CSDR Settlement Discipline Market Practice Model

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Introduction

CSDR requirements for Settlement Discipline impact on ISO Standards

- SWIFT together with AFME / ICMA / EBF have modelled the impact on ISO Standards of the CSDR Settlement Discipline requirements

- This presentation outlines the message flows and impact to ISO Standards for a base-level scenario

- The objective is for this to be the basis for
    - an ISO standards global market practice for CSDR
    - the industry sponsored changes to the ISO Standards

DRAFT BASE SCENARIO

The Scenario

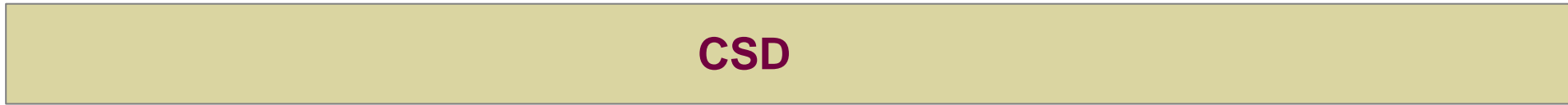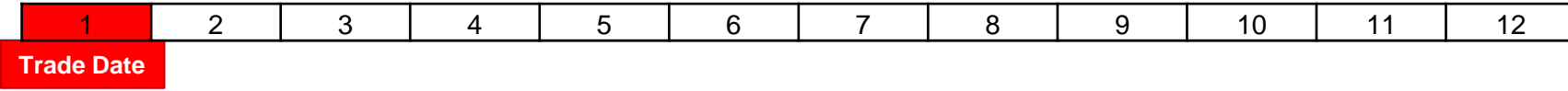**Scenario Parameters of the Base Scenario**

SCENARIO REFERENCE	#2
Scenario Parameters ▼	**Scenario Assumptions** ▼
RECEIVING/BUYER PARTY (PARTIES)	Broker 1
DELIVERING/SELLER PARTY (PARTIES)	Broker 2
CSD ACCOUNTS	Segregated
CSD PARTICIPANT ACCOUNTS	Segregated
MARKET	OTC
CCP	Not Cleared
BUY-IN	Fully completed in single instruction
FAIL REASON	Lack of Securities
T2S	T2S Out-CSD
INSTRUMENT FAILING	Liquid (5 days)
LOCATION OF TRADING PARTY	All parties in EU
LOCATION OF CUSTODIAN/AGENT	All CSD Participants in EU
TRANSACTION TYPE	purchase or sale of securities
BUY-IN	Buy-In is possible
FAILING PARTY DELIVERS	No
CASH COMPENSATION	Not Requested
CSD	Intra-CSD settlement
SETTLEMENT CHAIN	Custodian of IM is a direct participant at the CSD
BUY-IN AGENT	Buy-in Agent appointed by the Receiving Broker
NO PARTY	No Party is a settlement internaliser

Impact of Buy-Ins (for uncleared OTC trades) – scenario without T2S

1	2	3	4	5	6	7	8	9	10	11	12

Trade Date

Market Side Trade

BROKER 1

BROKER 2

CSD Participant 1

CSD Participant 2

CSD

5

A market-side trade is confirmed

1	2	3	4	5	6	7	8	9	10	11	12

Trade Date

BROKER 1

1

Exchange of Confirmations

BROKER 2
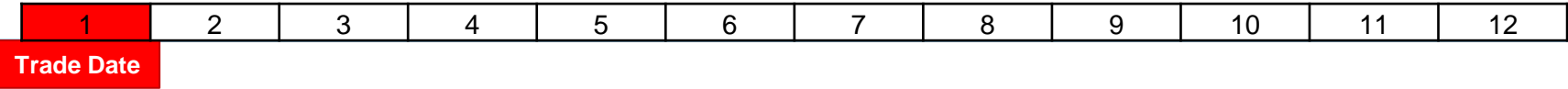
The relevant ISO message is the MT 518, or possibly the MT 515

CSD Participant 1

CSD Participant 2

CSD

Settlement Instructions are sent

1	2	3	4	5	6	7	8	9	10	11	12

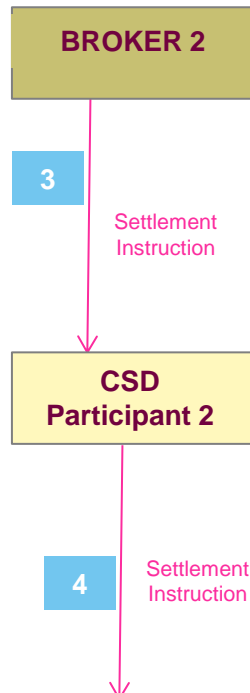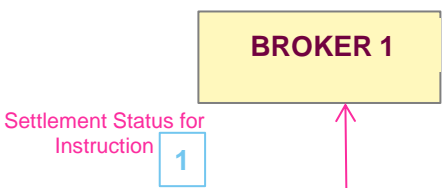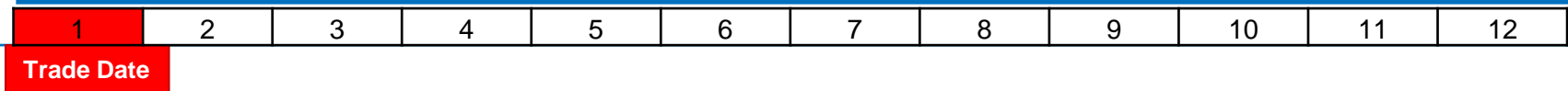**Trade Date**

ISO IMPACT ASSESSMENT FOR THIS STEP:

