General Information (Origin of Request)		
☒ User Requirements (URD)		
☒ Other User Functional or Technical Documentation (SYS)		
Request raised by: CSD Steering Group (CSG)	**Institute:** CSD	**Date raised:** 21/10/2015
Request title: Prevention of matching in case of insolvency of a CSD Participant or a dedicated cash account holder		**Request ref. no:** T2S 0559 URD
Request type: Common	**Urgency:** Normal	
1. Legal/business importance parameter: Low	**2. Market implementation efforts parameter:** Medium	
3. Operational/Technical risk parameter: Low	**4. Financial impact parameter:** High	
Requestor Category: CSD	**Status:** Withdrawn by the initiator	

Reason for change and expected benefits/business motivation:

The CSG Task-force on insolvency proceedings has been focusing on two deliverables:

i. the elaboration of a Collective Agreement that sets out inter alia the legal rights and obligations of the T2S CSDs and T2S NCBs arising in connection with the harmonised definition of the moment of entry and irrevocability of transfer orders which are subject to matching

ii. the definition of high-level procedures and principles to handle the insolvency of a participant in T2S, be it a CSD participant or a central bank's participant and the subsequent reporting requirements.

During the discussions on the insolvency procedures, it has been identified that, whilst T2S offers the adequate tools to ensure compliance with the Settlement Finality Directive, it is not possible with current T2S functionality to prevent matching of positively validated instructions.

This may bring additional operational risk/burden in cross-CSD scenarios, as once instructions are matched, bilateral cancellation involving action of 2 CSDs is necessary.

This business case is relevant in the scenario where a settlement instruction received after the opening of insolvency proceedings, and is unmatched by the time the CSD/CB system operator is made aware (scenario 4 as described in the attached annex). The settlement instruction could attain matching status between the point that the CSD/CB system operator becomes aware of the insolvency and the moment when they are manually cancelled. The unmatched instructions should be cancelled as early as possible in order to avoid further possibility of matching (as once matched, SIs requires bilateral cancellation which may be operationally cumbersome in cross-CSD scenarios). However, by the time such an action is performed by the CSD, due to slippage there could still be some instructions which are matched. From an operational view point, the insolvent party instruction (once matched) must also be put on hold[1] to avoid the risk of settlement attempt, in case the solvent counterparty's CSD does not comply with bilateral cancellation.

In the current implementation of the T2S it is already possible to block settlement i.e. moment of finality (SF3) using specific case 2 restriction rules. There is however, not a possibility to prevent settlement instructions from matching (activated by each system operator or on its behalf) between the point that the CSD/CB system operator becomes aware of the insolvency and the moment when they configure the rejection of settlement instructions belonging to the insolvent CSD participant/DCA Holder in T2S. The fact that such settlement instructions may still match after the rejection of new instructions is activated does not constitute a (legal) breach to the SFD. However preventing the matching would further lower operational risk and would bring T2S in line with the market practices applied by CSDs on their legacy platforms.

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Description of requested change:

Unmatched instructions submitted by an insolvent party (or on its behalf) and aiming at debiting one of its accounts (securities account or DCA) should not be eligible for matching.

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[1] According to the currently defined procedures, the insolvent party/account will be blocked through an intraday restriction (Case 2 Restriction Type)

Submitted annexes / related documents:

See attachment entitled "Insolvency of CSD/CB participants in T2S" from CSG Task Force (version of 29 October 2015)

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Proposed wording for the SYS Change request:

The following URD requirement must be added to address the above requirement:

T2S matching ineligibility

Reference ID	T2S.05.505

T2S shall prevent matching of an instruction submitted by an insolvent party (or on its behalf) and aiming at debiting one of its accounts (securities account or T2S dedicated cash account) unless the instruction is submitted on behalf of the insolvency liquidator[2].

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High level description of Impact:

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Outcome/Decisions:

* CRG meeting on 15 December 2015: The CRG agreed to make some changes to the Change Request and put the Change Request on hold.

* CRG meeting of 12/13 December 2016: The CRG recommended the Change Request for preliminary assessment

* CRG meeting of 28 February 2017: The CRG took note of the preliminary assessment on the Change Request.

* CRG meeting of 30 March 2017: The CRG was of the view that the CR initiator (CSG) could consider withdrawal of the Change Request considering its low business value, high implementation efforts and the feedback from the OMG that (i) the Change Request would be helpful but not mandatory and (ii) the OMG insolvency procedure has been drafted without counting on this Change Request.

* CSG meeting on 25 April 2017: The CSG agreed to withdraw the Change Request provided that there were no legal requirements which impede the withdrawal on 25 April 2017. On 5 May 2017, the CSG was informed that there was indeed none and the insolvency CSG TF only considered potential operational risks.

* CSG meeting on 25 April 2017: The CSG was of the opinion that while this change request was not seen as mandatory for the effectiveness of the collective agreement, a check should be conducted if creation of the CR by the insolvency CSG TF was also based on any legal requirement. On 5 May 2017, the CSG was informed that there was indeed none and the insolvency CSG TF only considered potential operational risks.

* CSG meeting on 13 June 2017:The CSG agreed that some operational tests are required before the CSG can consider the withdrawal of the CR

* CSG meeting on 12 April 2018: The CSG informed the ECB team of the withdrawal of the CR.

