

# The impact of T+2 settlement on the European repo market

## A report by the ICMA European Repo Council's Operations Group

### 1 Executive summary

- 1.1 Most European exchanges will anticipate the Central Securities Depository Regulation (CSDR) by adopting a 'standard' settlement date of two business days after the transaction date (T+2) for cash market transactions on 6 October 2014, which is in advance of the official deadline. Although the OTC fixed-income market is exempt, AFME, ICMA and ISLA have decided that the OTC markets they represent should follow suit, with the 'standard' settlement date (ie the earliest date which parties can reasonably insist on delivery) for OTC cash transactions moving to T+2 and SFTs to T+1.
- 1.2 Earlier settlement will narrow the window within which the repo market has to fund most cash transactions from three to two days. Unexpected cash and securities positions will have to be covered same day, adding to the volume of overnight repos. Funding and short-covering requirements will therefore fluctuate widely during the day before the settlement date (SD-1), making **cash forecasting and position management** more challenging. This will mean more frequent resort to credit lines and more urgent securities borrowing, which may be reflected in increased **fails** and **specialness**. Increased fails will in turn complicate cash management. Late demand to borrow securities could cause disruption in the market.
- 1.3 There is a risk of an incomplete and uncertain switch to T+2 in cash and T+1 in SFTs leading to the **fragmentation of trading** in the same asset and **confusion** about agreed settlement dates leading to disputes. Confusion about settlement date may result in mismatches between the receipt and delivery of securities that needs to be financed or covered, while frequent amendments of settlement instructions will impose additional settlement costs.
- 1.4 Should inefficiencies in the post-trade infrastructure, and in firms' systems and processes, result in a build-up of failed deliveries, investors might be dissuaded from lending securities for fear of them not being returned, which would damage **market liquidity**. This could be exacerbated if backlogs in settlement could put a brake on the ability of particular firms to continue trading.
- 1.5 The expected shift in trading from tom/next to **overnight repos** for managing unexpected cash and securities positions has implications for the resourcing and cost of post-trade management. Higher volumes of overnight repos would be greatly facilitated by the deadline for settlement of overnight GC at LCH.Clearent being delayed and (I)CSDs extending cut-off times.
- 1.6 Earlier settlement will mean that banks have one day less to (1) confirm/affirm transactions, (2) instruct settlement, (3) match instructions within the relevant (I)CSD and (4) correct any mistakes that are discovered. With one day less to process trades, it becomes ever more important that **confirmation/affirmation** and **settlement instruction** take place early on the transaction date, especially where there is a cross-border chain of multiple settlement intermediaries. The practice of using settlement matching at (I)CSDs as a cheap substitute for confirmation/affirmation in identifying problem trades will no longer be possible.

- 1.7 The compression of post-trade activity into a narrower window will intensify pressure on **inventory/collateral management** and **liquidity management** at banks. Any pre-settlement post-trade processes requiring **manual intervention** will make it difficult to meet early settlement deadlines. Fails and overdrafts could therefore increase, especially in the immediate aftermath of the switch.
- 1.8 Firms suffering particularly serious backlogs of unsettled transactions would have to absorb the **expense** of clearing back logs and the damage to their **reputations**.
- 1.9 Transactions with **Asian** counterparties or in Asian collateral will pose particular challenges, given the late and narrow overlap with European trading hours and the short window on payment cycles in Asian currencies in CLS.
- 1.10 **Automation** is the long-term key to efficient settlement within shorter time periods. However, to deal with the immediate challenges of earlier settlement, greater resources will have to be applied to post-trade processes, at least until the switch-over has been bedded down. Firms need urgently to assess the adequacy of their operational capacity, giving priority to key processes.
- 1.11 Earlier settlement is not expected to cause serious problems for **CCPs** or **(I)CSDs**, as they are used to T+1. Unfortunately, CCPs are taking divergent approaches to netting across the switch-over, which may require manual intervention by clearing members and could have funding and margining impacts.
- 1.12 A reduction in the time to instruct (I)CSDs will shift the average **timing of settlement** to daylight real-time cycles on the ISD and optional end-of-day settlement cycles, which may add to liquidity requirements as well as the cost and complexity of settlement.
- 1.13 **Settlement matching** will be delayed from ISD-1. It is therefore important that (I)CSDs and custodians provide status updates as promptly and frequently as possible throughout the trade lifecycle. They should also consider increasing the frequency of settlement cycles to facilitate instruction repairs. There is a risk of higher claims for late settlement, increased use of credit lines with agent banks and (I)CSDs,.
- 1.14 There is an urgent need for the repo market to agree on earlier **notification deadlines** for substitutions or terminations.
- 1.15 Post-settlement, efficient **fails management** will become more crucial, particularly given the penalty regimes already in place in some markets.
- 1.16 It is possible that volume in the repo market might dip sharply on Monday, 6 October, as the settlement convention switches.
- 1.17 Various recommendations for action by ICMA ERC are made.