No impact

CSDR has certain requirements that are met by current ISO message standards

BROKER 1

Settlement Instruction

1

BROKER 2

3

Settlement Instruction
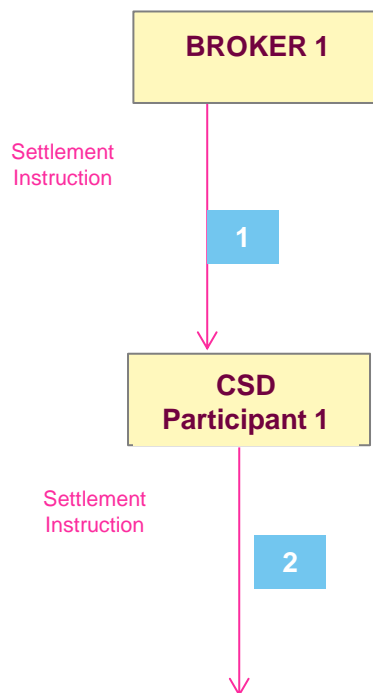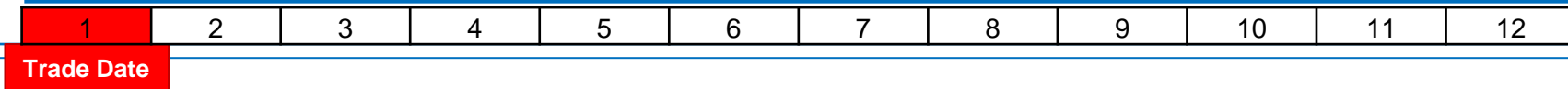
The relevant ISO messages are the MT 541 / MT 543

CSD Participant 1

Settlement Instruction

2

CSD Participant 2

4

Settlement Instruction

CSD

A Status message is sent each day for each Instruction

1	2	3	4	5	6	7	8	9	10	11	12

Trade Date

BROKER 1

BROKER 2

Settlement Status for Instruction **1**

Settlement Status for Instruction **3**

The relevant ISO message is the MT 548 status.

CSD Participant 1

CSD Participant 2

Settlement Status for Instruction **2**

Settlement Status for Instruction **4**
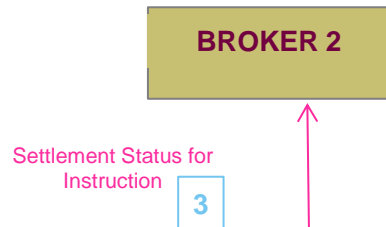
This Settlement Status message is sent for each update or at each settlement attempt.
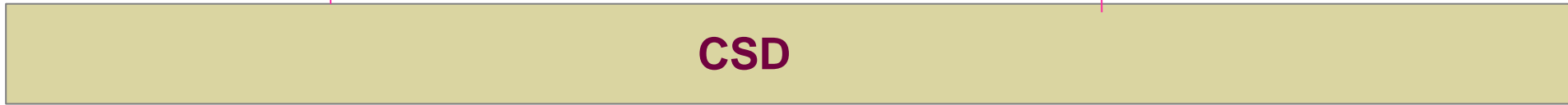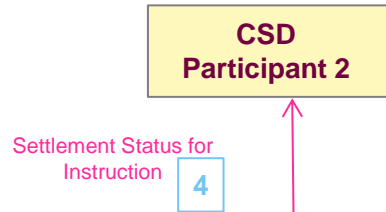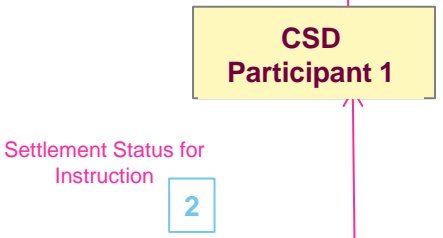
CSD

Status message could be used for penalty/compensation details

1	2	3	4	5	6	7	8	9	10	11	12

(Intended) Settlement Date + 1

BROKER 1

BROKER 2

Settlement Status for Instruction 1

Settlement Status for Instruction 3

Settlement Status message to be used to communicate Penalties & Compensation details *

CSD Participant 1

CSD Participant 2

Settlement Status for Instruction 2

Settlement Status for Instruction 4

CSD
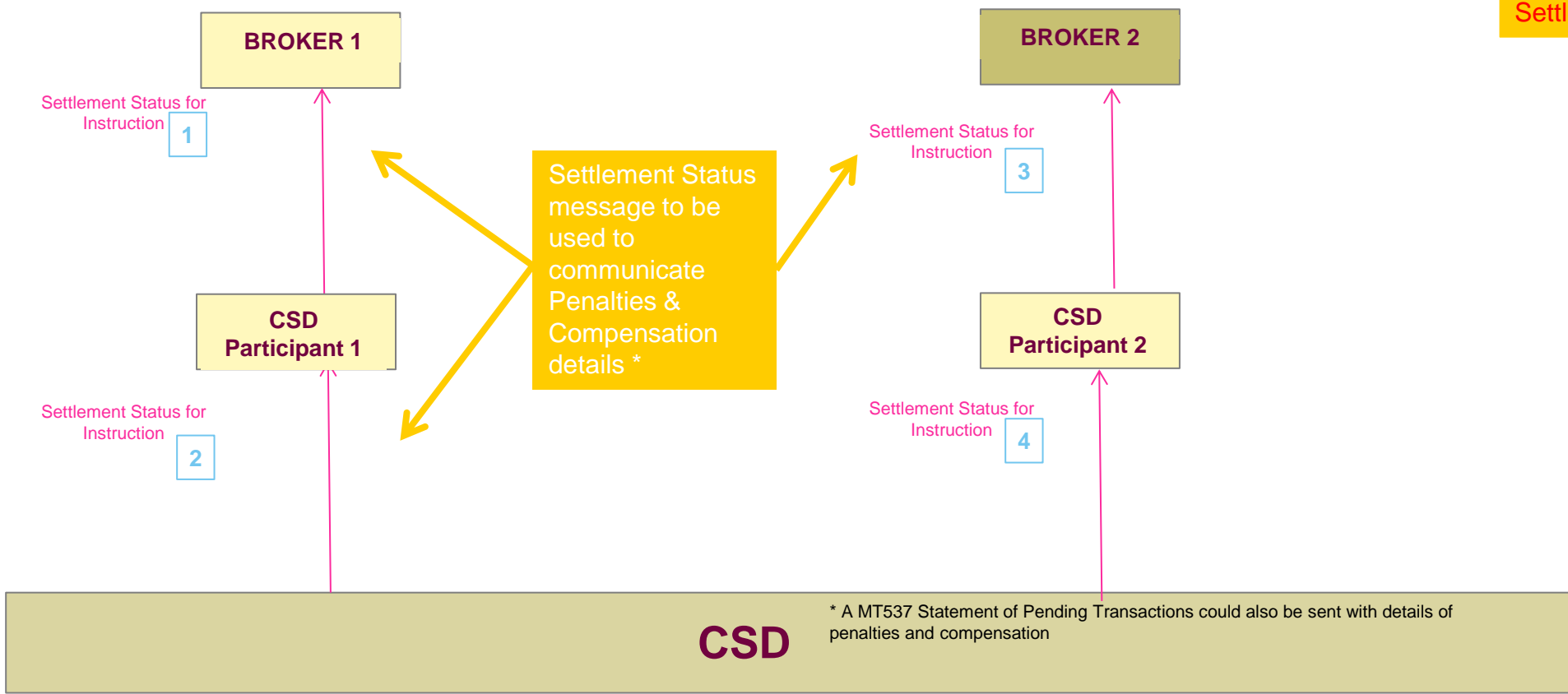
* A MT537 Statement of Pending Transactions could also be sent with details of penalties and compensation

