ANNOUNCEMENT

on improving securities settlement and on central securities depositories (CSDR) and the Settlement Discipline Regime (SDR)

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Brief summary of the CSDR Regulation and the Settlement Discipline Regime (SDR), the new reporting and new client obligations, as well as OTP Bank Plc's obligations

The CSDR Regulation

The CSDR is 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, which entered into force on 17 September 2014. The Regulation establishes a European regulatory framework for the institutions responsible for securities settlement, the Central Securities Depositories (CSDs). The Regulation removes current barriers to cross-border settlement, harmonises the timing and conduct of securities settlement in Europe and introduces rules on the safety and soundness of CSDs. Compliance with the Regulation is primarily mandatory for CSDs located in EEA Member States, but it affects all securities market participants directly or indirectly through certain of its provisions.

Commission Delegated Regulation (EU) 2018/1229 of 25 May 2018 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline (Settlement Discipline Regime – "SDR") forms part of the CSDR Regulation. The Settlement Discipline Regime will enter into force on 1 February 2022, with the exception of buy-in rules. Based on the information currently available to us, the mandatory cash penalty measures for Hungarian securities will enter into force on 2 May 2022, as decided by the Magyar Nemzeti Bank as the supervisory authority.

The European Central Securities Depositories Association's (ECSDA) CSDR Penalties Framework aims to incorporate the penalty mechanisms into the Commission Delegated Regulation (EU) 2018/1229 and to harmonise the penalty mechanisms across CSDs subject to the CSDR. The CSDR thus embodies market practice on cash penalties.

Scope of the CSDR

The most important effect of the CSDR, for the relevant transactions between different parties for which OTP Bank Plc. provides services, is the introduction of settlement disciplinary measures aimed at reducing the number of settlement fails and, if they do occur, at resolving them quickly and efficiently. The transactions covered are sales of securities, hedging transactions, securities lending and borrowing, and repo transactions with an intended settlement of the second leg beyond 30 business days after the first leg, which are recorded and executed regarding the securities listed below on a trading venue and over-the-counter (OTC):

- transferable securities (such as shares and bonds),
- money market instruments,
- units in collective investment undertakings and
- emission allowances that are admitted to or traded on a trading venue located in the European Economic Area ("EEA") or cleared by a central counterparty located in the EEA and cleared on a CSD located in the EEA ("EEA CSDs"). Derivatives are subject to CSDR in the cases set out in this paragraph and only if they are physically delivered at maturity.

Financial instruments covered by the SDR:

- The ISIN code of the financial instrument can be found in the ESMA Financial Instrument Reference Database (ESMA FIRDS).

- The ISIN code of the financial instrument is not included in the list of shares excluded under Regulation (EU) No 236/2012 of the European Parliament and of the Council (SSR – Short Selling Regulation).

- The FIRDS database may contain financial instruments that are no longer included in the settlement system and cash penalties for unsettled trades in such instruments will not apply for the days following the day of exclusion. The FIRDS database also includes financial instruments traded in locations outside EU Member States. These financial instruments are subject to cash penalties if the actual matching and settlement is carried out at CSDs in EU/EEA Member States.

Measures to prevent and manage settlement fails in securities transactions

a.) Measures to prevent settlement fails:

- **Allocation and settlement information requirements:** Investment firms shall require their professional and retail clients to send them written allocation / settlement information requirements for the securities or funds involved in the relevant transactions, identifying the accounts on which the credit or debit is to be made. Written allocations / settlement information requirements shall include any other information that the investment firm requests in order to facilitate the settlement of the transaction. These rules shall not apply to professional and retail clients who hold securities and funds relevant for settlement in the same investment firm.

- **Timely processing and transmission of trade instructions for financial instruments to the market(s):** The use of international standard message formats allows for the automatic processing of trade instructions, improving the efficiency of settlement processes.

- **Bilateral cancellation mechanism:** CSDs are required to operate a bilateral cancellation mechanism that requires participants to bilaterally cancel matched settlement instructions. Most CSDs in the EU/EEA currently operate bilateral cancellation, and other markets with unilateral cancellation mechanisms will also modify their processes to comply with the new rule.

- **Hold and release mechanism:** a wide range of settlement instructions are processed in the hold & release mechanism – the client can mark the pending transaction as blocked, i.e. set the transaction ‘on hold’ without settlement, or release the instruction for further processing and settlement. The mechanism will be implemented by all CSDs in EEA Member States, provided that they comply with certain requirements of the CSDR Regulation.

- **Recycling of settlement instructions:** the CSD will recycle matched instructions resulting in settlement fails until the date of final settlement or bilateral cancellation (according to the Hungarian CSD practice, no later than business day 60). According to the Hungarian CSD practice, unmatched instructions are recycled until the 20th business day following the intended settlement date, or the date of receipt if the intended settlement date is in the past, or the last status change, after which the settlement system automatically deletes the unmatched instructions. For example, KELER will delete an unmatched settlement instruction if it remains unmatched until 20 business days after the expected settlement date, or 20 business days after the instruction has been entered into the CSD system if it was submitted for settlement after the expected settlement date. Upon cancellation of a settlement instruction after 20 working days, the instruction shall be set to ‘expired’ status.

