securitiesfinancetimes

Over the line:

DTCC's Matt Johnson on preparing the market for the settlement discipline regime

CSDR

Annual 2021

TOP 6 WAYS TO ENSURE SUCCESSFUL FAILS PREVENTION AND AVOID CSDR PENALTIES

The upcoming Central Securities Depositories Regulation's (CSDR) Settlement Discipline Regime (SDR) will impose new measures to prevent settlement failure such as cash penalties for failing and/or late matching trades, and mandatory buy-ins. Given these new, potentially large, impacts of a failed trade — the time is now to maximize your current investments in Institutional Trade Processing's suite of services and to focus efforts on the prevention of failure.

PRE-TRADE ENRICHMENT

1 **Utilize the ALERT® platform,** the industry's largest and most compliant central database of standing settlement and account instructions (SSIs) and provide automatic enrichment of those SSIs on a matched trade when used in conjunction with CTM™.

2 **Take advantage of ALERT's Global Custodian Direct (GCD) workflow,** a fully custodian or prime broker managed workflow ensuring SSIs in the system come directly from and are maintained by source data providers.

3 **Upgrade your traditional ALERT enrichment capabilities by accessing our ALERT Key Auto Select (AKAS) functionality,** a seamless (and free) rules-based enrichment of CTM trades eliminating the need to provide ALERT Keys (Country, Method, Security) as part of the trade information.

ALERT

10.7M+
SSIs

1,800+
Investment Managers

1,300+
Brokers

ALERT GCD

9
Global Custodians Live

3
Regional Custodians & Trust Banks Live

54%
GCD has helped sell-side firms realize up to a 54% reduction in SSI related fails*

0%
Buy-side firms have driven their SSI related fails down to almost 0% by using GCD*

[A Roadmap to SSI Automation: How an SSI Utility Benefits All Participants](#)

TRADE DATE AGREEMENT

4 **Achieve straight through processing via CTM,** the industry's standard for central matching, by agreeing to the economics, place of settlement (PSET) and associated SSIs on trade date, allowing you to resolve any trade exceptions in a timely fashion.

SETTLEMENT & EXCEPTION MANAGEMENT

5 **Prevent penalties under CSDR through centralized trade exception management with DTCC Exception Manager,** quickly resolving exceptions and reducing delays in settlement.

DATA & ANALYTICS

6 **Gain a better understanding of who your higher risk counterparties are by leveraging ITP Data Analytics,** allowing you to identify potential missed trade affirmations in order to prevent fails.

CTM

165.8M
Trades Processed in 2020

95%
Average Same Day Matching Rate

1,562
Investment Managers

1,239
Brokers

DTCC EXCEPTION MANAGER

28
Organizations (brokers, prime brokers and custodians) submitting accurate data directly to the platform

212
Counterparty Pairings

Community includes investment managers, brokers, custodians, prime brokers, and outsourcers

ITP DATA ANALYTICS

100%
CTM client coverage

93.54%
Average same day match agreement for European trades in March 2021

€ 524B
Notional delta between what was entered on trade date but not affirmed on trade date in March 2021

WANT TO LEARN MORE? VISIT DTCC.COM/CSDR
See how DTCC's ITP suite of services can reduce your risk of trade fails, minimizing the impact of CSDR.

WANT TO LEARN MORE ABOUT DTCC CONSULTING SERVICES? VISIT DTCC.COM/CONSULTING
Need support implementing the ITP suite of services at your organization? We'll help you rethink your post-trade operating model.

Matt Johnson, director of ITP product management and industry relations, DTCC

Over the line: Preparing the market for the CSDR settlement discipline regime

It is expected that the implementation of the CSDR's settlement discipline regime will contribute to a further reduction in settlement failure rates and a corresponding decrease in the value of undelivered securities or funds. DTCC's director of ITP product management and industry relations Matt Johnson tells Bob Currie how DTCC is helping the market to prepare for the regulation

The Central Securities Depository Regulation (CSDR) is a multifaceted set of rules designed to increase the safety and efficiency of securities settlement and settlement infrastructures in the EU. It has done so, through a phased implementation, by introducing shorter settlement periods and strict organisational, conduct of business and prudential requirements for central securities depositories (CSDs). This establishes a passport system, enabling authorised CSDs to deliver their services across the EU. It also lays down prudential and supervisory requirements for CSDs that provide banking services supporting securities settlement.