The relevant CSDR requirements

Article 16.5. A CSD shall charge and collect at least monthly the net amount of cash penalties to be paid by each participant. On a <u>daily basis</u>, the CSD shall <u>provide to participants the details of the calculation of the penalties</u> for every failed settlement instruction, indicating the account to which each failed settlement instruction refers.

Article 17.1. The CSD shall <u>redistribute to the receiving participants</u> that suffered from a settlement fail the net amount of cash penalties that it has collected in accordance with Article 16, at least monthly.

Article 17.2. <u>On a daily basis</u>, a CSD shall <u>provide the receiving participants with the details of the calculation of the cash penalties for each failed settlement instruction</u>, indicating the account to which the failed settlement instruction refers to.

Article 30
1. The receiving participant, through its clients, shall inform without undue delay the receiving trading party of the existence of a settlement fail. The receiving trading party shall verify, on the business day following the expiry of the extension period, whether the buy-in is not possible in accordance with Article 21(b).

Article 32
4. The market value referred to in paragraph 2 [''reference price'] shall be determined as follows:
   a) for financial instruments referred to in Article 3(1) of Regulation (EU) No 600/2014 admitted to trading on a trading venue within the Union, the value determined on the basis of the closing price of the most relevant market in terms of liquidity referred to in Article 4(6)(b) of Regulation (EU) No 600/2014;
   b) for financial instruments admitted to trading on a trading venue within the Union other than those referred to in point (a), the value determined on the basis of the closing price of the trading venue within the Union with the highest turnover;
   c) for financial instruments other than those referred to in points (a), and (b), the value determined on the basis of a price calculated using a pre-determined methodology approved by the competent authority of the CSD that refers to criteria related to market data, including market prices available across trading venues or investment firms.

Changes that would enable the MT 548 and the MT 537 (and ISO 20022 equivalents) to accommodate these CSDR requirements

1. There needs to be a Penalty / Penalty Redistribution sequence
2. This sequence should not be mandatory but
   - if the Settlement Status is LACK then a Penalty sequence should be provided for CSDR applicable transactions
   - if the Settlement Status is CLAK then a Penalty Redistribution sequence should be provided for CSDR applicable transactions
3. If the Penalty / Penalty Redistribution sequence is present then
   - the relevant Account details need to be provided
     - currently optional field but CSDs need to be "indicating the account to which each failed settlement instruction refers."
   - Fields 35B and 36B (Identification & Quantity) need to be provided
     - currently optional fields but these are needed for the full understanding of the Penalty
4. Fields needs in the Penalty / Penalty Redistribution sequence:
   - Days since Intended Settlement Date
   - Basis Points penalty applicable (i.e. a numeric value 1, 0.5,0.25, etc)
     - *allow alternative types of calculation to be represented here to be future proof and global*
   - Reference Price (at end of trading date of today for instrument that failed)
   - Trading Venue (as used for the reference price)
   - Penalty Amount applied on today's date
   - Accumulated Amount Penalty or Penalty Redistribution
   - Final Amount Penalty or Penalty Redistribution (to be provided when instruction finally settles)

A Buy-In Agent receives details of the instrument they need to supply

ISO IMPACT ASSESSMENT FOR THIS STEP:

Yes (see next slide)

1	2	3	4	5	6	7	8	9	10	11	12

Trade Date (Buy-In)

(Intended) Settlement Date + 5

The details of the buy-in required can be sent using a MT 502 , and copied to the Failing Party

The actual appointment of the Buy-In Agent is not expected to be done via ISO 15022 messages

Could best is this process to be automated?

BROKER 1

1

Order details

Copy of Order details

BROKER 2

BUY-IN AGENT

Should the replies (MT509 status message, and MT515 confirmation message) also be copied to the Failing Party?

