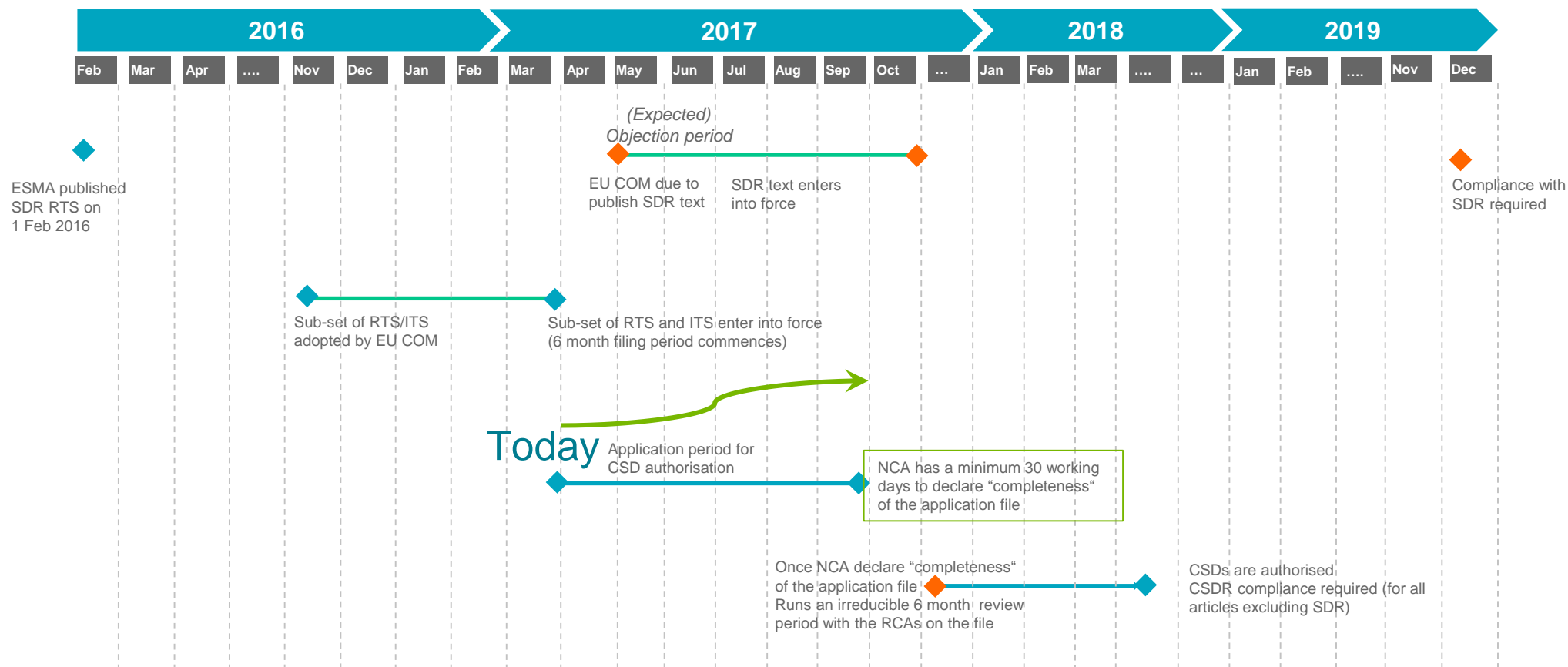

Presentation of the CSDR TF - T2S Penalty Mechanism

Mathias Papenfuß
SMPG meeting



CSDR timeline



◆ Milestones CSDR application and standards

◆ Expected date Milestones CSDR application and standards

→ Objection period by European Parliament and the European Council

Agenda

- 1 CSDR Impacts to Participants
- 2 Focus on T2S Framework and Settlement Discipline