The overarching aim of the settlement discipline regime (SDR) component of CSDR is to deliver improved settlement efficiency, and to reduce settlement failure rates, across European securities markets. It will do so through the introduction of cash penalties and deterrents to settlement failure, most notably through mandatory buy-ins.

Drawing on data from T2S Annual Reports and ESMA calculations of EU settlement rates, DTCC estimates that average settlement rates across EU securities markets are currently in the 94-95 per cent range. This does not cover every CSD in the EU or every settlement currency, but DTCC believes this provides a reliable barometer of current settlement efficiency.

While settlement efficiency has improved significantly over the past two decades, this settlement failure rate, at close to six per cent, remains unacceptably high when represented in terms of the total value of securities, or the total value of cash, that are still outstanding after the settlement deadline.

With this in mind, it is expected that implementation of the CSDR settlement discipline regime will increase settlement efficiency by contributing to a further decrease in settlement failure rates and a corresponding reduction in the value of undelivered securities or funds.

The SDR component of CSDR is scheduled to come into force in February, according to the current timetable, with the first trades expected to settle under the new regime on 3 February 2022.

DTCC has been working with clients to ensure that the transition to the new regime proceeds smoothly, as was the case with migration to T+2 settlement under Article 5 of CSDR in 2014. Although many in the industry feared widespread disruption during this transition to a shorter settlement cycle, in practice the migration was managed efficiently and with little negative impact on settlement rates.

"Testing and readiness audits that we have conducted with Tier 1 banks have delivered encouraging results and our CSDR project team estimates that, after SDR implementation in February 2022, settlement rates may rise to 97-98 per cent in H2 2022 and into 2023," says Johnson. This would bring settlement rates in the EU closer to those in Asia, where settlement rates are well above 99 per cent in Taiwan, South Korea, Hong Kong, Singapore and a number of other Asia Pacific markets.

From a market infrastructure perspective, Johnson believes that market participants in the EU are now in a stronger position than they were when the delay to SDR implementation (pushing SDR back to February 2022) was announced 12 months ago. This has enabled market participants to sharpen their modelling under the SDR regime and their mechanisms for calculating and allocating penalties.

Specifically, the settlement process may involve a complex network of interlinked transactions where a settlement failure can lead to the failure of a chain of settlement instructions, which may also include securities lending or repo transactions in this chain of trades. For some settlement parties, this has presented complexity in modelling the application of cash penalties along this chain of transactions, identifying which party is responsible for a settlement failure and where the settlement penalty should be applied.

"DTCC finds that most CSDs and the large global custodians are comfortable with how to calculate and apply settlement penalties," says Johnson, "although we continue to provide education and support to participants across this settlement network to assist this process. From a market infrastructure standpoint, the component of the regulation that is causing most concern is the buy-in component."

Currently only one organisation, Eurex Securities Transactions Services, has confirmed that it will serve as a buy-in agent. If this remains the case, this agent will manage buy-ins for all transactions settling in a European CSD that need to be bought in. This is likely to present a major onboarding challenge — requiring firms around the world that settle trades in an EU CSD to connect to the buy-in agent — and may create bottlenecks or delays for those firms that have not yet started this engagement.

Industry response

The Joint Trade Associations, a group of 16 industry associations, have written to the European Commission and the European Securities Market Authority (ESMA) regarding the implementation schedule for mandatory buy-in rules under CSDR.

This group states that it supports the European Commission's intention to consider amendments to mandatory buy-in rules under the CSDR's SDR, which are due to be introduced by 1 February 2022.

The Commission published a report on 1 July which says that the Commission will consider conducting a legislative review of CSDR, subject to an impact assessment. This impact assessment is expected to run during the second half of 2021.