CSD Participant 1

CSD Participant 3

CSD Participant 2

CSD

12
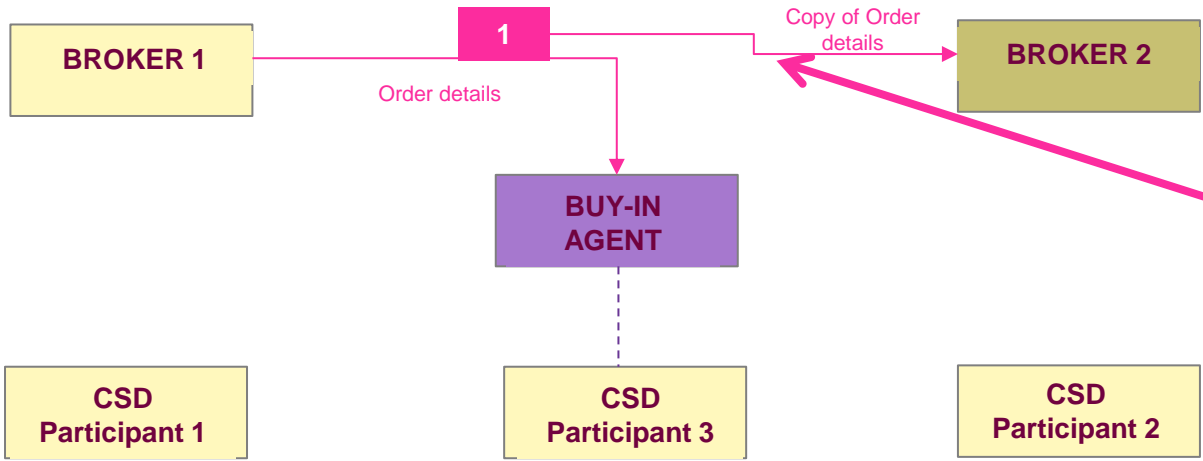
The relevant CSDR requirements

Article 29.
1. On the day referred to in Article 28(1), the receiving trading venue member shall appoint a buy-in agent and notify the failing trading venue member.

2. Following the receipt of the notification referred to in paragraph 1, the failing trading venue member may only deliver the financial instruments to the buy-in agent provided the buy-in agent gives its prior consent to the delivery.

Changes that would enable the MT 502/513/515 to accommodate these CSDR requirements

- There could be a need to automate the possibility to select a buy in agent. Order could be sent to several potential buy in agents for them to then accept.
- The selection of buy-in agent could be finalised by sending a MT502 order include giving the details of the original order that failed settlement. If the Front Office FIX Standard was to be used then a reference to the original Order ID could be provided
- The MT 502 should be able to include a reference of the failing settlement instruction.
- The Receiving Party could then send a MT 502 Copy message to the Failing Trading Party

Failing Party must then put their instruction on hold

1	2	3	4	5	6	7	8	9	10	11	12

Trade Date (Buy-In)

(Intended) Settlement Date + 5

BROKER 1

BUY-IN AGENT

BROKER 2

Settlement Instruction *(to Deliver to Broker 1 on HOLD)* | 2

9

CSD Participant 1

CSD Participant 3

CSD Participant 2

Settlement Instruction *(on HOLD)* | 4

10

CSD

14

The relevant CSDR requirements

Article 8
  Hold and release mechanism
    A CSD shall set up a hold and release mechanism that shall consist of:
    (a) a hold mechanism that allows pending settlement instructions to be blocked by the instructing participant for the purpose of settlement; and
    (b) a release mechanism that allows pending settlement instructions that have been blocked by the instructing participant to be released for the purpose of settlement.

Article 29.

3. Following the receipt of a notification referred to in paragraph 1, the failing trading venue member shall ensure that the relevant settlement instruction relating to the settlement fail is put on hold.

Changes that would enable the MT 54n Instructions (or MT 530) to accommodate these CSDR requirements

- Currently a Hold is issued with an initiating pre-advice settlement instruction using 23G:PREA. Does it make sense to use this after a NEWM has been sent?   Would not a specific qualifier of "HOLD" be preferable?
- An alternative is use of the MT 530 Processing change command message. Need to use the MT 530 if 1st instruction is sent as NEWM – The MT 530 is now widely used to hold/release the settlement instructions (indirect consequence of T2S).

Settlement instruction to receive from Broker 2 is put on hold

1	2	3	4	5	6	7	8	9	10	11	12

Trade Date (Buy-In)

(Intended) Settlement Date + 5

BROKER 1

BUY-IN AGENT

BROKER 2

11

Settlement Instruction *(to Deliver to Broker 1 on HOLD)* 1

CSD Participant 1

CSD Participant 3

CSD Participant 2

12

Settlement Instruction *(on HOLD)* 2

CSD

ISO IMPACT ASSESSMENT FOR THIS STEP:

Yes (see previious slide)

Not in CSD-R but felt that the Market Practice should be that the Receiving Party should also put their original Instruction on Hold once the Buy-In Agent is appointed

16

Buy-In Agent informs the Receiving Party of trade execution

1	2	3	4	5	6	7	8	9	10	11	12

Trade Date (Buy-In)

(Intended) Settlement Date + 5

Order Execution / Confirmation details

2

Copy of Order Execution

BROKER 1

BROKER 2

BUY-IN AGENT

CSD Participant 1

CSD Participant 3

CSD Participant 2

The trade made by the Buy-In Agent can be confirmed to the Receiving Party via a Confirmation MT 518, or possibly MT 515
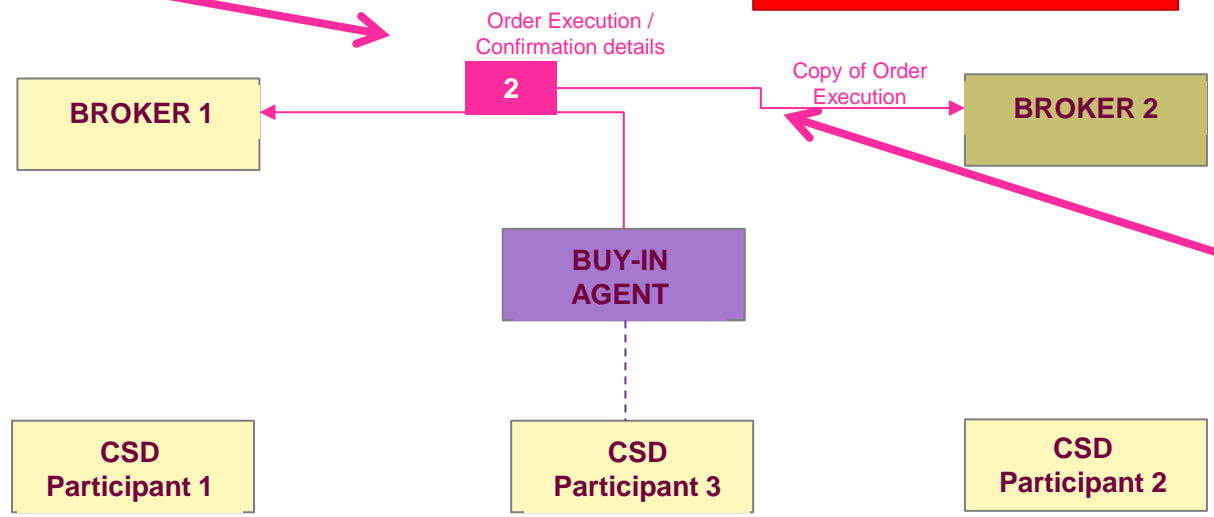
ISO IMPACT ASSESSMENT FOR THIS STEP:

No impact

CSDR has no requirements for this step but could be useful for the Failing Party to know if the Buy-In Agent has executed the Order

Should the replies (MT509 status message, and MT515 confirmation message) also be copied to the Failing Party?

CSD

17

Instruction sent informs the CSD of the Buy-In Agent

1	2	3	4	5	6	7	8	9	10	11	12

Trade Date (Buy-In)

(Intended) Settlement Date + 5

BROKER 1

BUY-IN AGENT

BROKER 2

Settlement Instruction *(to Receive from Buy-In Agent)* **5**

7 Settlement Instruction

CSD Participant 1

CSD Participant 3

CSD Participant 2

Settlement Instruction **6**

8 Settlement Instruction

CSD

These Instructions are used to contain data that enables the CSD to have details about the Buy-In in order to report to the regulator.
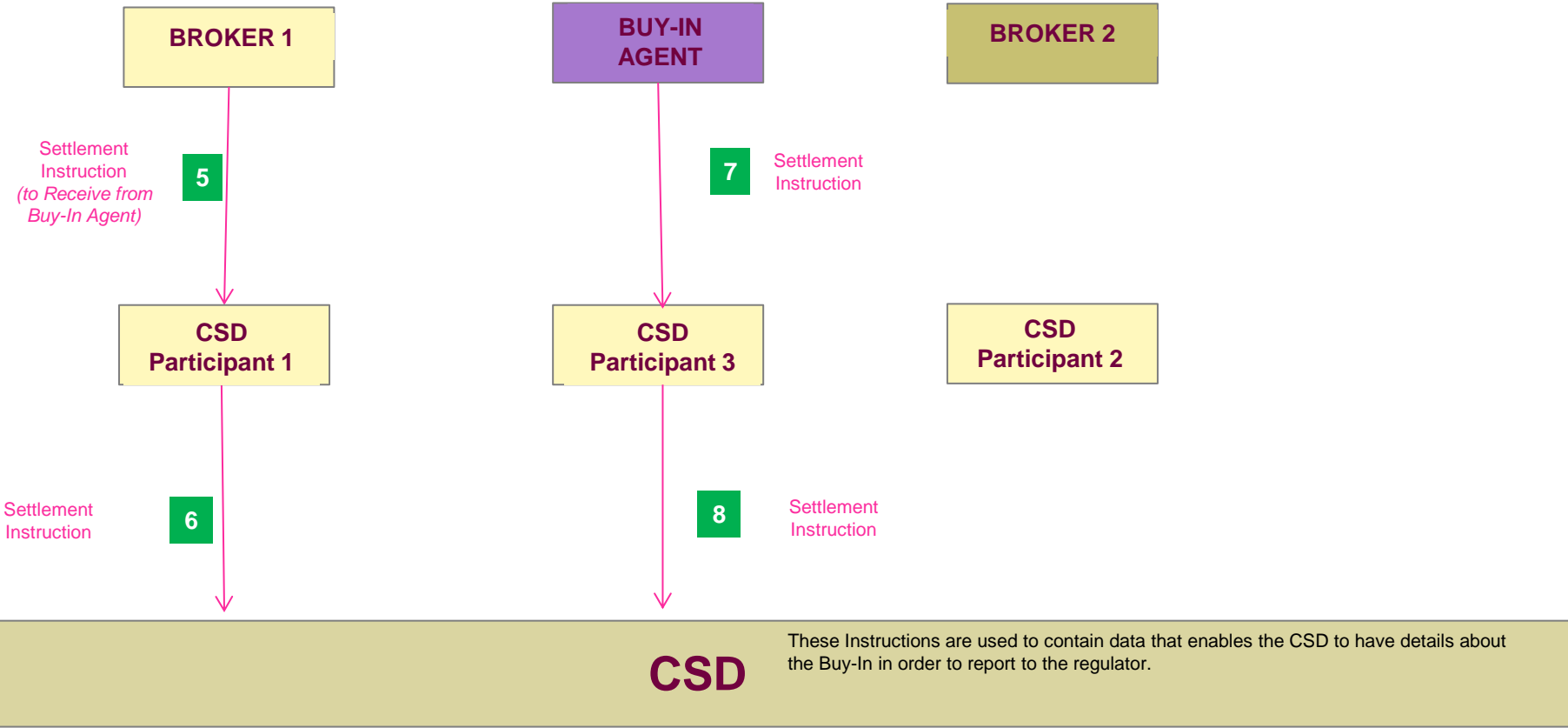
The relevant CSDR requirements

Article 31

4. At the latest on the last business day of the applicable period referred to in Article 37, the receiving trading party shall notify the results of the buy-in to the failing trading party.

5. Where buy-in is successful in part or in full, the notification referred to in paragraph 4 shall indicate the quantity and value of the financial instruments.