## 2 Introduction

- 2.1 The EU Central Securities Depository Regulation (CSDR), which was adopted on 15 April 2014, will impose a harmonised 'standard' settlement date within the European Economic Area (EEA) of two business days after the transaction date (T+2) for transferable securities, money-market instruments, units in collective investment undertakings (UCITS) and emission allowances and, for the start leg of SFTs, a settlement date no later than T+2 (ie T+0 and T+1 would be allowed). Currently, the 'standard' settlement date for cash transactions in OTC fixed-income securities --

which means the earliest date on which parties can reasonably insist on delivery or the last non-forward settlement date --- is generally T+3, although parties often agree to settle earlier.<sup>1 2</sup> For repo, the 'standard' settlement date in euro-denominated collateral is T+2, with significant volumes also settling at T+0 and T+1.

2.2 The CSDR applies to the settlement of **transferable securities** that have been executed on **trading venues**<sup>3</sup>. 'Transferable securities' and 'trading venues' are categories defined in MiFID/MiFIR II. Trading venues are categorized as:

- **regulated markets**
- **multilateral trading facilities (MTFs)**
- **organized trading facilities (OTFs)**<sup>4</sup>

Trading venues include regulated markets like MTS Repo and MTFs like BrokerTec. Therefore, OTC repo is limited to direct and voice-brokered repos.

2.3 There are two exemptions from the CSDR requirement for T+2 settlement:

- transactions negotiated 'privately' but executed on trading venues
- transactions executed bilaterally but reported to a trading venue.

These exemptions would seem to apply only to voice-brokered transactions logged onto electronic trading platforms.

2.4 The CSDR mandates a deadline for the switch to T+2 for all T2S-settled markets of the earlier of (1) six months before migration to T2S or (2) 1 January 2016. Non-T2S EEA markets (eg the UK) have to switch by 1 January 2016.

2.5 European equity exchanges have voluntarily decided to switch to T+2 ahead of the CSDR deadline. The chosen date is 6 October 2014. Most European financial market infrastructures, including (I)CSDs and CCPs, have announced that they will follow suit. This means that trades executed on 3 and 6 October will have the same intended settlement date (ISD) of 8 October (see below). The most significant opt-outs are the Spanish exchanges, which plan to switch in Q4 2015. However, Iberclear, the Spanish central securities depository (CSD), has advised that the settlement cycle for fixed income trades booked on ATS (SENAF, BrokerTec and EuroMTS) and settled through

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<sup>1</sup> In OTC fixed-income markets, cash and securities financing transactions (SFTs), securities can be traded for settlement on any day in the future. However, beyond a certain horizon, settlement is considered to be 'forward'. At the moment, the forward horizon is generally T+3 for euro-denominated cash transactions and T+2 for repos. The majority of transactions settle on these dates. For this reason, the ICMA *Guide to Best Practice in the European Repo Market* refers to these settlement dates as the 'earliest conventional' settlement dates. Others call these dates the 'standard' settlement dates. In academic terms, the earliest conventional settlement date involves the payment or exchange of present values (whereas forwards involve future values). In practice, it is often possible to settle earlier than the earliest conventional settlement date by agreement with a counterparty, either same-day (T+0), next-day (T+1) or, in the case of cash transactions, spot value (T+2).