The Joint Associations welcomed the Commission's message that it will consider amendments to the mandatory buy-in regime, stating that this is a positive step towards delivering an effective settlement discipline regime that achieves its objectives and avoids negative consequences for European capital markets and investors.

The associations warned the Commission against enforcing the current rules and then revising them at a later point. This, they say, would risk damaging the competitiveness of EU capital markets and increasing cost for investors, but would also lead to a duplication of efforts and unnecessary disruption for market participants. The correct approach, they say, will be to enact necessary amendments prior to implementation, following a review of mandatory buy-in rules by co-legislators, notably the European Parliament and Council.

This letter follows earlier recommendations advanced by the Joint Trade Associations on the CSDR settlement discipline regime in letters to the European Commission and ESMA on 22 January 2020 and 11 March 2021.

Managing implementation

DTCC's Consulting Services was established in October 2020 to provide an advisory service to clients around the world with access to the firm's expertise and experience in post-trade operations. CSDR rules have had a major impact on the way that financial markets and market participants behave. DTCC's team of consultants work with firms to perform detailed impact analysis and process reviews to help design and implement robust solutions that aim to ensure they are ready to adhere to new operating standards. “DTCC’s experts can either help a firm transform its entire infrastructure or start with smaller projects as building blocks for longer-term prevention of settlement fails,” says Johnson. The services include: assisting further automation of a firm’s settlement processes; providing better understanding of the root cause of fails; implementing exception management processes and controls to manage those fails quickly and avoid increasing penalties; and maximising use of DTCC services and firms’ ability to align with pending regulatory implementations.

“From a consultancy standpoint, the advice that DTCC is providing to all clients is that the best way to navigate the CSDR settlement discipline regime and mandatory buy-in process is to ensure that you do not fail transactions,” says Johnson.

In simplest terms, this will be dependent on ensuring that the seller has sufficient securities in inventory, and the buyer is holding sufficient cash, to discharge their settlement obligations.

Beyond this, DTCC provides an audit of factors that can have a key influence over whether a firm is settling transactions efficiently. For example, does the firm have access to the most current and accurate settlement information that is available by using a standard settlement instruction (SSI) database such as DTCC’s ALERT, as well as its Global Custodian Direct (GCD) workflow to ensure that SSIs are coming directly from and maintained by source data providers?

Is the firm using electronic pre-matching platforms, such as DTCC’s CTM platform? CTM is currently the most-widely used matching platform in the securities market and, through ALERT Key Auto Select (AKAS), allows users to enrich their trades automatically with the most accurate settlement instructions from ALERT.

Lastly, does the firm automate their settlement exception management processes by utilising a platform like DTCC’s Exception Manager to publish, manage and communicate about exceptions throughout the trade lifecycle process — with the objective to resolve any exceptions promptly and to reduce delays in settlement?

All services and consultancy that DTCC provides are delivered in the context of promoting resilience, process automation and high straight-through processing rates, with the aim of ensuring settlement finality “on time, each time,” says Johnson.

“We are able to conduct an audit of clients’ pre-trade and post-trade processes, allowing our consultancy division to provide a deep-dive view of their transaction processing arrangements, understanding where the gaps lie and where they are not automating as fully as possible,” he adds.

If a firm is using an old or invalid set of SSIs, for example, this will substantially increase the risk of trade failure. However, if it is also utilising an automated pre-trade matching platform such as CTM, these mismatches will be identified on execution date and immediate remedial action can be taken.

“The consultancy approach is all about delivering operational excellence,” says Johnson. This is not simply driven by regulation, although the large volume of ongoing regulation that is confronting the industry has provided a foundation for conversations around operational efficiency and control processes with clients and prospects.

In the settlement arena, there is still wide variation across the market in terms of firms’ same-day matching rates. Some counterparties are currently fulfilling pre-matching on T+0 for close to 100 per cent of their trades. In contrast, others have matching rates that are down in the low 80s. At industry level, this can result in high aggregate cash values of trades that are unmatched overnight — and significant delays before settlement finality is established.

DTCC is working with the market to reduce settlement failures, to improve STP rates and to remove operational risk and cost. Steps to assist market participants with their SDR preparations are key to this agenda.