The receiving trading party shall accept the delivery of the financial instruments by the buy-in agent and shall pay the price for the delivered financial instruments subject to the conditions set out in Article 35.

At the end of each business day on which bought-in financial instruments are received by the receiving trading party, the receiving and failing trading parties shall ensure that the relevant settlement instructions relating to the settlement fail are cancelled and that new settlement instructions are entered into the securities settlement system for the non-delivered financial instruments. Cash penalties shall apply to each new settlement instruction from the day it is entered into the securities settlement system.

6. On the last business day of the applicable period referred to in Article 37, where the buy-in fails or results in partial settlement, the notification referred to in paragraph 4 shall also indicate whether, for the non-delivered financial instruments, the buy-in shall be deferred or cash compensation shall be due. In the absence of such indication, cash compensation shall be due.

11. The receiving trading party shall ensure that the CSD receives the information notified pursuant to paragraphs 4 and 8 and the information necessary to identify each new settlement instruction referred to in paragraphs 5 and 9.

Changes that would enable the MT 54n to accommodate these CSDR requirements

- For the Settlement Instruction sent by the Buy-In agent, and the associated one from the Receiving Party, there needs to be :
    - An indication that this settlement instruction is for a buy-in trade
    - A link with cross reference to the original failed instruction
    - Whether the Buy-In period is to be deferred
    - Whether cash compensation is due

- The Receiving Trading Party needs to notify the Failing Trading Party either the **Result of Buy-in**, or, in the case that the Buy-in fails or results in partial settlement then one of the following
    - **Result of partial Buy-in**
    - **Need for cash compensation**
- Options on how this could be done:
    - If a successful Buy-in, then send a copy of the settlement instruction related to the Buy-In to the Failing Party
    - If Buy-in has only partial settlement, then send a replacement MT 502 sent to the Buy-In Agent (to update the original order), and copy to the Failing Trading Party both the MT 502, and the settlement instruction for partial settlement.
    - If Cash Compensation is chosen, then
        - Send a MT 502 (and/or MT509) to Buy-in Agent to cancel original Order
        - Send MT509 direct to the Failing Party in parallel with a Qualifier for the amount of the cash compensation required from the Failing Party.

For discussion !

Status messages inform participants of status of all their instructions

1	2	3	4	5	6	7	8	9	10	11	12

Trade Date (Buy-In)

(Intended) Settlement Date + 5

BROKER 1

BUY-IN AGENT

BROKER 2

Settlement Status for Instruction **1 /11**

Settlement Status for Buy-In Instruction **5**

Settlement Status for Buy-In Instruction **7**

Settlement Status for Instruction **3 / 9**

CSD Participant 1

CSD Participant 3

CSD Participant 2

Settlement Status for Buy-In Instruction **2 / 12**

Settlement Status for Buy-In Instruction **8**

Settlement Status for Instruction **4 / 10**

Settlement Status for Instruction **6**

CSD

21
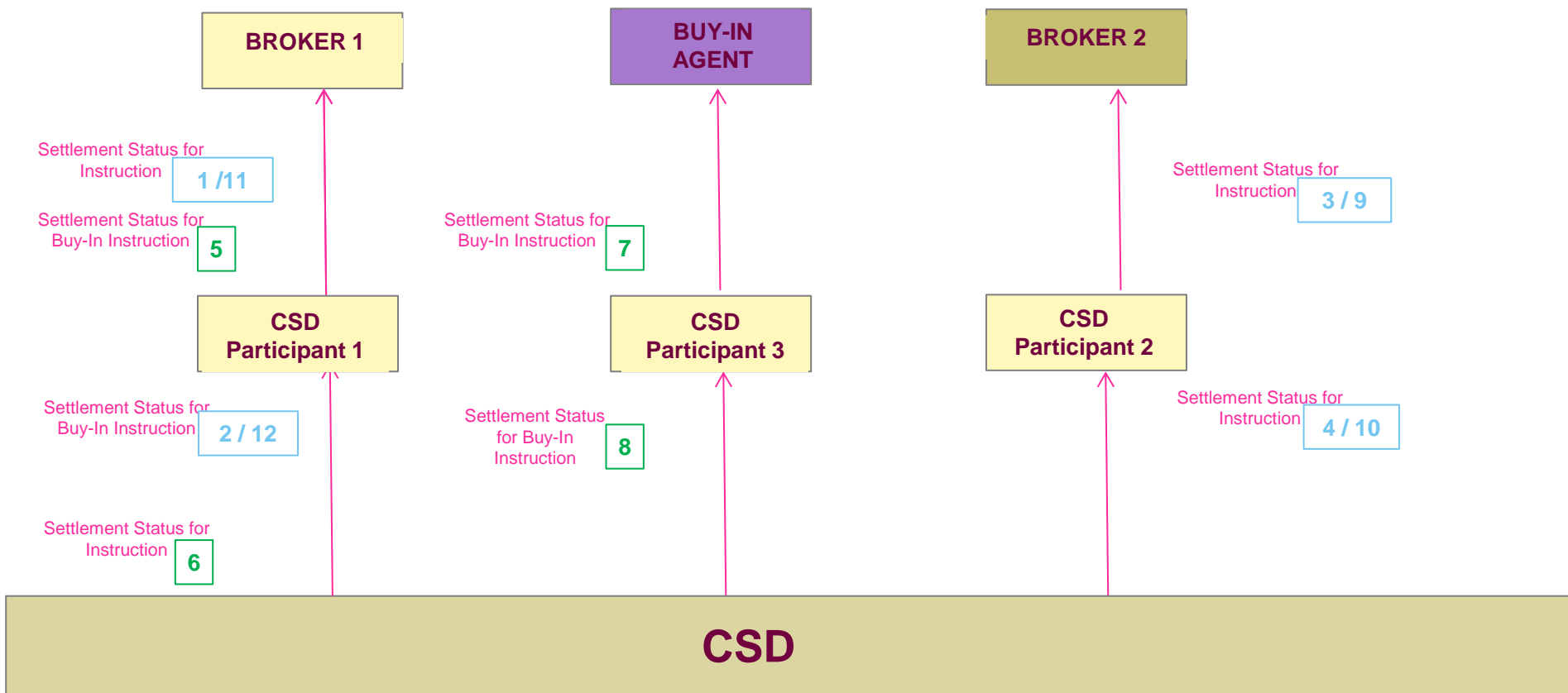
Status messages inform participants of successful settlement

