

REPORT OF THE TASK FORCE ON ADAPTATION TO CROSS-CSD SETTLEMENT IN T2S (TFAX)

- COVER NOTE -

1. Scope of the TFAX analysis

The Task Force on Adaptation to Cross-CSD Settlement in T2S (TFAX) was launched as a sub-group of the Advisory Group (AG) in September 2011 with the mandate to “Define and document common solutions for adaptation to cross-CSD settlement in T2S based on the available T2S functionality as described in the URD and other T2S scope defining documents, with the aim of increasing the efficiency of cross-CSD settlement for the CSDs and their participants on a non-discriminatory basis.”¹

Eight issues were selected for analysis by the TFAX. Following the initial analysis, two mini-consultations were conducted with the NUGs to verify the initial insights of the TFAX and to get additional input.

In the course of the analysis, it became clear that one key issue constitutes the core of most topics under analysis: how to transmit and store information that is required for various procedures and practices interacting with settlement. This topic is relevant not only for the issues in scope of the TFAX but relates to a wider range of potential issues, which CSDs and CSD participants might have to face during their adaptation process. Consequently, the TFAX examined the issue of transmission and maintenance of information from a generic perspective, specifically the potential use of T2S messages to pass additional details through the settlement chain as well as the use and impacts of account segregation in a cross-CSD context.

¹ Mandate of the Task Force on Adaptation to Cross-CSD Settlement in T2S, approved by the AG in September 2011.

2. TFAX findings and recommendations

The TFAX analysis resulted in a set of findings and recommendations for each of the issues. The report details the analysis and findings as well as recommendations of the TFAX. In the context of the analysis additional issues, which go beyond the technical or process-based considerations, were detected. Therefore, the TFAX has complemented some of its recommendations by invitations to the HSG to follow up on the respective issues.

The report is structured into two parts: In the first part the issues related to the transmission and maintenance of information are examined. Within this section, the generic analysis is presented first, followed by the relevant TFAX issues. The second part deals with the remaining issues in scope of the TFAX's analysis. For each issue the section "TFAX findings and recommendations" summarises the main points and recommendations of the respective issue.

For a comprehensive summary of all TFAX recommendations please refer to the annex of this cover note.

3. Conclusion and outlook

Taking everything into account, the TFAX has achieved its mandate i.e. it has selected and prioritised a set of issues, defined common solutions for adaptation to T2S for these issues, and verified the applicability of these solutions by means of a mini-consultation with the NUGs. No Change Requests were raised as a result of the TFAX.

The TFAX would like to point out that the assessment of message fields and their harmonised use could not fully be completed based on the current stage of the market's adaptation process. Similarly, the TFAX would like to highlight there might be a number of new issues occurring as a result of the market's adaptation process. The T2S set-up allows for flexibility in the adaptation process, therefore market participants have to make choices when it comes to the implementation of their processes and practices with T2S. As of today there are many discussion forums at the level of local markets, but no discussion forum at a cross-CSD level, which considers the broader implications of CSDs' and their participants' adaptation to T2S. Nevertheless, decisions made at a local level on the use of T2S functionality may impact other CSDs and CSD Participants. While these decisions might be justified at national level and supported by the local market, they might cause complexities and barriers for cross-border business. Therefore, such choices need to be made in a harmonised way across market, while taking into account the specific processes impacted.

The TFAX considers it crucial that markets comply with the recommendations included in this report. By adhering to the TFAX recommendations, market participants can help to diminish or mitigate issues in the context of cross-CSD settlement. Therefore, the TFAX sees the need for one or several T2S substructures to follow-up on its work. These T2S substructures should a) monitor the market's compliance with the TFAX recommendations in its adaptation to T2S, and b) identify and analyse new cross-CSD settlement issues arising in the context of adaptation to T2S, including the follow-up on the potential issue of message fields population.

4. Annex: Comprehensive list of TFAX recommendations

Topic	Recommendation
Transmission and maintenance of information in a cross-CSD context	The TFAX recommends not using T2S settlement messages to pass on additional details through the settlement chain. Additional information requirements should be handled outside T2S.
Transmission and maintenance of information in a cross-CSD context	The TFAX recommends minimising account segregation, in particular at the higher levels of the settlement chain (e.g. issuer CSD level). Account segregation that needs to be propagated through the settlement chain should be avoided. If account segregation is required, this should be implemented at the lowest possible level of the settlement chain. However, investor and issuer CSDs should be free to offer their participants the possibility to operate segregated accounts on a voluntary basis.
Registration processing	Under current conditions (e.g. unharmonised information requirements and T2S specification) the TFAX recommends not to use T2S settlement messages as a means of passing registration details.
Registration processing	The TFAX recommends that account segregation for the purpose of registration, which needs to be propagated throughout the settlement chain, should be avoided.
Registration processing	<p>The TFAX therefore invites the HSG to discuss other potential solutions of legal/regulatory nature - which go beyond the above technical or process-based approaches.</p> <p>The TFAX has identified the following non-exhaustive potential solutions: (1) the possibility of nominee registration, (2) linking the transfer of rights to settlement such that there is no post-settlement event questioning the transfer of rights, and (3) to abandon transaction-by-transaction registration completely. All of these options would aim at further integration of registration and settlement as a means of ensuring the realignment of both processes.</p>
Tax processing	Based on current conditions, the TFAX recommends that the tax related information for domestic and cross-CSD transactions is not passed via T2S settlement messages for both domestic and cross-CSD settlement.
Tax processing	The TFAX recommends avoiding account segregation as a mechanism to support tax processing.

