

Settlement Discipline Regime Working Group Minutes – 20 February 2017

1) Approval of minutes from 19 January 2017

The named law firm in Section 4 should be removed for confidentiality purposes

The minutes were approved without further comment.

2) Update on settlement level gap analysis and task force composition

Due to the absence of CP, an update was circulated to the group prior to the meeting. Included in this update was an explanation on how EUI differentiates between transactions settling in the CREST UK system and the CREST Irish system. Please refer to update for more details.

CR asked that given that Irish and UK securities could now be distinguished, that CP present updated settlement efficiency per securities settlement system charts by the next SG meeting – **ACTION 1**

3) Update on clearing level gap analysis and task force composition

VP provided the update:

- Preparing to schedule next meeting.
- Preparing a consolidated impact assessment with co-operation on other CCPs - Eurex, EuroCCP and X-Clear.
- Hoping to sign off the consolidated impact assessment this week - no major changes anticipated.
- Starting to look at impact areas and have opened up discussions with AFME regarding buy-ins and reporting which are likely to present significant challenges moving forward.
- Looking towards drafting a Level 3 Q&A in the next few weeks, which they intend to prioritise in order of importance of getting answers to.
- The TF reports good engagement from key stakeholders at all levels.
- Positive meeting with EUI regarding fixed income and the flagging of netted transactions.

CR questioned whether the TF would be in a position to provide timelines now that there were distinct deliverables emerging.

The group were advised that timelines were to be discussed at the next TF meeting, and that any agreed timelines would be shared at the next SDRWG meeting – **ACTION 2**

CR added that any Q & As should be opened up to the other TFs as well as the regulatory bodies, and encouraged coordination in this area.

4) Update on trading level gap analysis and task force composition

DS provided the update:

- Task force met two weeks ago.
- TORs agreed and circulated.

- Collectively working through RTS analysis line by line.
- An early focus is the issue of systematic failures for certain types of participant which are most likely to adversely affected e.g. market makers for illiquid securities. It was noted that firms were very worried about being locked out if they fell below the 15% threshold.
- Explored possibility of using issuer's treasury stock to ease settlement fails;
 - Who has access? Is there a role for corporate advisors? How can we reward and incentivise the issuer?
 - Some key issues need to be addressed regarding the potential use of treasury stock relating to re-registration and investor rights, e.g. legal restrictions.
 - Market makers are reaching out to issuers and registrars for further opinions, a new line of stock being one.
- The TF is seeking a legal opinion regarding the amendment of rules to accommodate the new regime and mitigation of market abuse.
- Serious concerns regarding the 15% threshold were raised especially with regard to small cap market makers. This highlighted the need for the threshold to be process driven rather than a definitive cut-off.
- Discussions to take place with EUI on how 15% is applied in the failure cascade i.e. when a market maker is trading flat and is failing to onward deliver due to the failure of inbound delivery.
- Additional resource with CSDR experience.
- The trading TF is next due to meet on 13 March 2017

It was asked whether there would be a formal review of the noted concerns and subsequent impacts and if so how it would be managed? Will there be a committee determining the treatment of participants who systematically fail and who the composition would be?

CR confirmed that the competent authorities will undertake a review under Article 75 in 2019 but it should be based on documented evidence. CR also noted the uncertainties regarding settlement failure cascades in the context of systematically failing participants. The current text does not consider this issue fully. Significant questions remain that need clarification, in particular:

- How can a failure cascade be identified and proven?
- How does a failure cascade impact assessment of settlement efficiency?

CR added that this issue is not unique to the UK market, and that this will need to be addressed across Europe. He also highlighted the need for this to be discussed at all three FMI levels.

It was asked whether there was co-ordination between the European working groups?

CR noted that minutes from the SDRSG should be published and shared with the other regulators of Euroclear entities as well as an operational bulletin informing the wider market. He encouraged the group to suggest appropriate contacts in other working group with the him to allow him to reach out on behalf of the SG to establish cooperation – **ACTION 3**.

Article 75 provides an opportunity to review (among other points) the appropriateness of penalties for settlement fails, and whether there should be additional flexibility around penalties for fails related to illiquid securities. This review is potential date to highlight issues. The group should have an eye on this going forward and the review should be evidence based where possible.

5) Review of Risk Register items

CB presented the Risk Register. It was agreed that updated version would be provided at next meeting – **ACTION 4**

Gap analysis provided at CSD TF. 24 items at settlement level, of which 12 have been discussed. Removal of 'Remove Cash Freeze' diary event should comply with hold and release.

The Clearing level TF has created a raid log which can be incorporated into the Risk Register.

Market Maker and Market abuse impacts - A systematic failure benchmarked at 15% is likely to have significant impact on some firms. The impact assessment will identify participants that will have problems. It was added that the trading level are reviewing impacts from both sides:

- How can assistance be provided to participants susceptible to systematic failures?
- How can participants help themselves?

An example would be to soften market rules however this would have a likely impact on liquidity and availability of stock. Further questions include:

- Can we identify scenarios where there is no stock available?
- Can we have a backstop in place in scenarios where we may lose offer pricing until stock situation eases?
- What can be done to avoid market makers deregistering and exacerbating illiquidity?

CR highlighted that the risk register needed to set out the associated risks of the regime at a granular level to allow the TF (and ultimately the WG) to create a targeted action plan that could effectively mitigate the identified risks. All three TFs should analyse buy-ins and the impacts under the new regime. CR requested that the group should develop an action plan from Risk Register – **ACTION 5**

It was noted that a priority of the Risk Register was to complete a line-by-line gap analysis and identify areas that need further clarification and refinement.

CR asked how qualitative rating columns of the risk register should be used? Does the table need to be completed to achieve this? Can we bring together all three sponsors together to discuss these options? CR noted the need for a clear relationship between gap analysis templates and the Risk Register. Gap analysis templates from each Sponsor should be recirculated – **ACTION 6**

CR stated the need to define and detail specific risks, as this will be central to the development of the action plan moving forward. CR noted that the maintenance and review of the Risk Register is will require significant resource and asked for a dedicated task force to ensure it is carried out appropriately. HSBC and BAML's representatives kindly volunteered to help CB. Additional volunteers should make themselves known to the secretariat – **ACTION 7**

The group also noted a full discussion of the Risk Register was a key agenda item for the next meeting, and was therefore set a deadline to populate it with as much detail as possible by 24/03/2017. CR queried the progress of the impact assessment by each Sponsor – the Clearing TF's consolidated impact assessment was best practice, setting a new benchmark for the other TFs to match. A deadline of 24/03/2017 was agreed to submit updated analysis across all work streams – **ACTION 8**

6) Review of open actions

The status of each open action was reviewed. The actions log will be updated accordingly.

7) AOB

BAML reported on a recent AFME meeting whereby it was noted that no significant changes to RTS on settlement discipline were expected. There was, however, the suggestion that the time frame for acceptance and implementation would be pushed back again.