

## Conclusions of the workshop on T2S Partial Release functionality (CR-653)

27 September 2018

On 16 November 2019, Change Request T2S-0653-URD (CR-653) will be deployed in T2S as part of its release 3.2, thus introducing a new functionality in T2S, Partial Release.

During the AMI-SeCo meeting of 22 June 2018, considering the broad range of expectations expressed by participants towards Partial Release, the members of the AMI-SeCo recommended the organisation of a workshop to ensure an optimal implementation of Partial Release. **The purpose of the workshop was to identify which factors would contribute to the most effective use of Partial Release for those T2S actors which intend to use it.**

Partial Release is indeed not a mandatory functionality of T2S. It will be used only by some CSD participants who manage omnibus accounts gathering the holdings of several clients.

This note summarises, for AMI-SeCo consideration, the main conclusions of the workshop. After a description of the features and limitations of the Partial Release functionality, the note presents the identified use cases for Partial Release along with their expected benefits. The potential effects of the CSD Regulation (CSDR) on the use of Partial Release are then discussed. Finally, the expectations resulting from the workshop conclude the note.

The expectation is that the usage of Partial Release is expected to be gradual and concentrated in some markets and some types of market participants.

### 1. What is Partial Release?

T2S currently offers a 'Party Hold' functionality, allowing the owner of any settlement instruction to prevent its settlement even if all other conditions for settlement are met – such as sufficient securities on the T2S delivering account. T2S also offers a Release functionality, allowing the owner of an instruction to remove a Party Hold.

Unlike the current Release functionality, which applies at instruction level for the full quantity, the new Partial Release functionality will allow to release instead only part of the instruction. A detailed functional presentation about Partial Release is available on the ECB website<sup>1</sup>.

### 2. What could prevent the successful execution of a Partial Release request?

To be successfully executed, a Partial Release request needs to fulfil a number of criteria detailed in the functional presentation about Partial Release, some of them being derived from the existing criteria for a transaction to be eligible to Partial Settlement. Among these conditions, a crucial one is

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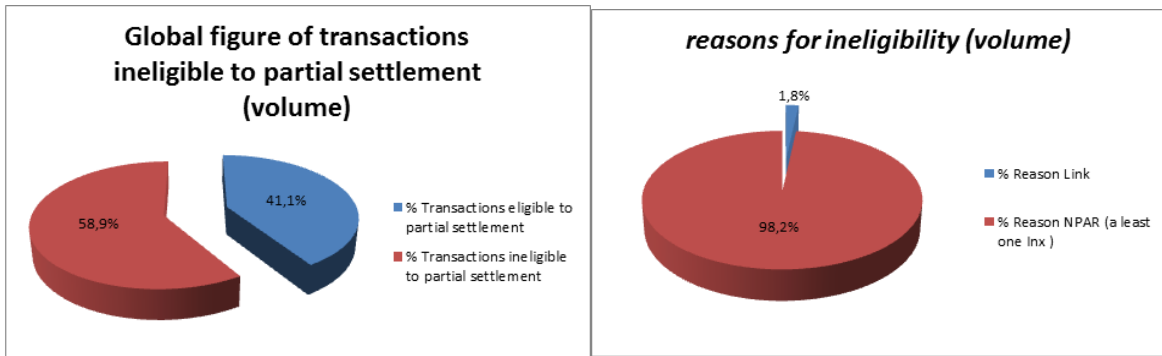
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that a Partial Release request will only be executed by T2S if both the delivering and the receiving party allow Partial Settlement, i.e. none of the instructions includes the flag NPAR.

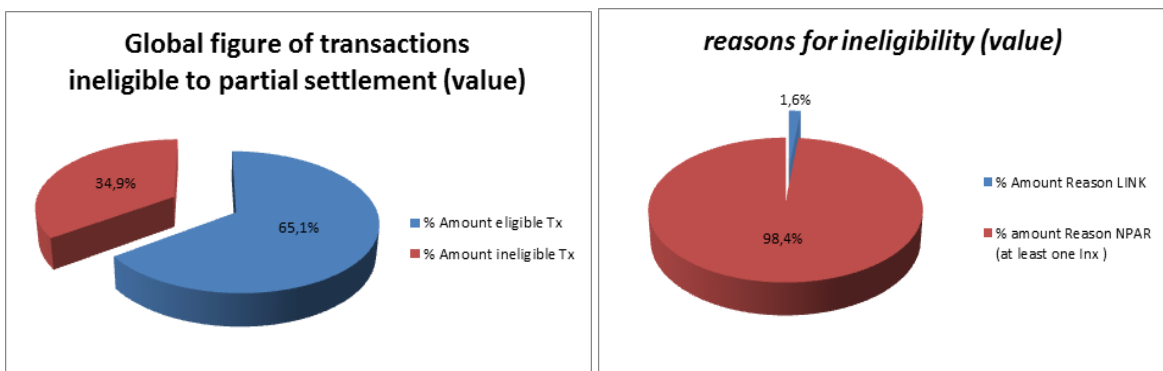
This, in turn, depends on the business needs of the underlying clients: while some of them, for example brokers, may usually wish to resort to partial settlement, to increase the overall volume of settled transactions, other clients, like asset managers, could prefer to settle on an “all-or-nothing” basis and, therefore, include the flag NPAR in their own instructions.