CSDR Impacts on Participants

Credit and Collateral

1. Collateralisation of credit exposures
2. Collateral eligibility & valuation

Integrity of the issue

1. Daily Reconciliation
2. Suspension of settlement
3. Processing of corporate actions

Issuance

1. Legal Entity Identifier (LEI)
2. Provide and maintain valid LEI

CSDR Impacts on Participants

Enhanced Risk Management requirements

1. Identification of Key Participants
2. Required to provide enhanced information regarding their operational setups

Account segregation

1. Omnibus accounts
2. Segregated accounts
3. Requirement to publish information on risks and costs associated

Transparency requirements

1. Definition of a Settlement Internaliser
2. Impact on Settlement Internalisers

Agenda

- 1 CSDR Impacts to Participants
- 2 Focus on T2S Framework and Settlement Discipline

Introduction

Who

The CSDR Task Force (TF) was formed in April 2016 by the T2S Governance and is composed of T2S CSD representatives, market participants, ECB and 4CB representatives

What

As per its mandate, the objective of the T2S CSDR TF is:

- To analyse and document the requirements of CSDs for complying with the CSDR, which would have an impact on the T2S functionalities
- To make a recommendation to the T2S Steering Level on which compliance requirements stemming from the CSDR should be envisaged by changes to the T2S Platform
- To document those requirements of CSDs for their compliance to the CSDR, which impact the T2S functionalities, in the form of T2S change requests (CR)

T2S Penalty Mechanism Overview

Scope of the T2S Penalty Mechanism

The T2S penalty mechanism aims at covering the following functionalities:

- Identification of settlement instructions eligible for cash penalties,
- Daily calculation and reporting of cash penalties to relevant T2S parties
- Monthly reporting of the aggregated amounts of cash penalties computed for a given month
- Operational tools for CSDs to handle manual updates on an ad hoc basis, e.g. removing penalty, update of reference data triggering the calculation of a penalty, etc...
- Availability of queries

Out of scope:

- Derivation of the list of securities subject to penalties, settlement of cash penalties, reporting to competent authorities, interaction with buy-in process, insolvency, reconciliation between penalty mechanisms, etc...

Background information

When

The work of the T2S CSDR was structured sequentially around the expected timing for entry into force of the Technical Standards related to CSDR:

Analysis of Regulatory / Implementation Technical Standards (RTS/ITS) on CSD Requirements and Authorisation - *Completed*

✓ The output of this work has materialised into a number of T2S CRs^(*)

Analysis of RTS on Settlement Discipline – *Ongoing (more details on slides labelled ‘T2S Penalty Mechanism Overview’)*

- ✓ Discussions are essentially focused on the settlement penalty mechanism that will take the form of cash penalties for settlement fails:
 - The design of the new service offered by the Eurosystem
 - The set of principles which are platform agnostic, i.e. “rulebook”

() CR600, 606, 607, 608, 609 can be found on the T2S Change Review Group website: [Link](#)*

Background information

How (1/4)

- The CSDR TF has based its analysis on draft versions of the CSDR RTS and hence works on the basis of assumptions commonly agreed at TF level
- Some of the working assumptions and questions are shared with ESMA staff in the form of a list of items requiring clarifications. On an ad-hoc basis, further explanations are provided by the ECB Team
- The benefits of this approach are two-fold:
 - Sharing the CSDR TF's understanding of the RTS and highlight areas where further regulatory clarification may be beneficial, e.g. in the form of Q&A and/or Guidelines
 - Collect preliminary/informal feedback at ESMA staff level to help the TF to structure its analysis
- The main objective for the Eurosystem is to have key questions clarified by the time of the publication of the RTS on Settlement discipline, i.e. when the 24 months countdown for compliance to the RTS has started, to ensure a smooth implementation of the T2S Penalty Mechanism

Background information

How (2/4)

- For each topic discussed in the TF, it is also assessed whether it applies outside of the context of the T2S Penalty Mechanism, e.g. considerations in case of insolvency of a participant, reconciliation principles between 2 penalty mechanisms, rules for common calendar, payment of cash penalties, etc...
- In doing so, the CSDR TF aims at establishing a “rulebook” that is also applicable for any CSD subject to CSDR (in or out of T2S) who develops a CSDR penalty mechanism

Background information

How (3/4)

- T2S will make use of new ISO20022 message to be created (based on the draft proposal from Dec. 2016) to report penalties information on a daily basis.
- Translation into 15022 has not yet been discussed, our understanding is that there is no adequate message/ format yet existing to “replicate” the proposed 20022 content; however, as some market already apply penalties today, they may have reporting mechanisms in place (but probably use proprietary formats).
- If MT548 qualifies for (parts) of the reporting.