- **Partial settlement:** CSDs allow partial settlement of instructions. The use of this option can be indicated by the client in the purchase instructions for the financial instrument concerned.

- **Tolerance level:** CSDs shall publish the tolerance levels applied when matching settlement instructions. These amounts represent the maximum difference between the settlement amounts

in two corresponding instructions that would still allow matching. If the instruction is executed using the settlement tolerance level, this fact shall be clearly indicated in the settlement confirmation notice.
The current settlement tolerance levels can be found in the effective version of depository announcement no. 9-20 on the DETAILED PRESENTATION OF SETTLEMENT ORDERS issued by KELER.

- **Additional information on settlement instructions:** CSDs will introduce real-time status messages and notifications to be transmitted to participants in the settlement chain.

b.) Addressing settlement fails

- CSDs are required to monitor and report settlement fails. Aggregated information on settlement fails shall be published annually on the CSDs' websites free of charge.
- CSDs calculate and charge daily cash penalties for all instructions not matched on time (LMFP = Late Matching Fail Penalty) and for all instructions not settled on the Intended Settlement Date (SEFP = Settlement Fail Penalty).

CSDs inform their clients about the penalties and compensations calculated daily for a given counterparty. This information is passed down the settlement chain to the end-customers of the securities transaction. Under the Regulation, CSD clients are required to monitor notices and statements of cash penalties and to pay the required cash penalties on time and, if they are involved as an intermediary in a default, to ensure that the necessary information from the CSD's reported penalty data is made available to their clients and that the amount of the penalties is collected from them or the penalties due to them are paid to them.

c.) Cash penalties

- **Calculation and allocation of LMFP and SEFP penalties:**

If the settlement instruction is matched after the intended settlement date, the cash penalties are calculated and applied from the intended settlement date (ISD). For the period from the intended settlement date until the business day preceding the settlement date, the cash penalty shall be calculated and applied against the last party to enter or modify the relevant settlement instruction in the settlement system.

If the transaction is not matched by the relevant cut-off time on the intended settlement date (ISD date), the CSD will calculate and charge the late matching fail penalty (LMFP) for a single day on ISD+1. If the transaction is matched, for example, on the ISD date but after the relevant cut-off time, or on ISD+1 before the relevant cut-off time for matching, the penalty is also calculated for one day.

If the transaction remains unsettled on the intended settlement date (ISD date) until the end of the settlement period, but is settled on the next day, the SEFP penalty is calculated and imposed on the ISD date. If the transaction is settled on ISD+1 before the end of the settlement cycle of that day, the SEFP penalty shall be calculated and levied on the intended settlement date (but not on ISD+1).

If the transaction is settled on ISD+2 before the end of the settlement cycle of that day, SEFP penalties are calculated and charged for 2 days; on the intended settlement date and on ISD+1, but not on ISD+2. SEFP penalties will be charged for all blocked (hold mechanism) instructions marked with the following statuses: shortage of funds and shortage of securities, however, if both instructions are on hold, the SEFP penalty will be levied against both parties.

The method of calculation for settlement fails in the case of delivery versus payment is different from the method of calculation in the case of purchase versus payment. Similarly, in the present case, it should be stressed that the cancellation of a matched instruction subject to a penalty does not have the effect of cancelling the penalties already reported.

CSDs will send to their clients an aggregated report of the amounts of the penalties for the month by the 14th working day/PBD (Penalty Business Day, which includes all days except Saturdays, Sundays, 25 December and 1 January[1]) of the month following the month of the penalty calculations. CSDs aggregate penalties (debits) and compensations (credits) by currency and by counterparty.

For all transactions settled in KELER and KELER-KSZF, the currency in which the penalty is paid is Hungarian forint (HUF), while for transactions settled in other markets the penalty is paid in the currency in which it is reported to OTP Bank Plc. by the CSD or the sub-custodian. At the level of the CSD, the currency of the penalty for a Free of Payment (FoP) transaction is the currency of the reference price of the financial instrument concerned (in the case of shares) or the currency of the denomination of the instrument (in the case of bonds). If the above currency is not available to the CSD, the CSD will convert the currency to the default currency of its choice.

CSDs net out the compensations and fines – in order to limit the number of transfers - which are financially settled on the 17th working day of the month following the month in which the penalties are calculated – first collecting the calculated net penalties and then distributing them as compensation to the participants in the settlement chain who are directly linked to them. Only after that will OTP Bank Plc. be able to settle cash penalties and compensations to its own clients.

OTP Bank Plc will transfer the amount of the compensation credited to the customer concerned and will send a receipt (certificate of payment) of the transfer. OTP Bank Plc shall pass on the amount of the fine it has been charged with to the customer concerned and send a certificate about it if OTP Bank Plc determines that the delay in settlement was caused by a reason attributable to the customer concerned.