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Preliminary assessment:

- **Impacted modules are: LCMM, SD, INTF and DMT**

- **Functional Findings:**

  LCMM

o   The need for the implementation of the CR-0559 remains questionable: All in all, the only enhancement to the current T2S Insolvency procedure would be avoiding the need of contacting the counterpart to agree on the bilateral cancellation for cross-CSD SIs falling under scenario 4. In any case, two cancellations should be sent (one per leg if situation has to be completely reverted) Without CR-0559, the insolvency procedure is fully in

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[2] Such instruction will be submitted by the CSD.

line with the regulation.

o   The logic to implement this CR is based on the scenarios defined by the Insolvency TF, and concretely speaking, focused in the scenario 4 where the prevention of matching in the context of an Insolvency procedure applies. SIs falling under such scenario are defined as follows: "*Transfer orders entered after the opening of insolvency proceedings, which were not matched on the T2S platform by the time the operator becomes aware*".

Therefore, and considering the description of the CR, the implementation of CR559 must ensure that for instructions debiting an insolvent SAC or DCA which were entered in T2S after the opening of the insolvency procedure outside T2S started (i.e. Timestamp of the opening of insolvency proceedings = TS1) and remaining unmatched by the time the operator becomes aware (i.e. Timestamp of the moment when RT4 as defined in the operational procedure is put in place in T2S = TS2) NO matching is performed.

This definition implies that:

-   SIs entered in the system before TS1 must be matched and settled without any restriction as they are protected according to the SFD (i.e. Insolvency scenario 1);

-   SIs considered as "insolvent" but entered in the system after TS2 will always be rejected due to the active RT4, unless the Insolvency liquidator instructs them. In such case Matching shall not be prevented (i.e. Insolvency scenario 6 and 5 respectively)

o   In order to successfully implement the logic described above a new timestamp must be provided by the CSD/CB and stored in T2S in case of insolvency scenario: "*Time of the opening of the insolvency proceedings*" (I.e. TS1 in the previous examples).

Note that this timestamp is currently neither stored nor needed in T2S for any process in the insolvency procedure. Also, TS1 will have to be declared at SAC and DCA level, since it is at this level of granularity that the time-eligibility of the insolvency restrictions potentially impacting the instruction is defined.

o   Proposal to store the "Time of the opening of the insolvency proceedings" based on the application of RT4 restrictions:

Basically, the issue is the time gap between the opening of insolvency proceedings outside T2S and the moment the CB/CSD Operator in T2S becomes aware of them and sets the restrictions on the relevant accounts.

Static Data could waive the normal checks on the Valid From of these specific restrictions only; i.e. we would allow restricting a Securities Account/DCA with them with a Valid From timestamp in the past. This timestamp would be set by the operator to the relevant value for the "opening of insolvency proceedings". This would also allow having a specific timestamp at individual account level.

o   Updating the matching process would have a slight impact on the performance when the insolvency state is set to off since the application should retrieve the T2S insolvency status twice in the same flow (at validation level and at matching level when needed). However, when the insolvency status is set to on, the impact on the performance is higher since the application has to perform all the checks at least twice (at validation level for the instruction itself and at matching level for the candidate instructions which could be its counterparty).

SDMG

o   The timestamp for the opening of the insolvency proceedings will be stored using the Valid From of the DCA and Securities Account Restrictions. This means that it should be possible to set these Valid From timestamps in the past if needed.

o   Business rules for Update (and possibly Create) T2S Dedicated Cash Account and Securities Account will be modified to allow setting DCA/Securities Account Restriction Valid From timestamps in the past as well, only for these specific Restriction Types.

o   This change would have to be reflected in the Data Migration Tool specifications as well.

Open issues/ questions to be clarified by the originator:

o   Based on the Insolvency TF deliverables, our working assumption is that the purpose of this CR is only to avoid matching of SIs debiting an insolvent DCA or delivering securities from an insolvent SAC on scenario 4. Could you please confirm our understanding?

o   SIs falling on scenario 1 should still be subject to matching and therefore must not be affected by the solution implemented due to CR559. In addition, SIs on scenario 5 (i.e. sent by the Insolvency Liquidator) should not be prevented for matching in T2S.

o   For real-time status reporting in the scenario applicable to CR559 (i.e. for the insolvent instruction already in the system before matching) no changes will be made in principle regarding the possibility to send status updates to the insolvent parties to inform them that the SI is not eligible for matching, since they will require considerable changes to both Information Flow Consistency and Data Collection for Messages core functionalities, with the added risk that such alterations would represent. No specific status/reason code will be included in Queries & Reports regarding the ineligibility to match of the insolvent SIs.

o   No specific real time status reporting will be send to any counterparty as the insolvent SI will not be considered as eligible for matching.

o   No changes either to the Allegement process, since the way allegements are generated (i.e. after a delay that may theoretically be longer than the time it would take to activate RT4 restrictions) may negate any potential advantage of any change intended to prevent them from being sent in this scenario. And even if they were sent in the first place, their corresponding allegement cancellations would be sent anyway after the instructions finally get cancelled (as defined in the Insolvency procedure).

o   It should be clarified whether there is a business case for creating a DCA/Securities Account for an already insolvent participant. In this case the Static Data impact described above (allowing Restriction Valid From in the past) would have to be replicated on the Create functions as well as on the Update ones. By only modifying the Update functions, it will still be possible to open an account and set the Restrictions with a past Valid From but there would be a time gap between the two operations.

o   It should be clarified whether the application has to leave the instructions as unmatched forever until they are cancelled or, if on the contrary, it should be envisaged a way to make instructions eligible for matching upon request or specific event.