<sup>2</sup> Three European countries currently settle equities at T+2: Germany, Slovenia and Bulgaria.

<sup>3</sup> Currently it is unclear whether this will apply to repo trades executed on trading venues for settlement longer than T+2. While securities financing transactions are not explicitly listed in Article 5 of CSDR as being in scope of T+2, they are mentioned in Recital 13 of the regulation, which refers to Article 5. Trading venues currently support trading in forward markets for repos, and it is hoped that this will not be affected by the regulation. In light of this, ICMA and ISLA have written to the Commission requesting clarification on the treatment of forward repos negotiated and executed on trading venues.

<sup>4</sup> OTFs are more informal trading venues than regulated markets or MTFs, and involve execution on a discretionary basis, eg negotiation may be possible to improve the terms. OTFs include derivatives trading platforms, broker crossing systems and matched principal trading. They are limited to bonds, structured finance products, emission allowances and derivatives.

CADE will change to T+2 as of 6 October 2014. The change will affect the settlement of both private and public debt trades.<sup>5</sup>

- 2.6 ICMA and AFME are recommending that their members in the OTC fixed-income cash market (including Spanish firms) also switch to T+2 on 6 October. ICMA is amending its Secondary Market Rules 221 and 222 accordingly<sup>6</sup>. However, parties in the OTC market are still free to agree to settle some or all OTC transactions at T+3<sup>7</sup>.
- 2.7 OTC markets in some types of fixed-income asset are unlikely to be able to switch to T+2. For example, US dollar high yield debt securities are frequently converted between Reg.144a and Reg.S status as they are moved between the DTCC and the ICSDs. This process takes 3-5 days, making T+2 delivery impracticable. It is also possible that convertible bonds will continue to settle at T+3.
- 2.8 The ICMA ERC and ISLA believe that, when the 'standard' or earliest conventional settlement date in the cash market moves to T+2, then the 'standard' or earliest conventional settlement date for repo and securities lending will have to move to T+1. This is because the cash positions that need to be financed and the securities positions that need to be covered in the SFT markets are only known after close of business on the cash market transaction date (T). This leaves just one business day before settlement of cash trades at T+2. Therefore, most SFTs would need to settle at T+1.
- 2.9 To avoid confusion and fragmentation in European repo, the ICMA ERC believes there should be a co-ordinated switch by the market on the same day as the cash market (6 October 2014).

### **3 Trading and market liquidity**

- 3.1 There would seem likely to be three principal market impacts.
  - There is likely to be a shift in trading from tom/next to overnight repos, which has implications for the resourcing and cost of post-trade management.
  - The risk of an incomplete and uncertain switch to T+2 in cash and T+1 in SFTs leading to the fragmentation of trading in the same asset and confusion about agreed settlement dates leading to disputes, both of which would damage liquidity and entail extra cost.
  - A major build-up of failed deliveries would damage market liquidity by dissuading investors from lending securities for fear of them not being returned and could put a brake on the ability of badly affected firms to continue trading.
- 3.2 Earlier settlement will narrow the window within which the repo market has to fund cash transactions. Unexpected cash and securities positions will have to be covered same day, adding to the volume of overnight repos. Funding and short-covering requirements will therefore fluctuate widely during the day before the settlement date (SD-1), making cash forecasting and position management more challenging. This will mean more frequent resort to credit lines and more urgent securities borrowing, which may be reflected in increased fails and specialness. Increased fails would in turn

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<sup>5</sup> On the other hand, the settlement lifecycle of fixed-income trades settling through the SCLV platform will not change in October 2014. It has not been clarified yet whether the shorter settlement cycle will apply to the primary market. The settlement lifecycle of equities is expected to change in Q4 2015, after the implementation of the Spanish Market Reform.