**3. Which proportion of transactions are flagged with NPAR in T2S today?**

Statistics presented during the workshop indicate that in T2S, about 59% of transactions in T2S were *not* eligible to Partial Settlement due to one or both parties flagging their instruction with NPAR – as a result, the delivering leg of these transactions would also not be eligible to Partial Release.



Although only 41% of number of transaction qualify for Partial Settlement (and Partial Release), it represents 65% of the total value of transactions.



The proportion of (in)eligible transactions would vary a lot per market. Out of 21 CSDs in T2S, in 6 CSDs more than half of the transactions are eligible for partial settlement (50%-75%). In 10 CSDs practically no transaction is eligible for partial settlement (0%-5%).

In support of the idea that a significant portion of the T2S community prefers its transactions to settle only in full, representatives of several custodians indicated that a majority of their customers were indeed requiring Partial Settlement to be disabled on their instructions.

#### **4. Which impact is Partial Release expected to have on the use of the NPAR flag?**

A receiving party in a transaction, if it accepts Partial Settlement today, will bear some adaptation costs as a result of Partial Release, relating to the way the information about the quantity released by the delivering party will be conveyed in the messages sent by T2S. However, responses to the preparatory survey to the workshop showed no evidence that the use of NPAR would increase as a way for receiving parties to shield themselves from the costs resulting from the introduction of Partial Release.

It is also worth noting that, conversely, there was no indication that Partial Release would result in a higher acceptance of Partial Settlement. Indeed, the main reasons for not accepting Partial Settlement - increased complexity of the settlement and reconciliation processes - would not be affected by the availability of Partial Release.

#### **5. How could adaptation costs affect the pace at which Partial Release is adopted?**

Many players likely do not support Partial Settlement today: for such institutions, implementing Partial Release (on a voluntary basis) would require implementing Partial Settlement as well. Likewise, some institutions may also need to consider implementing Hold/Release if interested in Partial Release. In these situations, the Partial Release functionality itself may represent only a fraction of the full adaptation costs for an institution to benefit from it – however these full costs are the ones relevant to assess the pace at which the use of Partial Release could extend.

It was also highlighted during the workshop that the switch to Partial Settlement or to Partial Release was all the more complex as the number of links in the custody chain increased – as adaptation costs are borne at every layer. Accordingly, participants expected that the take-up of Partial Release would be first seen in short custody chains, made of comparatively larger players.

Finally, besides the length of the custody chain, a lower or slower rate of adoption could be expected in custody chains that include global institutions. Indeed, an international player might be unwilling to support a functionality introduced by T2S until it is more broadly adopted and/or becomes a standard.

#### **6. Which use cases can Partial Release support?**

CSD participants segregating the securities positions of their clients have no interest in using the Partial release functionality, as they are already able to control that settlement takes place only after the underlying client has created the securities provision, without running any risk of using assets of other clients.

Today, the 'Party Hold' functionality is typically used by entities operating omnibus accounts in T2S, to manage cases where the underlying client's position is insufficient – in this case, the Hold prevents that assets from other clients, also held on the omnibus account, are used to settle the instruction of the client with an insufficient position. The current Release functionality can be used for instance once the holdings of their client have become sufficient to settle the instruction. The entire instruction is then released.

By allowing to release only part of the instruction, Partial Release is a tool for entities with omnibus accounts in T2S to manage cases where their clients hold some, but not all of the securities to be delivered. This situation appears to be common, one typical example being some CCPs expecting to receive securities from their participants representing several underlying clients.

## 7. How are such use cases handled today?

Workshop participants reported that when such situations occur today, they can be handled following a cancel and reinstruct approach: the transaction lacking securities is bilaterally cancelled, and two new transactions are created: one for the quantity actually available for delivery and the other with the remaining quantity not available set on 'Party Hold'. This process requires communication between the final delivering and receiving parties to agree on the cancellation and the parameters of the instructions to be reinstructed (quantity, amount). Being inherently manual, the cancel and reinstruct solution cannot be easily industrialised and is therefore attempted only on a limited number of instructions (typically the higher value ones).