Background information

How (4/4) – Reference prices

- T2S has to be provided by CSDs with reference price data; RDF/ WSS will store the relevant (MIFID, if required) price data and provide it to T2S (technical process is still TBD).
- Reference price will be part of the fails penalty reporting to customers.
- Reference prices need to be sourced by CSDs from their providers for usage in penalty mechanism and regulatory reporting (“substantial importance – Settlement” for Free of Payment (FOP) transactions counter-values and end of year positions-values calculation).
- There will be no changes to current process / valuations for customers as ref prices will only be used for CSD regulation reporting and penalties calculations.

T2S Penalty Mechanism

Eligibility for a cash penalty

- **All settlement instruction and transaction types** generated by CSDs and their participants, except those related to Corporate Action on stocks recognised by specific codes (CORP and REDM ISO transaction code)
- **All reasons for non-timely settlement** of the instruction are considered, whether failure or non-eligibility of settlement, such as lack of securities or cash, instruction put on hold, linking of instructions, but also the late submission of instructions. Hence two types of cash penalties are applied:
 - **Settlement Fail Penalty (SEFP):** all matched instructions which are unsettled on the Intended Settlement Date (ISD) at end of the relevant settlement cut-off processing for any reason associated to this instruction and not to the counterpart's instruction
 - **Late Matching Fail Penalty (LMFP):** all matched instructions entered too late for settlement on their ISD, which have an accepted timestamp higher than the counterpart (= responsible for late matching)

Disclaimer: Pending regulatory confirmation

T2S Penalty Mechanism

Computation of cash penalties

Rate* Reference Price* Quantity and/or Rate*Amount (See examples in Annex)

Type of Settlement Instruction	SEFP (daily computation) / LMFP (computed once)
Delivering/Receiving versus Payment (DVP/RVP)	Penalty based on the quantity of securities failed to be delivered and penalty rate of the ISIN, unless the reason for failing is “lack of cash”(*), in which case the penalty rate will be the discount rate of the relevant currency
Delivering/Receiving Free of Payment (DFP/RFP)	Penalty based on the quantity of securities failed to be delivered and penalty rate of the ISIN
Debiting/Crediting Payment Free of Delivery (DPFOD/CPFOD)	Penalty based on the amount of cash failed to be delivered and the penalty rate will be the discount rate of the relevant currency
Delivery/Receiving with Payment (DWP/RWP)	Penalty will be the sum of: - The penalty based on the quantity of securities failed to be delivered and penalty rate of the ISIN, and; - The penalty based on the amount of cash failed to be delivered and the discount rate of the currency

Disclaimer: Pending regulatory confirmation

(*) only possible for SEFP

Source :

European Central Bank - DG Market Infrastructure & Payments
Presentation of the CSDR TF - T2S Penalty Mechanism of 27 July 2017

4 October 2017

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T2S Penalty Mechanism

Reporting of cash penalties

- **Daily reporting** of cash penalties consolidating all information related to the penalties computed in ISO20022 format, inter alia references of the penalties, calculation details, underlying settlement instructions details, etc...
- **Availability of queries** for individual penalties or obtaining full report
- **Monthly reporting of aggregated amounts** for collection and redistribution

Update of an existing cash penalty

- Removal of a cash penalty: T2S will allow CSDs to perform the removal of a penalty by setting the amount to zero (foreseen by the Regulation in exceptional cases)
- Modification of reference data used for the calculation: Ex-post changes in reference prices of ISIN, security attributes used for deriving the penalty rate, or the penalty rate will trigger a re-calculation of penalties
- In both cases, a **List of Modified Penalties** will be reported

