerned. KELER performs the identification of account holders in the KYC questionnaire to be introduced; however, in line with the above, this identification will be performed only for its clients with the highest turnover.

It will be mandatory for KELER to involve its clients in IT system testing. The currently known requirement of testing is not expected to result in major changes in the present practice of KELER.

8. Dematerialization and immobilization

Article 3 (1) of the CSDR requires the issuer established in the European Union of any transferable securities that are admitted to trading on trading venues (exchange, MTF, OTF) to arrange for such securities to be represented in book-entry form as immobilization or in dematerialized form. As of 1 January 2023, the

⁶ Article 45 (6) of the CSDR

⁷ Article 64 (1) of [Commission Delegated Regulation \(EU\) 2017/392 of 11 November 2016 on regulatory technical standards on authorization, supervisory and operational requirements](#)

requirement applies to all transferable securities issued after this date, and as of 1 January 2025 the requirement applies to all transferable securities.

Currently only dematerialized securities are traded at the trading venues involved in the services provided by KELER and KELER CCP Central Counterparty Ltd. (KELER CCP) (BÉT, BÉTa Market, MTS Hungary); thus, this requirement means no change for the Hungarian market.

9. T+2 settlement cycle

In line with the requirement of Article 5 of CSDR, the intended settlement date of the trades concluded at trading venues, i.e. with respect to Hungary the trades made on

- the BSE
- the BÉTa Market
- and on MTS Hungary

is no later than on the second business day after the trading takes place ($SD=T+2$).

As of 6 October 2014, simultaneously with the major European securities markets, KELER CCP introduced the T+2 settlement cycle for BSE equities and investment unit settlement, while bond trades were already settled T+2. Thus, the Hungarian market is fully compliant with this requirement of CSDR, it means no change in the current practice.

CSDR treats fix price and auction trades made on the BSE as exceptions and does not regulate the intended settlement date.

IV. Other CSDR provisions

1. What licenses does KELER acquire?

As KELER also has a special credit institution license under Hungarian law, it is required to obtain CSDR license not only for the performance of central securities depository activity but for ancillary banking-type activities also. Additionally, as part of the licensing, the MNB approves the participation of KELER Ltd. in KELER CCP also.

2. The central securities depository services

In accordance with the practice to date, KELER will provide various issuer services, such as the creation and cancellation of securities, the keeping of the central register of securities, or share registry maintenance, securities account management and custody services, such as account management and safekeeping, furthermore, similarly to the current practice, it will manage collateral, issue codes (ISIN, LEI) and offer trade reporting (the listing is not comprehensive).

As of the date of the CSDR license, KELER will not engage in securities lending and will not provide services related to the settlement of trades made on the Deutsche Börse XETRA system.

KELER submitted its request to become a LEI issuer (currently LEI can also be requested through KELER), and to undertake APA/ARM activity under MiFID II, the related licensing processes are in progress.

3. Banking-type ancillary services

As a special credit institution licensed in accordance with Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises, currently KELER can provide a limited group of credit institution services in line with the provisions of the Capital Market Act.

In the future, KELER will provide the following services from among the banking-type ancillary services stated in CSDR:

- cash account management and payment services,
- provision of cash credit to KELER CCP only,
- management of the long positions of participants.

Later on the license can be extended to cover additional services not listed above:

- provision of cash credit to any client,
- cash lending to pre-finance corporate actions,
- securities lending to securities account holders,
- guarantees and commitments related to securities lending and borrowing.

4. Organizational requirements

Among CSDR requirements on organizational structure, it is worth highlighting the provisions on the establishment of various committees and the requirement to increase the number of the under-represented gender on the KELER Board of Directors.

KELER decided to set up the User Committee to meet the requirements of CSDR: the User Committee serves as a forum for the participants of the securities settlement system and the issuers to express their opinion. The first meeting of the User Committee was held on 13 December 2016.

The Committee was created not only to meet the requirements of CSDR but also to set up an independent sounding board that can serve as the primary forum of consultation both for market participants and KELER.

KELER requested the industrial associations that it is in contact with (Association of Hungarian Investment Fund and Asset Management Companies, Association of Securities Dealers, Hungarian Banking Association), the Budapest Stock Exchange Issuer Committee, the Investor Protection Fund, the representative of energy market clients and KELER CCP to form the Committee. Each requested organization delegates one representative to the Committee.

Once the Settlement Discipline is published, the enlarged Committee will work on the requirements, for more details please refer to Point 1. Chapter III.

In line with the requirements of CSDR, the KELER Risk Management Committee was created to inform the KELER Board of Directors on the actual and future overall risk tolerance and strategy of KELER, and the Audit Committee was formed, the tasks of which are performed by the KELER Supervisory Board due to the overlap in tasks.

On 7 July 2016, the non-managing director members of the KELER Board of Directors accepted the target number of representatives of the under-represented gender and the strategy for 2016-2020 to achieve the target, these documents are available on the KELER website. Based on the strategy, the objective of KELER is to ensure that there are 2 representatives on the Board of Directors of the under-represented female gender.

5. Prudential requirements

KELER is required to comply with the prudential provisions of CSDR, and, as a central securities depository providing banking-type ancillary services also, it is required to comply with any current or future regulations applicable to credit institutions.

Some of the prudential requirements are already public in the valid regulations (for example: restriction of operational, business risks, investments, capital requirements); some other provisions required that KELER create new risk management methods (for example the extension of the recovery plan and the preparation of related restructuring and orderly winding down plans, management of intraday counterparty risks, extension of counterparty ratings).

The User Committee members were involved in the finalization of the KELER recovery plan: they reviewed the plan before approval, thus all stakeholders had time to make comments.

In order to assess counterparty risks comprehensively, CSD links and the institutions involved in settlements are surveyed annually, with the use of the applicable questionnaire.

Due to the profitable operation of the past years, the capital adequacy of KELER is stable and will not change due to the new capital requirement types under CSDR; although the level of capital use will be higher. KELER does not need to increase capital for compliance.

V. Summary

All in all, the services of KELER change very little; based on CSDR, until the effective date of the Settlement Discipline, clients will have no new task to perform or requirement to meet that would represent major change (e.g. development need, additional tasks) to the current practice.