## 8. How does Partial Release compare with the Cancel & Reinstruct procedure?

Partial Release on the other hand does not require a preliminary agreement between T2S parties: once the delivering party sends a Partial Release request, T2S will assess whether the request can be executed and inform on the outcome.

While a Partial Release can always be *requested* by the delivering party in any case, whether it can be *executed* or not (i.e. whether the specified quantity can be made available for settlement) may depend on settlement parameters set by the counterpart. Therefore some participants may prefer to agree bilaterally with their receiving counterparty before sending a Partial Release request to T2S to maximise the success rate of Partial Release requests (e.g. avoiding the sending of Partial Release requests if the receiving counterparty refuses Partial Settlement anyway).

While also possible in U2A mode, the interaction between T2S and the T2S parties is fully covered by A2A messages and therefore automatable. By requiring less operational effort to make the delivery of "partly available" quantities of securities possible, Partial Release could be key to dealing with these situations systematically, rather than on a case-by-case basis. Besides the immediate advantage of possibly lower processing costs vs the cancel/reinstruct procedure, this could in turn contribute to reducing the overall quantities kept on hold and thus increasing the settlement efficiency in T2S.

## 9. Which effect could CSDR have on the use of Partial Release?

As higher settlement efficiency is an objective in itself, but also a particularly relevant one in the context of the introduction of the CSDR Settlement Discipline regime, some workshop participants were of the view that the entry into force of CSDR in 2020 might represent an incentive for T2S participants to make use of partial release in the business scenarios identified above.

However the CSDR impulse will not be systematic, and CSDR will not mechanically result in a higher use of Partial Release by T2S Actors. Indeed, from the delivering party's side, there may be an expectation that usage of Partial Release will result in a lower overall value of settlement fails, and therefore lower penalties. However, this expectation can only be fulfilled if in the first place, Partial Settlement of the transaction is possible.

In this respect, the effect of CSDR penalties may be limited, as the CSDR does not foresee that penalties are waived for quantities that the delivering party attempted (unsuccessfully) to partially release – even if the Partial Release request failed because of a settlement parameter set by the receiving party, such as the refusal of Partial Settlement (NPAR flag set on the receiving instruction). What matters for the allocation of cash penalties is the immediate reason for the non-settlement of instructions, and in this case, the reason would be the hold on the delivery instruction (which the Delivering Party could not remove partially).

On the other hand, in some buy-in scenarios, CSDR not only requires the trading parties to put their instructions on hold but also mandates to attempt a partial settlement of the transaction. These provisions of CSDR constitute an incentive for end-investors to acquire the ability to hold/release instructions and to accept partial settlement, and to potentially expect these services from intermediaries in the custody chain to T2S.

## **10. Expectations**

From the points highlighted above, workshop participants expect that the use of Partial Release is likely to be gradual, and to concentrate in some markets and on some types of market participants more than others.

Partial Release should be seen as an additional tool available to parties already making use of Partial Settlement and Hold/Release today. It does not affect in any way the ability of parties to decide whether to accept Partial Settlement or not.

Some workshop participants were of the view that the entry into force of CSDR settlement discipline regime in 2020 might offer some incentive for T2S participants to make use of partial release, but there was no hard evidence that it will represent a major shift.

As Partial Release is to be used on a voluntary basis, workshop participants saw no need to define a best market practice on Partial Release or on Partial Settlement. Instead, there was a consensus among participants to consider that it would be useful to periodically measure the usage of the NPAR flag with more granularity, as well as the volumes of Partial Release, over an extended period of time.

### 11. Annex - Eligibility of transactions to Partial settlement

Eligibility of transactions to Partial settlement (Week2-September 2018)					
CSD (in no particular order)	Eligible to partial settlement (volume)	Not eligible to partial settlement (volume)		Eligible to partial settlement (value)	Not eligible to partial settlement (value)
1	58%	42%		81%	19%
2	32%	68%		20%	80%
3	0%	100%		0%	100%
4	59%	41%		66%	34%
5	50%	50%		70%	30%
6	62%	38%		58%	42%
7	74%	26%		61%	39%
8	57%	43%		51%	49%
9	14%	86%		4%	96%
10	0%	100%		0%	100%
11	33%	67%		0%	100%
12	4%	96%		4%	96%
13	26%	74%		40%	60%
14	0%	100%		0%	100%
15	8%	92%		0%	100%
16	0%	100%		0%	0%
17	0%	100%		0%	100%
18	0%	100%		0%	100%
19	0%	100%		0%	100%
20	27%	73%		33%	67%
21	0%	100%		0%	100%