T2S Penalty Mechanism

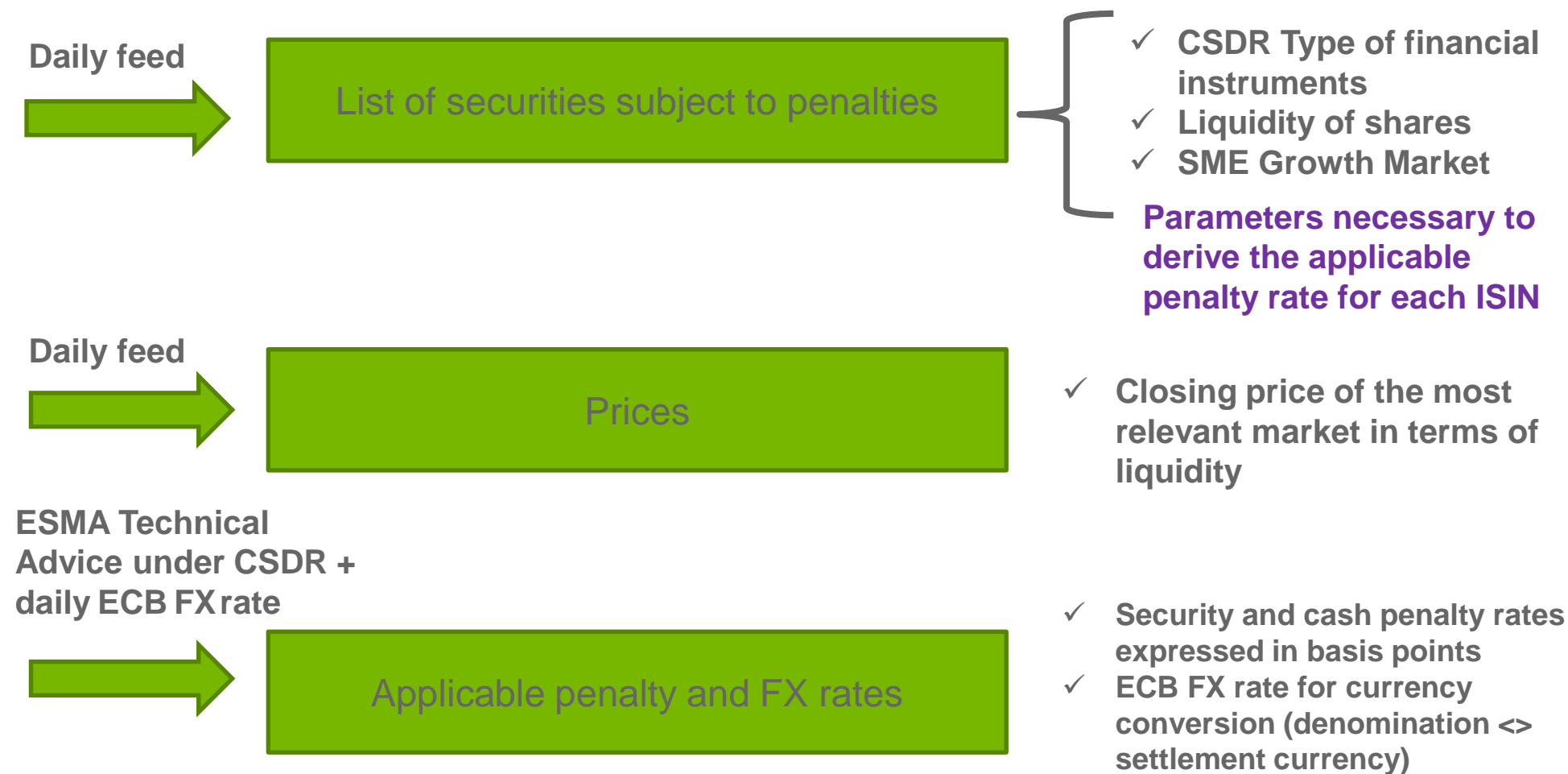
Current status of the work on T2S Penalty Mechanism

- Working assumptions on the future T2S Penalty Mechanism have been translated into relevant user requirements and gathered into the T2S CR 654^(*)
- The CR has been submitted for detailed assessment of the costs to the 4CB for the main purpose to provide an idea of the costs of the new service for T2S CSDs, so that they can confirm whether they will subscribe to the T2S Penalty Mechanism
- As the RTS are still in draft version, it is acknowledged that some working assumptions of the CSDR TF may need to be revised following regulatory clarifications, which would trigger updates to the T2S Penalty Mechanism CR654 and related user requirements
- The CSDR TF will also concentrate in its next meetings on the definition of the “rulebook” documentation