As of spring 2022, the payment accounts of customers linked to their securities accounts may be subject to credits arising from CSDR compensation and debits arising from late settlement for securities transactions and money market instruments transactions.

For customers with a consolidated securities account, the credits and debits detailed above are primarily booked with a cost adjustment to the consolidated securities account, from which the amount can be subsequently transferred to the linked payment account in the corresponding currency. If no payment account in the corresponding currency is linked to the securities account, the credits/debits are debited and credited to the HUF payment account, calculated at the buying rate of OTP Bank Plc. for the foreign currency of that day.

No CSDR-related debits or credits can be applied to a Long-Term Investment Securities Account (”LTISA”) and/or a Retirement Savings Account (”RSA”), subsequently, if the owners of the aforementioned LTISA and/or RSA accounts do not have a payment account at OTP Bank Plc, then OTP Bank Plc. opens a technical account for the crediting of compensation arising from CSDR activity in order to comply with the legal obligation, and will notify the owner by postal mail.

In the case of investment funds or portfolio managed clients, OTP Bank Plc will debit the amount of the fines from the account of the relevant fund manager or the portfolio manager in accordance with the relevant position statement issued by the National Bank of Hungary (MNB) and credit the compensation to the account of the relevant investment fund or portfolio managed client.

[1] Repo (smpg.info)

- **Objection period:**

CSDs inform their clients about the penalties and compensations calculated daily for a given client, which information is also broken down for the clients' clients (including the clients of OTP Bank Plc.). The clients of OTP Bank Plc. also have the possibility to object to the calculated penalties. Information on the last deadline for objections can be obtained from the bank's contact person. The objection must be duly documented, clearly identifying the disputed penalty, the reference of the instruction and the grounds for the objection. Please note that disputes between two parties involved in a trade are handled bilaterally, without the involvement of OTP Bank Plc.

Corrections to CSD penalties calculated for a given period can only be made for that period, not for penalties calculated in previous months. In view of the CSDR rules, there are very few valid grounds for objections and a small number of objections to CSDs are expected. However, if they do occur, OTP Bank Plc. will use the channels provided by the CSD concerned or its sub-custodians to forward the objections.

- **The accuracy of penalties:**

OTP Bank Plc. does not verify the accuracy of the calculation of the penalty and transmits the details of the calculation when they are provided by the CSD and its sub-custodians. Please note that the reference price used by the CSD is not made public. OTP Bank Plc. pays particular attention to any cases that appear unusual and reconciles each penalty imposed with the underlying instruction in the system. Any discrepancies are investigated immediately. For the purpose of reconciliation, a monthly check is carried out at OTP Bank Plc. to confirm that the total amount of penalties included in the monthly report corresponds to the amount of penalties included in the daily report.

- **Costs of the penalty mechanism:**

These costs are charged by CSDs and sub-custodians as compensation for setting up and operating the penalty mechanism, the current rates of which are published on their websites (for example, KELER introduces costs associated with the penalty mechanism, currently in the form of a fixed monthly fee to be paid by KELER members).

d.) Buy-in process

The SDR regime introduces a system of buy-in, which aims to close outstanding settlements by purchasing missing securities through a third party ("buy-in agent") or, as a last resort, by cash compensation.

This new buy-in system goes beyond the current CCP-induced buy-in procedure, as it applies to all failed transactions (including OTC transactions). In view of the many challenges that market participants face with the buy-in process, ESMA has proposed to the European Commission to postpone the application of the buy-in rules, first until October 2022 and then, probably, until the end of 2025.

Our clients can find other useful information on the CSDR and the Settlement Discipline Regime (SDR) on the websites listed in Annex 1 to this Information Note.

If you require further information on this subject, please contact OTP Bank Plc. through your contact person.

OTP Bank Plc.

www.otpbank.hu

Annex 01 – Annex on the CSDR Regulation and the Settlement Discipline Regime (SDR), the new reporting and new client obligations, as well as OTP Bank Plc's obligations

Useful information and internet addresses

Information in Hungarian on the CSDR by the National Bank of Hungary (MNB):
https://www.mnb.hu/felugyelet/szabalyozas/csdr

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:
https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0909&from=EN

COMMISSION DELEGATED REGULATION (EU) 2018/1229 of 25 May 2018 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline:
https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1229

ESMA Q&As:
ESMA70-156-4448 CSDR Q&As (europa.eu)

ECSDA Framework:
https://ecsda.eu/wp-content/uploads/2021/10/2021_10_05_ECSDA_CSDR_Penalties_Framework.pdf

AFME guidelines for bilateral claim management
https://www.afme.eu/Portals/0/CSDR%20Settlement%20Discipline%20-%20Bilateral%20Penalty%20Claims%20August%202021.pdf?ver=2021-09-02-091345-440