<sup>6</sup> Refer to members' circular no. 4 of July 2014

<sup>7</sup> It is expected that agreement between two parties in the OTC market who wish to settle on a different settlement date than T+2 will be recorded, in writing, at the time of trade

complicate cash management. Late demand to borrow securities could cause disruption in the market.

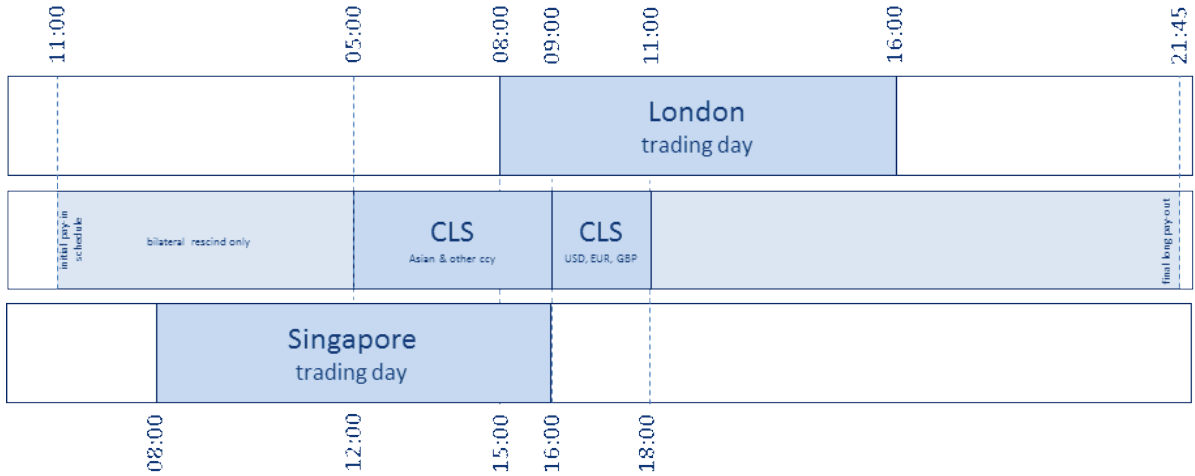
- 3.3 **Overnight repo** is likely to become more important and replace many of the tom/next transactions currently used to absorb unexpected cash and securities positions. This is because, although the bulk of the financing and short-covering requirements for each day's cash trades are filled with next-day repos transacted on the day after such trades (T+1 in the cash market), unexpected cash surpluses or deficits and unexpected long or short securities positions will inevitably arise on T+1. With only one day to cash settlement, these will need to be financed or covered with overnight repos. Overnight repo for late position management will add to the existing overnight volume generated by money market mutual funds, etc.
- 3.4 Given that the financing and short-covering of all unexpected positions will have to take place on one day, and with greater urgency, there may be wider fluctuations in overnight flows and higher volatility in the overnight repo rate, at least in the immediate post-changeover period.
- 3.5 The switch to T+2 for cash and T+1 for repo may fragment trading in the same asset between competing dates and cause confusion between counterparties about settlement dates:
- Customer repos which settle for **corporate value date**, which is currently T+3, should logically shift to T+2. However, some customers may be unaware of the impending switch and even those who are aware may take time to re-organise their operations. In the interim, they would continue to ask for T+3 corporate value dates, even as other customers may be moving to T+2. So, for a time, there could be two different corporate value dates in operation at the same time! Confusion about settlement date may also result in the discovery that the counterparty on one side of matched cash transactions cannot settle at T+2, requiring the amendment of the settlement instructions and creating a mismatch between the receipt and delivery of securities that needs to be financed or covered. Frequent amendments will impose additional settlement costs.
  - In the **Spanish market**, there may be confusion because of the variable response to T+2 (ie the fact that Iberclear's CADE platform is switching on 6 October but its SCLV platform is not).
  - **Time zone differences**, for both Asian collateral trading by European investors and European collateral traded by Asian investors, mean narrow windows of communication between parties to initiate post-trade processes such as confirmation/affirmation and instruction of settlement (see 4.2 below). These problems may cause cross-border markets to continue to settle cash at T+3 and repo at T+2. Or it may force parties to extend back office hours, increasing the cost of such transactions.
- 3.6 The switch to T+2 for cash and T+1 for repo will logically require corresponding changes in the **FX market**. Thus, cross-currency repo settling at T+1 will require value-tomorrow exchange rates and FX swaps with a next-day front leg. In addition, if spot FX transactions fail that have been arranged for T+2 cash trades in foreign securities for domestic clients or in domestic securities for foreign clients, there will only be one day to settle replacement FX transactions, in other words, these will also have to be for value tomorrow.
- 3.7 If the potential for confusion is realized or if any of the post-trade stresses discussed below should materialise, an increase in the demand for late funding and securities borrowing can be expected over the immediate post-changeover period. In some markets, firms could also be hit by fail penalties and mandatory buy-ins. The risk may