(*) Link to the CR as published on CRG website: [Link](#)

ANNEX

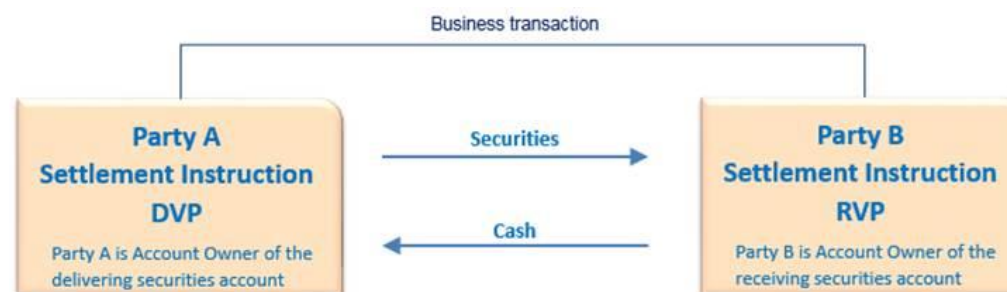
Necessary reference data (static and dynamic)



Disclaimer: Pending regulatory confirmation

SEFP : Computation examples

Delivery versus Payment transaction



Example 1 The status and reasons at the time of the end of processing of the relevant cut-off are:

DVP instruction: *Lack of securities*

RVP instruction: *Counterparty has lack of securities*

In this example, the result of the computation will be the computation of one penalty:

Party A is imposed with a Penalty to be paid to Party B. Amount of the penalty:

SEFP = Rate for the ISIN * Reference Price * Securities Quantity

Example 2: The status and reasons at the time of the end of processing of the relevant cut-off are:

DVP instruction: *Counterparty has lack of cash*

RVP instruction: *Lack of cash*

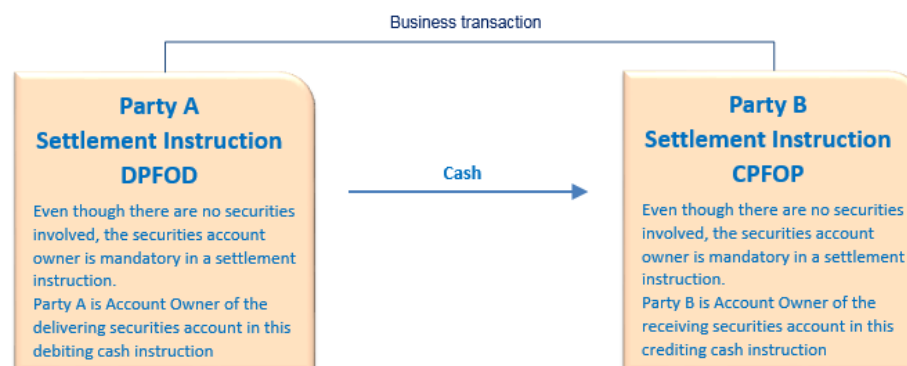
In this example, the result of the computation will be the computation of one penalty:

Party B is imposed with a Penalty to be paid to Party A. Amount of the penalty:

SEFP = Discount Rate * Reference Price * Securities Quantity

SEFP : Computation examples

Payment Free of Delivery transaction



The status and reasons at the time of the end of processing of the relevant cut-off are:

DPFOD instruction: *Party hold*

CPFOP instruction: *Counterpart's instruction is on hold*

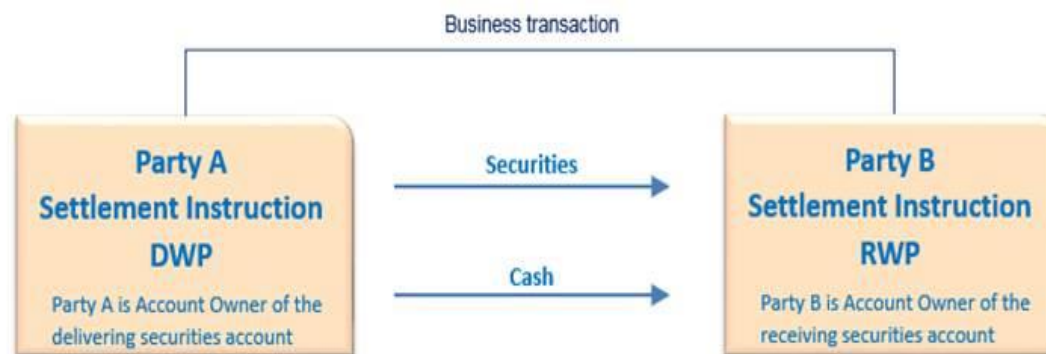
In this example, the result of the computation will be the computation of one penalty:

Party A is imposed with a Penalty to be paid to Party B. Amount of the penalty:

SEFP = Discount Rate* Settlement Amount

SEFP : Computation examples

Delivery with Payment transaction



The status and reasons at the time of the end of processing of the relevant cut-off are:

DWP instruction: *Lack of securities*

RWP instruction: *Counterparty has lack of securities*

In this example, the result of the computation will be the computation of one penalty:

Party A is imposed with a Penalty to be paid to Party B. Amount of the penalty:

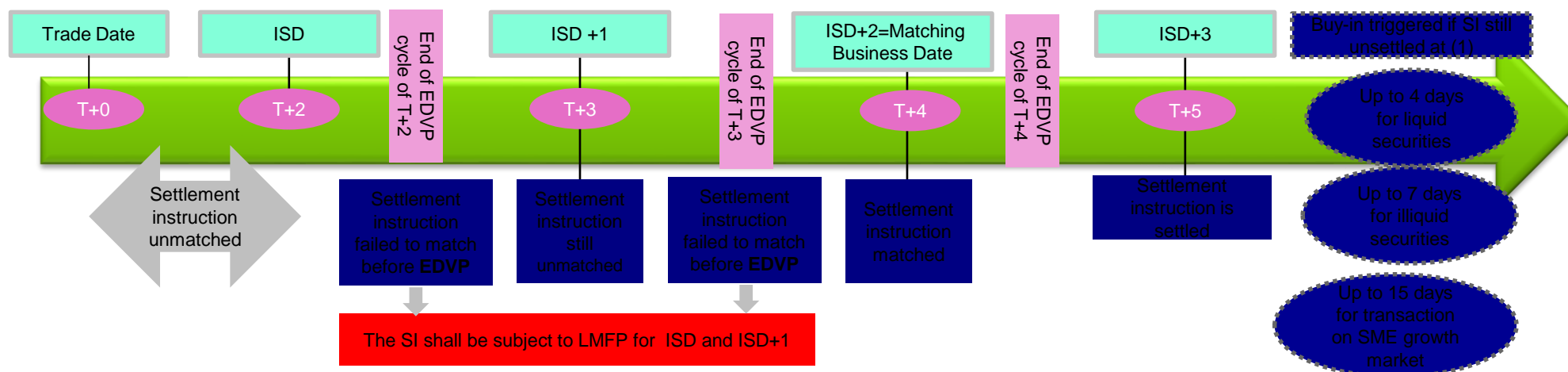
SEFP = SEFP for securities + SEFP for cash

= Rate for the ISIN* Reference Price* Securities Quantity + Cash Discount Rate* Settlement Amount

LMFP : Computation example

Key differences with SEFP:

- Calculated once based on matched timestamp in T2S retroactively from ISD
- Matching Business Date may be excluded, calculation based on reference price of each BD
- Settlement status not relevant (pending, settled,...)



- A DVP settlement instruction (delivering 5000 units of ISIN1 versus 39.000 Euros) is matched at 15:00 two business days after its ISD (T+4). As it is matched before the relevant cut-off of T+4 it can still settle on T+4 and therefore T+4 is excluded from LMFP calculation.
- Assuming that the Rate (R) and reference Price (P) for the ISIN1 are $R(T+3) = 1\text{bp}$; $R(T+2) = 1\text{bp}$; $P(T+3) = 9\text{ Euros}$ and $P(T+2) = 8\text{ Euros}$
- LMFP will be calculated as follows: $0,0001 * 9 * 5000 + 0,0001 * 8 * 5000 = 8,5\text{ Euros}$