

Spanish National User Group response to the Market Consultation feedback on T2S user requirements and annexes

Jean-Michel Godeffroy
European Central Bank

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Subject: Fails management

Dear Jean-Michel,

The issue of the fails management, as currently presented in the User Requirements Document, has intensively been discussed within the Spanish National User Group. I am writing you this letter in order to provide you with the reasons why Option 2 is widely preferred (as mentioned in the "Market consultation feedback on T2S user requirements and annexes" document).

In Chapter 3 of the Users Requirements (T2S.03.260), two options for fails management are proposed within the T2S deadlines: - Option 1: a specific deadline in the local system of the CSDs requiring this fails management or - Option 2: two different global deadlines for receiving DvP instructions for same day settlement, one for the T2S parties and one for the CSDs.

The Spanish NUG has carefully analysed the "pros & cons" of both options and, finally, the NUG widely supports the Option 2, considering that this option presents more advantages in the European context, although it is not a fully optimal solution.

In relation to Option 1, although it gives more autonomy and flexibility to the CSD for setting up their specific deadlines (tailor-made solutions), it has several drawbacks:

- Those CSDs with fails management mechanisms (which means that they carry out relevant efforts to minimise settlement risk) will be the worst treated. They would have to bring forward "yy" minutes its deadline for DVP instructions and as a consequence, they and their participants would have "yy" less minutes for sending DVP instructions, in comparison to the CSDs (and their participants) without such tools. In conclusion, such option does not respect the "level playing field" principle and put the most prudent CSDs in a competitive disadvantage.
- Due to the fact that, the longer the period for fails management is, the greater disadvantage for the local markets and their CSDs, each infrastructure will tend to minimize their own period as much as possible. This period seems to be insufficient, in particular in stress situations (*"race to the bottom"* or *"downward harmonization"*).
- Besides, a situation with different deadlines, depending on each CSD, could bring a high number of tailor-made solutions, thus increasing the complexity in the European context and hampering the harmonisation efforts.

In the view of the Spanish NUG, Option 2 presents more advantages than disadvantages. On the one hand, this solution gives less autonomy to the CSD and it could be difficult to find a well suited solution for all CSDs, since a common and harmonized deadline can result too long for some CSD and maybe too short for others. As advantages, this option does not harm the competitiveness of those CSDs with fails management tools and contributes to establish a "level playing field" in T2S. Thanks to these equivalent conditions, the CSDs would be encouraged to establish and promote fails management mechanisms, which overall increases

the efficiency and decrease the risks. Finally, the establishment of a common harmonized solution will imply more simplicity and more harmonisation in the European context.

In spite of being Option 2 the preferred one, the NUG considers that it is not a completely satisfactory solution and should be complemented with other measures (some of them currently considered by the TG1 within the work of harmonisation). To find an optimal solution, the following issues should be considered:

- Establishment of a common framework for fails management, including: buying-ins, securities lending, self-collateralisation, etc... (Issue ref B.11).
- Consistency between Option 2 and other measures like the "recycling". The Spanish NUG supports to establish a harmonised rule for recycling after matching ("issue ref B.03"). In any case, it is considered very important to encourage the settlement instructions in the "intended settlement date".
- Establishment of a common framework of penalties (actually not harmonized), that will promote a level playing field and will avoid regulatory arbitrage. (Issue ref C.20)
- The possibility of closing the deadlines for DVP and FOP transactions.
- Coherence with the International Standards: (Recommendation 5 CPSS-IOSCO)
"Securities lending and borrowing should be encouraged as a method for expediting the settlement of securities transactions". Besides, it is necessary to point out that the future European commitment in this respect, included in the ESCB-CESR standard 5, will be more stringent than this international recommendation.

It should be remarked that the fails management policy is not a pure technical issue but of a wider nature, including regulatory aspects. Therefore, although the technical component could be solved within T2S, the substance of this topic is beyond the scope of T2S. The dimension and the scope of the measures for harmonising the framework for fails management require the involvement of other relevant authorities, in particular the regulators.

Yours sincerely,

Susana Núñez
Chairperson of the T2S Spanish National User Group