cause banks to avoid or reduce activity in these markets for a few days after the switch, reducing **market liquidity** and increasing price volatility.

- 3.8 Market liquidity could also be damaged by a build-up of failed deliveries, as investors might be dissuaded from lending securities for fear of them not being returned. If problems were concentrated at particular firms, they might not be able to continue trading so actively in the face of a backlog of unsettled trades, which would further sap market liquidity, as well as posing reputational risk.
- 3.9 It is possible that the difficulty and extra cost of settling cash trades at T+2 and repos at T+1 may cause market users to re-allocate some activity away from markets subject to the CSDR settlement requirement over the medium term. In other words, business may migrate out of MTFs and OTFs, and into the **OTC markets**. But it is difficult to gauge whether such an incentive is, on its own, sufficient to drive a significant strategic shift in activity.
- 3.10 A faster settlement time should also make **tri-party repo** more attractive for customers, given the convenience of delegating to an (I)CSD. However, such an impact is likely to be difficult to distinguish from the effect of other evolutionary forces. Given the operational requirements of setting up tri-party relationships, any migration would tend to be longer-term.

**4 Post-trade operations (pre-settlement)**

- 4.1 Cash settlement at T+2 and repo settlement at T+1 will mean that banks will have less time to (1) confirm and affirm transactions, (2) instruct settlement, (3) match instructions within the relevant (I)CSD and (4) correct any mistakes that are discovered.
- 4.2 The compression of the pre-settlement period makes it even more important for all market users, especially customers, to implement the best practices of early **confirmation/affirmation** and **instruction** of custodians and (I)CSDs on the transaction date rather than T+1. The need for urgency will be even greater where instructions have to be passed along a cross-border chain of multiple intermediaries. Early confirmation/affirmation and instruction will also be particularly challenging for Asian counterparties/customers, given that their overlap with European trading hours is narrow and late in their day.