1	2	3	4	5	6	7	8	9	10	11	12

Settlement Date (Buy-In)

(Intended) Settlement Date + 7

BROKER 1

BUY-IN AGENT

BROKER 2

Settlement Status for Instruction **1 /11**

Settlement Status for Buy-In Instruction **5**

Settlement Status for Buy-In Instruction **7**

Settlement Status for Instruction **3 / 9**

CSD Participant 1

CSD Participant 3

CSD Participant 2

Settlement Status for Buy-In Instruction **2 / 12**

Settlement Status for Buy-In Instruction **8**

Settlement Status for Instruction **4 / 10**

Settlement Status for Instruction **6**

The Instructions from the Buy-In Agent match so that the Receiving Party now have the instruments – so the original failed settlement instructions can be cancelled

CSD

22

The original instructions need to be cancelled

ISO IMPACT ASSESSMENT FOR THIS STEP:

Yes (see next slide)

1	2	3	4	5	6	7	8	9	10	11	12

Settlement Date (Buy-In)

(Intended) Settlement Date + 7

BROKER 1

BUY-IN AGENT

BROKER 2

Settlement Instruction *(to Receive from Broker 2 Is Cancelled)* — 1

13

Settlement Instruction *(to Deliver to Broker 1 Is Cancelled)* — 3 / 9

15

CSD Participant 1

CSD Participant 3

CSD Participant 2

Settlement Instruction *(CANCEL)* — 2

14

Settlement Instruction *(CANCEL)* — 4 / 10

16

The original instructions have to be bilaterally cancelled as they were matched

CSD

23

The relevant CSDR requirements

Article 7

A CSD shall set up a bilateral cancellation facility that enables participants to cancel bilateral matched settlement instructions that form part of the same transaction.

Article 9

A CSD shall recycle settlement instructions that have resulted in a settlement fail until they have been settled or bilaterally cancelled.

Article 11

2. A CSD shall provide participants access to real-time information on the status of their settlement instructions in its securities settlement system, and more specifically information on:

(a) pending instructions, which can still settle on ISD;
(b) failed settlement instructions, which cannot settle anymore on ISD;
(c) fully settled settlement instructions;
(d) partially settled settlement instructions, including the settled part and the missing part of either financial instruments or cash;
(e) cancelled settlement instructions, including information whether it is cancelled by the system or by the participant.

Article 31

5.. At the end of each business day on which bought-in financial instruments are received by the receiving trading party, the receiving and failing trading parties shall ensure that the relevant settlement instructions relating to the settlement fail are cancelled and that new settlement instructions are entered into the securities settlement system for the non-delivered financial instruments. Cash penalties shall apply to each new settlement instruction from the day it is entered into the securities settlement system.
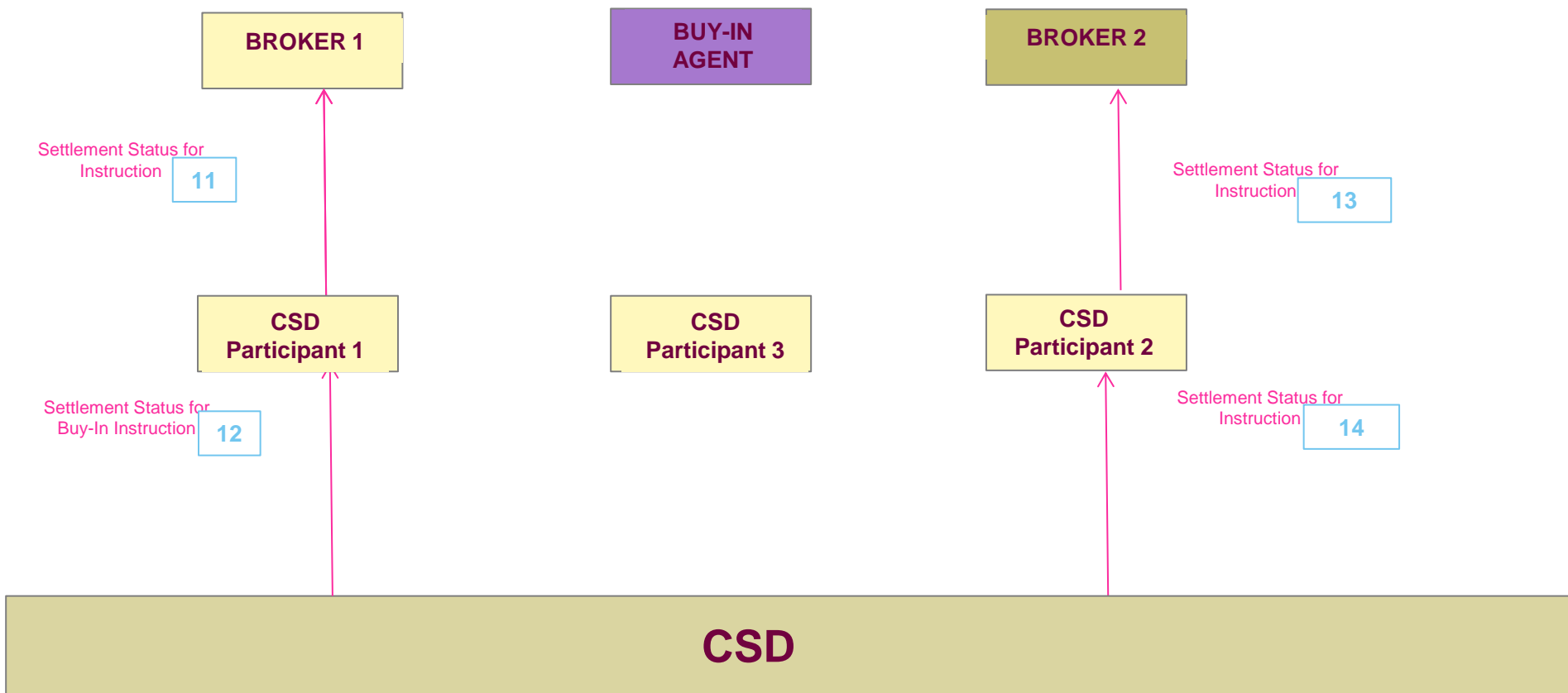
Changes that would enable the MT 54n to accommodate these CSDR requirements

