Simon Davies, director of business development, Pirum

Getting CSDR right: advancing settlement management in securities finance

As firms prepare for the rollout of Phase 3 of CSDR, the Settlement Discipline Regime (SDR) which is due to go live in February 2022, Pirum's director of business development, Simon Davies, looks at the potential impact of the regulation and what securities financing businesses should be doing to prepare

Settlement efficiency provides many benefits, including operational productivity and reduced risk, along with delivering firms with a robust framework to prevent the proposed SDR buy-in and fine costs in the first place. Despite this, currently we see around 5-6 per cent of European stock lending and repo transactions failing for one or more days – with two thirds of fails on the return or off-leg. Additionally, during the busy season or periods of market volatility, fails increase by 18-21 per cent.

We estimate this will cost the industry around €150 million in CSDR settlement fines annually — and much more with the associated potential buy-in costs and the additional resources to manage the accompanying reconciliation and claims processes.

The driver for CSDR is to harmonise the various CSD regimes within the EU, firstly to bring some standardisation and efficiency to a very heterogeneous market but also to reduce counterparty risk in the event of any defaults. While the industry's focus has been on the potential costs of fines and buy-ins, CSDR is also designed to provide the market with improved functionality — such as auto-partialling and better, more frequent, intraday data. Clearly there is an incentive to minimise fines and buy-in costs and firms should also leverage both the harmonisation and increased market capabilities to improve their overall settlement efficiency.

With six months to go, firms are now accelerating their preparations to minimise the impact that the regulation brings. As part of that preparation, firms are using the implementation of CSDR as an opportunity to review and eliminate various inefficiencies and risks seen in their post-trade processes.

Practical implications

At Pirum, this requirement for greater automation manifests itself in a number of different areas. First, we have seen a huge increase in demand for pre-settlement matching and lifecycle event automation, including partialling trades. Additionally, as firms look at their intraday fails coverage they are expecting an increase in their intraday T+0 settlement bookings.

As a result, these firms need to reduce the timing of the settlement cycle and latency between instruction to market and settlement. To facilitate this, there has been a push to increase automation around pre-matching and exposure management. This includes a drive to automate the release of loan instructions to the local custodian on the back of the borrower collateralising trades — what we call Loan Release — along with enhancements to provide real-time exposure calculation and alerts.

In addition, where firms are currently relying on running exposure reports and then manually reviewing these at set times of the day, there is a realisation they will struggle to manage collateral coverage efficiently with the growing focus and resulting pressure on settlement timings. This has led to increased demand for real-time exposure data, along with a need to introduce alerts and exception workflows to keep on top of changing priorities.

Firms are focusing on automation, with the expectation that having more efficient settlement processes will help to prevent fails — initially by preventing the actual loan, or on-leg, fail. Thereafter — where two thirds of fails happen on the return, or off-leg — efficiently managing lifecycle processes to ensure the return/off-leg is in line between the counterparts is also critical and shouldn't be overlooked. Critically, this needs to include an overview of the collateral exposure processes, particularly if firms are going to ramp up intraday T+0 settlement, with very short settlement cycles to achieve same-day borrows close to settlement cut-offs.

Firms are also focusing on what happens when a fail does occur. They are looking to identify issues prior to settlement cut offs, and to increase their ability to resolve issues through exception-based prioritisation and auto-partialling trades to minimise the overall cost of a fail.

Prevention better than cure

As firms gear up to deal with the SDR fails and buy-in regime, there is a realisation that preventing problems is not only prudent and best practice, but will also provide broader operational efficiency benefits and reduce risk. Here we summarise what firms should introduce:

- Standardised settlement pre-matching fields — identifying the core trade details impacting settlement processes

- Continuous real-time trade matching for the life-cycle of the trade
- Hold and loan-release functionality
- Real-time exposure management oversight and alerts
- Real-time exception monitoring and improved work-flow
- Partial settlement management
- Adoption of industry best practices and industry services

We review fails prevention in more detail in our CSDR white paper (www.pirum.com/ whitepaper-securities-finance-and-csdr-dont-fail-to-deal-with-fails).

How Pirum is helping

Pirum has been at the forefront of the drive to increase STP and low fail rates for the securities finance market for over 20 years and recognises the value and importance of best practice.

Along with our pre-matching and life-cycle processing services, we can help automate the collateral lifecycle to link the lender's loan instruction to the borrower's collateral coverage, thereby dramatically reducing the timing from loan instruction to settlement. Additionally, we can provide operations teams with real-time intraday alerts when something changes that needs to be prioritised for either collateralisation or settlement.

For the last year, we have been working with the industry body on their CSDR initiatives and our clients on providing further tools to help both the overall workflow around lifecycle event processing and support clients' CSDR initiatives. This has culminated in the introduction of our Trade Risk Manager service (TRM).

The goal has been to help firms manage their P&L, with enhanced management information systems (MIS) and workflow capabilities, and provide them with real-time breaks analysis and a CSDR settlement overview and exception prioritisation. Firms can use TRM's advanced communication capabilities to agree resolution of issues both internally within the organisation and with their counterparts.

Finally, we have automated the break resolution booking process — so when the action is agreed with the counterpart in TRM, the firm responsible can use that agreement to trigger the trade amendment or rebooking, where required, in their internal books and records.

We have also been supporting firms in managing their partial settlement processing — giving firms the ability to track the alpha and beta trade bookings by persisting the original alpha trade reference on to the partialled beta trade positions and, of course, showing any discrepancies between them and their counterpart in real-time.

Our pre-matching, exposure management, loan release functionality and lifecycle automation helps firms to manage trades pre-settlement and throughout the lifecycle of the trade for both stock loan and repo transactions in real-time. Clients can identify and resolve issues through our enhanced workflow to minimise the impacts of the SDR, and provide improved P&L and risk management. Simple for firms to implement and supported by our client service team — which helps firms integrate the service and manage this on a day-to-day basis, we're able to help firms get CSDR-ready and get it right by 2022.

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connect@pirum.com
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