- 4.3 In the past, the need for prompt and efficient confirmation/affirmation could be avoided by relying on settlement matching and the reporting of allegations by (I)CSDs to identify errors and misunderstandings in trade execution and capture. And the longer settlement period allowed exceptions processing to be used as a routine method of resolving mismatches in instructions. After the switch, the loss of a day will mean that exceptions processing will have to be focused on true exceptions.
- 4.4 Early confirmation/affirmation is also the only practicable way of satisfying CSDR requirements that transactions should be confirmed on the date of receipt of an order from a customer; that agents promptly allocate to clients no later than the end of the trade day; and that the receipt of confirmations, affirmations or rejections is timely.
- 4.5 Any pre-settlement post-trade processes requiring **manual intervention** will clearly make it difficult to meet early settlement deadlines. This includes exceptions processing, given that dealing with allegations is heavily reliant on key individuals, including front office personnel. Amendments, trade repairs and pair-offs are also very manual. And where there continues to be a need for the realignment of government bonds to domestic CSDs and where those CSDs continue to suffer interconnectivity problems with ICSDs, T+1 may not allow enough time, given that realignment is a complex and time-consuming largely manual process. This could mean more fails and more collateral having to be pre-deposited at (I)CSDs, at least until T2S is operational.
- 4.6 The compression of post-trade activity into a narrower window will intensify pressure on **inventory/collateral management** at banks. Particular problems may arise during the immediate post-switch period, as banks have to cope with disruptions and adjust to changes in counterparties' delivery behavior. Fails and overdrafts could increase. There could also be knock-on effects between market segments, eg there may be a higher rate of substitution in tri-party repo in response to increased collateral movements elsewhere.
- 4.7 Pressure will become especially intense on **liquidity management** as there will be less time to fund unexpected deficits. Liquidity forecasting will be complicated by cross-currency repos, as it is necessary to take into account the time to execute FX orders and payment cycles in CLS.
- 4.8 The increase in **overnight repos** will bring operational challenges for banks, as there will be little time for correcting errors that prevent settlement. Although banks already transact overnight repos, a significant increase in volume may stretch systems and processes. Evidence from the ICMA ERC paper to the Cogesi Joint Group on Efficient Settlement in Commercial Bank Money suggests that high volumes of overnight (and same-day term) transactions tend to be reflected in earlier internal cut-off times within banks. If internal cut-offs are not to start regressing back to earlier times (reversing the progress made in recent years), banks will require much faster, if not real-time, treasury and bond management. They would be assisted if the deadline for settlement of overnight GC at LCH.Clearnet was delayed from the current time (10:30 CET for German collateral and 11:30 CET for other euro collateral) and if (I)CSDs were able to extend cut-off times.
- 4.9 In order to achieve high levels of settlement efficiency under earlier deadlines, further **automation** will be required right along the settlement chain. Automation of confirmation/affirmation is needed to build a clear audit trail. These are longer-term responses, but the opportunity should be taken to implement solutions that will allow even further compression of the settlement period (towards T+0) in the future.

- 4.10 To deal with the immediate challenges of earlier settlement, plans should be made to apply greater **resources** to post-trade processes over the switch and in the immediate aftermath. Not to do so could prove a false economy, as emergency remediation costs are likely to be more expensive in time, resources and the distraction of management, possibly adding to fails penalties and auto-borrowing costs.