- No changes required – the messages types can already accommodate these requirements – specifically
    - (a) if pending instructions, which can still settle on ISD;
    - (b) if failed settlement instructions, which cannot settle anymore on ISD;
    - (c) if fully settled settlement instructions;
    - (d) if partially settled settlement instructions, including the settled part and the missing part of either financial instruments or cash;
    - (e) if cancelled settlement instructions, including information whether it is cancelled by the system or by the participant.

Status messages to confirm cancellations

1	2	3	4	5	6	7	8	9	10	11	12

Settlement Date (Buy-In)

(Intended) Settlement Date + 7

BROKER 1

BUY-IN AGENT

BROKER 2

Settlement Status for Instruction **11**

Settlement Status for Instruction **13**

CSD Participant 1

CSD Participant 3

CSD Participant 2

Settlement Status for Buy-In Instruction **12**

Settlement Status for Instruction **14**

CSD

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Article 31 in full (Part 1)

CSDR Text	Cross-check
1. On the day referred to in Article 30(1), the receiving trading party shall appoint a buy-in agent and notify the failing trading party.	See slide #12 and #13
2. Prior to the receipt of the notification referred to in paragraph 1, the failing trading party may deliver the financial instruments to the receiving trading party.	
3. Following the receipt of the notification referred to in paragraph 1, the failing trading party may only deliver the financial instruments to the buy-in agent provided the buy-in agent gives its prior consent to the delivery.	Not covered – to be done offline/manually
Following the receipt of a notification referred to in paragraph 1, the failing trading party shall ensure that the relevant settlement instruction relating to the settlement fail is put on hold.	See slide # 14
4. At the latest on the last business day of the applicable period referred to in Article 37, the receiving trading party shall notify the results of the buy-in to the failing trading party.	See slide # 20
5. Where buy-in is successful in part or in full, the notification referred to in paragraph 4 shall indicate the quantity and value of the financial instruments.	
The receiving trading party shall accept the delivery of the financial instruments by the buy-in agent and shall pay the price for the delivered financial instruments subject to the conditions set out in Article 35.	
At the end of each business day on which bought-in financial instruments are received by the receiving trading party, the receiving and failing trading parties shall ensure that the relevant settlement instructions relating to the settlement fail are cancelled and that new settlement instructions are entered into the securities settlement system for the non-delivered financial instruments. Cash penalties shall apply to each new settlement instruction from the day it is entered into the securities settlement system.	See slide # 23
6. On the last business day of the applicable period referred to in Article 37, where the buy-in fails or results in partial settlement, the notification referred to in paragraph 4 shall also indicate whether, for the non-delivered financial instruments, the buy-in shall be deferred or cash compensation shall be due. In the absence of such indication, cash compensation shall be due.	See slide # 20

Article 31 in full (Part 2)

CSDR Text	Cross-check
7. Where the receiving trading party chooses to receive cash compensation, <u>the notification referred to in paragraph 4 shall also indicate the amount of cash compensation</u> corresponding to non-delivered financial instruments that it has determined in accordance with Article 32.	See slide #20
The failing trading party shall pay the cash compensation in accordance with Article 33(3) and both the failing and receiving trading parties shall <u>ensure that the relevant settlement instructions relating to the settlement fail are cancelled upon the payment of the cash compensation or, at the latest, on the second business day after the notification of the amount of cash compensation.</u>	Cash compensation is not covered in this scenario – but will be as in slide #23
8. Where the receiving trading party chooses <u>to defer the execution of the buy-in, the receiving trading party shall notify the results of the buy-in to the failing trading party</u> at the latest on the last business day of the deferral period referred to in Article 38. 9. Where, during the deferral period referred to in Article 38, the buy-in results in partial or full settlement, the <u>notification referred to in paragraph 8 shall indicate all information referred to in paragraph 5</u>, and the receiving trading party, and failing trading party as applicable, shall proceed in accordance with paragraph 5 with respect to the bought-in financial instruments and each relevant settlement instruction.	See slide #20
10. On the last business day of the deferral period referred to in Article 38, where the buy-in fails or is only partly successful, the <u>notification referred to in paragraph 8 shall indicate the amount of the cash compensation</u> for non-delivered financial instruments that the receiving trading party has determined in accordance with Article 32. <u>The failing trading party shall pay the cash compensation</u> in accordance with Article 33(3) and both the failing and receiving trading parties shall ensure that the relevant settlement instructions relating to the settlement fail are cancelled upon the payment of the cash compensation or, at the latest, on the second business day after the notification of the amount of cash compensation.	Cash compensation is not covered in this scenario – assume a standard payment message
11. <u>The receiving trading party shall ensure that the CSD receives the information</u> notified pursuant to paragraphs 4 and 8 and the information necessary to identify each new settlement instruction referred to in paragraphs 5 and 9.	See slide #18

Conclusion

To ensure updates to the ISO Standards are included in the Standards Release November 2018 the following steps need to be followed:

1. Updates to the ISO Standard need to be consolidated and presented as a CSDR Change Request to the Working Groups for approval prior to June 2017

2. SWIFT to model and finalise the details of changes resulting from this change request between June and August 2017