Tax processing	The TFAX invites the HSG to monitor the harmonisation of European tax regulations related to settlement.
Tax processing	The TFAX recommends that trade-related taxes should not be collected at settlement level. If this cannot be avoided, then this should be done in a harmonised manner across markets in order to prevent detrimental impact on cross-CSD settlement.
Portfolio Transfers	Since matching is mandatory for T2S settlement, the TFAX recommends that settlement instructions related to portfolio transfers should be sent to T2S as “to be matched” instructions or “already matched” instructions.
Portfolio Transfers	The TFAX recommends that information on portfolio transfers should be passed outside T2S (scenario 2). Whether scenario 2 is implemented as variant a) information is exchanged between the custodians directly or b) information is passed through the CSD(s), e.g. by means of a tax application provided by the CSD, depends on the CSDs and their choice whether or not to offer the particular service.
Portfolio Transfers	The TFAX recommends that the information required by the receiving custodians should be harmonised to the extent possible to ensure smooth cross-CSD settlement.
Portfolio Transfers	The TFAX invites the HSG to follow up on the harmonisation of information requirements and related message fields for portfolio transfers.
Bond stripping and reconstitution	When the bond stripping process is handled by the CSD via standard settlement messages, the TFAX recommends that T2S allegation messages should be used to trigger the validations required for bond stripping and reconstitution (option 3).
Bond stripping and reconstitution	The TFAX recommends removing restrictions on the location of primary and recognised dealers’ securities accounts i.e. primary dealers should be free to choose the CSD of their preference.
Non-standardised securities	<p>The TFAX recommends that non-standardised securities (as defined for this document), should be eliminated over time in order to avoid the implementation of additional complexities in the settlement chain, preferably before T2S Go-Live.</p> <p>For those non-standardised securities that need to be handled in T2S, either CSD Validation Hold (option 1) is to be applied, or instruction needs to take place indirectly via the CSD (option 2).</p>

	The TFAX invites the HSG to follow up on this matter.
CSD Ancillary Services (Classic Repo)	The TFAX recommends that participants should use 'Common Trade Reference' in the ISO20022 message SecuritiesSettlementTransactionInstruction (sese.023) in order to avoid the risk of matching a Repo transaction with other types of transactions (e.g. a trade related transaction).
CSD Ancillary Services (Tri-party Repo)	The TFAX recommends that it should be up to the agent and its client to determine the need for segregation and the appropriate segregation method (i.e. the use of accounts or position segregation such as earmarking and blocking in T2S).
CSD Ancillary Services (Tri-party Repo)	When segregation is used, the TFAX recommends that earmarked and blocked positions should be named in a uniform way across markets, so that the agents can process the collateral in a seamless way in a cross-CSD repo transaction.
CSD Ancillary Services (Securities Lending and Borrowing)	When segregation is used, the TFAX recommends that this should be done in a uniform way across markets, so that the agents could process the securities lending in a seamless way in cross-CSD transactions.
CCP instructions	The TFAX recommends that all markets should recognise the PoAs granted by CMs to their CCPs. In order to allow for the PoA concept to be effective, CSDs should set up privileges on T2S securities accounts based on the request of their participants (the CCPs' CMs).
CCP instructions	The TFAX recommends that there should be no segregation of accounts based on OTC and on-exchange trades on a mandatory basis.
CCP instructions	The TFAX recommends that trading venues, CCPs, CSDs and regulators should not impose any dependency between the locations of securities account of CMs and CCPs (or settlement agents). The CMs and CCPs (or settlement agents) should be allowed to open securities accounts in the CSD of their choice in order to be able to receive/offer CCP services.
Issuance Practices	The TFAX comes to the conclusion that from a T2S and cross-CSD perspective no issues are apparent in the context of issuance.
Message Fields	The TFAX invites the HSG to re-conduct the survey on message fields with the markets in order to be able to fully gauge the impact in the second quarter of 2013.