## 5 Clearing and settlement

- 5.1 The bulk of European repo transactions are cleared across **CCPs**. T+2 for cash settlement and T+1 for repo settlement are not expected to cause serious problems for CCPs. Several already settle T+1 and T+2. Unfortunately, CCPs are taking divergent approaches to netting across the switch. Some are netting trades executed on Friday 3 and Monday 6 October into a single settlement instruction for the ISD on Wednesday 8 October. Others are splitting netting into two separate settlements. This last approach may require manual reconciliation by clearing members and, if the overall efficiency of netting is reduced, could have funding and margining impacts.
- 5.2 The European Central Securities Depositories Association (ECSDA) believes that T+2 will have minimal direct impact on their members, given that **(I)CSDs** already settle shorter settlement periods (T+0 and T+1).
- 5.3 For the member firms of (I)CSDs, on the other hand, there will be a shorter window to complete internal processes and co-ordinate externally with counterparties, customers, settlement and payments agents and CCPs. A reduction in the time to instruct (I)CSDs will shift the average **timing of settlement**. Fewer trades are likely to make it into overnight batch-processing cycles, which means that more repo trades will have to be settled in daylight real-time cycles on the ISD. This may increase liquidity requirements. There is also likely to be greater use of optional (bilaterally agreed) end-of-day settlement cycles, such as those available at the ICSDs, on ISD-1. Use of optional settlement cycles is a manually-intensive process for banks and will add to the cost and complexity of settlement.
- 5.4 Heavier settlement on ISD will make accurate **end-of-day funding** a more challenging objective. Funding and covering requirements can fluctuate significantly during the day. Liquidity/treasury and inventory/collateral desks at banks will need to analyse feedback from (I)CSDs as soon as possible and, as mentioned already, they will need this feedback early and promptly, preferably real-time. The increased difficulty of end-of-day funding may mean that, over the transition period, there is a risk of higher claims for funding late settlement.
- 5.5 As more repo trades will be settled real-time on ISD, so **settlement matching** will be delayed from ISD-1. This means a shorter window to correct any unmatched instructions and more pressure on operational resources. It is therefore important that (I)CSDs and custodians provide status updates as promptly and frequently as possible throughout the trade lifecycle, preferably real-time, so that any matching or positioning issues can be identified in a timely manner. (I)CSDs should also consider providing more opportunities to repair unmatched trades by increasing the frequency of cycles in both batch-processing and quasi real-time settlement windows to as close to real-time as possible.
- 5.6 An increase in **unmatched trades** on ISD with Asian counterparties/customers is expected, as those trading outside European trading hours will have less time to instruct, especially where there are cross-border chains of global custodians and sub-custodians. Smaller European buy-side clients also present a challenge, given the generally low level of automation and disparate types of business.



- 5.7 More settlement matching on ISD and later notice of unmatched instructions will also reduce the window of opportunity to **borrow securities**. The concentration of demand into a shorter period has the potential to increase fails, particularly during the immediate post-switch period, when lenders may be reluctant to risk failed returns and recalls. This could increase resort to credit lines with agent banks and (I)CSDs, which therefore need to be re-assessed and monitored carefully. Higher fail rates may also increase the amount of auto-borrowing at the (I)CSDs that offer this facility, which would be another extra expense.

## 6 Post-trade operations (post-settlement)

- 6.1 In order to give adequate time for settlement instructions to be processed and executed, there is an urgent need for the market to agree on earlier **notification deadlines** for substitutions or terminations --- of open repos and in response to fails, income events under the Equity Annex and tax events (and, in the case of securities lending, for recalls or returns of securities loans). The current convention of 16:00 (CET) in the eurozone market for the notification of repo substitutions and terminations (and for recalls/returns of securities loans) --- which is for the return of securities two business days after the notice (T+2) --- will no longer be appropriate. In the case of repos, the period for the return of securities will need to be aligned with the shorter standard settlement period of T+1, ie the next business day. In order to provide enough time to the recipient of a notice to respond and deliver on the next business day, the notification deadline in the repo market needs to be advanced to **12:00pm**, ie noon, on the notice day. The deadline for closing open repos with the Asian market (generally 17:00 BST/GMT) also needs to be earlier.
- 6.2 It is not clear that T+2 will cause general problems for **corporate actions** on equity or corporate bond collateral. There is no need to change notice periods for corporate actions (only consequent settlements, if any, need to be accelerated).
- 6.3 T+1 settlement for most repos may put pressure on **substitution** in repos and securities lending outside tri-party, given the market practice of pre-delivery of the substitute collateral. Either the substitute is delivered T+0 in order to allow the equivalent securities to be returned on T+1, or the substitute is delivered T+1 and the equivalent securities are returned on T+2. In practice, however, substitution is not widespread outside tri-party repo, so this should not be a material problem.
- 6.4 Given the probable increase in fails following the switch to T+2, efficient **fails management** will become more crucial in order to maintain market integrity and avoid the incurring of extra costs. Although low interest rates reduce the implicit penalties on failure to deliver in the repo market, there are regimes in place in a number of countries that impose fines and buy-in penalties for fails. Consideration should therefore be given, in advance, to the efficient management of fines and buy-in penalties. This is of particular importance for customer business, where an intermediary is not in full control of settlement but will be responsible for fines levied by CSDs or others in respect of late deliveries.

## 7 Transition

7.1 Most markets and CCPs have announced the timetable for transition set out in the table below.

trades on	Fri 3 Oct	Sat 4 Oct	Sun 5 Oct	Mon 6 Oct	Tue 7 Oct	Wed 8 Oct	Thu 9 Oct
3 Oct	T			T+1	T+2	T+3 = S	
6 Oct				T	T+1	T+2 = S	
7 Oct					T	T+1	T+2 = S

7.2 Cash trades executed on Friday, 3 October, for T+3 will settle on Wednesday 8 October, at the same time as cash trades executed on Monday, 6 October, for T+2. The resulting surge in trading volume will follow through into clearing and settlement, potentially amplifying the scale of the problems identified above and generating unusual levels of fails for some time after the switch-over date. Banks will need to ensure that adequate resources are available to manage this spike in post-trade activity.

7.3 If (T+3) cash trades executed on Friday 3 October settle on Wednesday 8 October, along with (T+2) cash trades executed on Monday 6 October, banks will not know their final financing and short-covering requirements for trades settling on 8 October until 7 October. The question arises as to whether parties will finance/cover Friday's trades on Monday for T+3 and Monday's trades on Tuesday for T+2, or do it all on Tuesday for T+2. The latter option could cause volume in the repo market to dip sharply on Monday 6 October.

## 8 Recommendations<sup>8</sup>

8.1 It is suggested that the ICMA ERC should recommend:

- 8.1.1 Firms try to be clear as clear as possible about settlement dates in negotiations, especially with clients and cross-border.
- 8.1.2 Firms fully adopt the established best practices of affirmation/confirmation and instruction of settlement early on the transaction date.
- 8.1.3 Specific earlier notification deadlines for substitutions and terminations.
- 8.1.4 Firms take precautions ahead of the switch on 6 October to ensure that backlogs of fails are not allowed to build up, including earmarking adequate extra resources for the management of fails and unmatched instructions, and assessing the adequacy of their funding and securities borrowing capacity. Attention should also be paid to capacity in key processes such as pair-offs, monitoring and resolution of settlement/trade matching and allegements, management of buy-in and mini close-out, interest claims, inventory/collateral management, high yield debt registration conversions and recalls.
- 8.1.5 Firms to endeavor to continue to provide liquidity to the market and avoid precautionary hoarding.
- 8.1.6 CCPs try to assist the market by extending the cut-off times for overnight GC.
- 8.1.7 ICSDs increase the frequency of settlement cycles and provide more frequent and prompter settlement status reports to firms.
- 8.1.8 Financial market infrastructures and custodians resist imposing earlier cut-offs on settlement instructions.

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<sup>8</sup> Please note that such recommendations have not yet been approved or published as such by the ICMA ERC.

- 8.1.9 The effect of any increase in fails over the transition period should be mitigated by the full adoption of established best settlement practices such as shaping and acceptance of partial deliveries.
  - 8.1.10 Firms work over the longer term to increase the degree of automation in post-trade processes, future-proofing solutions to allow a further compression of the settlement period in the future.
  - 8.1.11 (I)CSD and custodians work over the longer term to provide real-time status reporting.
  - 8.1.12 (I)CSDs work over the longer term to provide convenient auto-borrowing facilities, where these do not already exist.
  - 8.1.13 Clarity should be sought about changes in trading conventions in the FX market.
- 8.2 It will, of course, also be necessary for the ICMA ERC to engage with ESMA on the shortcomings of the CSDR requirement for T+2 settlement in respect of its implicit (and surely unintended) prohibition of forward transactions.

*ICMA European Repo Council's Operations Group  
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