



EUROPEAN CENTRAL BANK

EUROSYSTEM

Status update on ongoing work

Asset Servicing Expert
Group

CMH-TF
29/09/2020

Single Collateral Management Rulebook for Europe
common rules for managing collateral



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Overview

I. Guidance notes on:

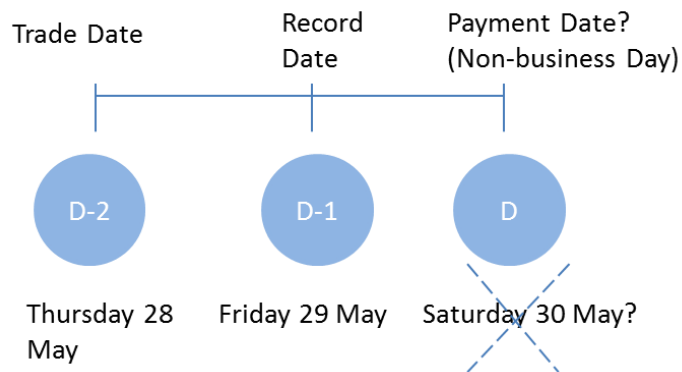
- CA STANDARD 6: Business day rule
- CA STANDARD 8: Payment time

II. Upcoming work

Guidance Standard 6 – Business Day Rule

CMH- TF Expert Group on Asset Servicing is discussing guidance on Standard 6:

- Processing of payments falling on a non-business day



- **Standard 6:** *If the payment date of a corporate action falls on a non-business day (in the country of the currency in which the payment is due), the payment shall be made on the next business day.*
- Draft guidance note on implementation of Standard 6 was sent for feedback.

Guidance Standard 6 – Business Day Rule

Feedback:

- Agree on need for consistent treatment across markets & need to ensure level playing field between payments in central bank money and commercial bank money (i.e. no use of back valuation in commercial bank money)
- Many respondents agreed with the recommendation of avoiding usage of the “Unadjusted Modified Following Business Day Convention” (MFBDC) / “Unadjusted Preceding Business Day Convention” (PBDC). There is the need for a clear rule to always postpone payment to the next day (for unadjusted business conventions) and the need to apply the guidance to both CSD and ICSDs.
- Unadjusted MFBDC is used within the international market and could create operational challenges. Whilst MPBDC is rarely utilised within the international market, security remains eligible.
- CSDs to recommend to issuer/issuer agent to not use Unadjusted conventions.
- Existing securities: need clarity on responsibilities, processing and reporting between parties.

Guidance Standard 6 – Business Day Rule

Guidance for new securities issuances

- **Avoid the usage of “unadjusted” business day conventions which would result in the anticipation of payments** (i.e. to avoid that the Payment Date and Record date are brought forward)

Means to ensure compliance under discussion

- Recommendation is directed to the issuers/agents.
- (CSDs are invited to reflect this in the CSD eligibility rules/ making it non-eligible and/or non-compliant for use across Europe).

Post-trade issues/complexities with:

A. Modified Following Business Day Convention / Unadjusted (MFBDC Unadjusted).

B. Previous Business Day Convention / Unadjusted (PBDC Unadjusted)

C. Modified Previous Business Day Convention / Unadjusted (MPBDC Unadjusted).

- **Record date is determined by the CSD at close of business on the business day preceding the payment date**

Post-trade issues/complexities with:

Differences in CSD practices

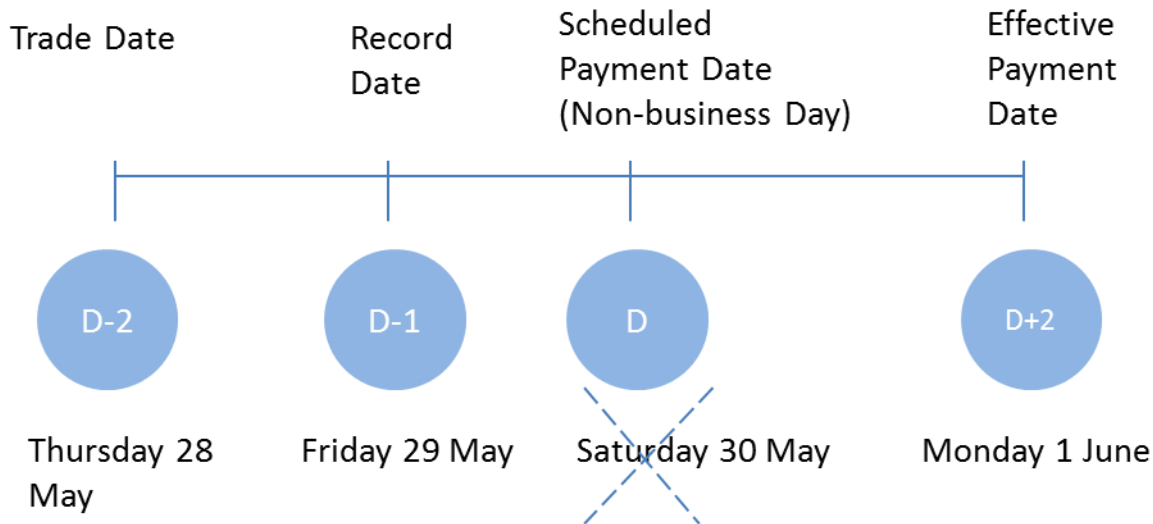
Guidance Standard 6 – Business Day Rule

Guidance for new securities issuances

Business Day Convention		Admitted	Post-trade processes
Following	Adjusted	✓ Yes	Payment the next business day
	Unadjusted	✓ Yes	Payment the next business day
Modified Following	Adjusted	✓ Yes	Payment the previous business day
	Unadjusted	✗ No	None
Previous	Adjusted	✓ Yes	Payment the next business day
	Unadjusted	✗ No	None
Modified Previous	Adjusted	✓ Yes	Payment the next business day
	Unadjusted	✗ No	None

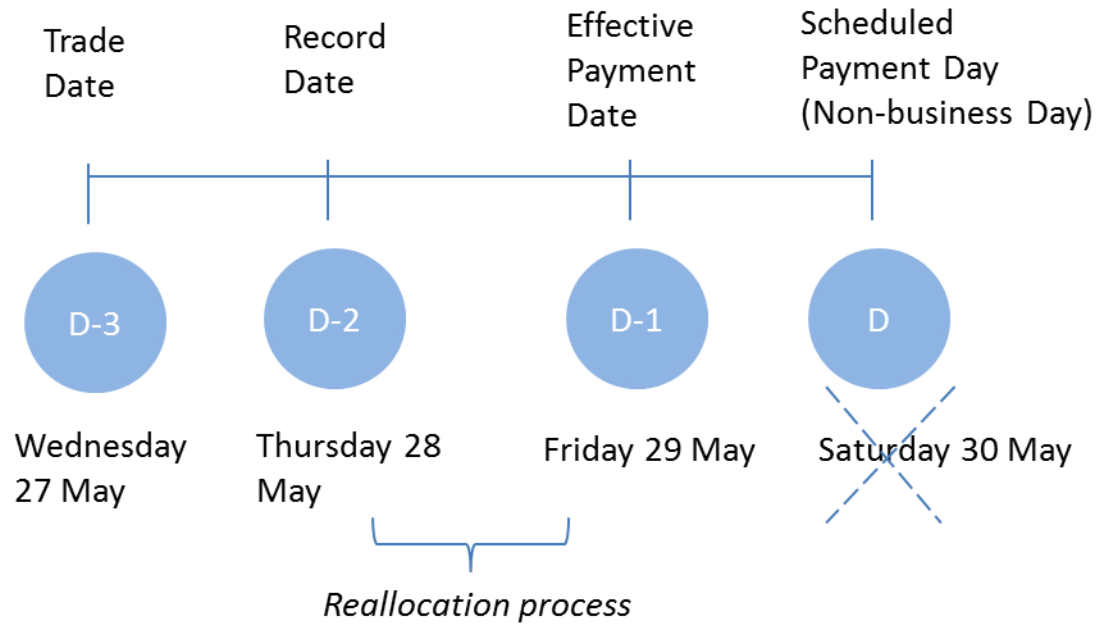
Guidance Standard 6 – Business Day Rule

Background: Standard 6 for new securities issuances



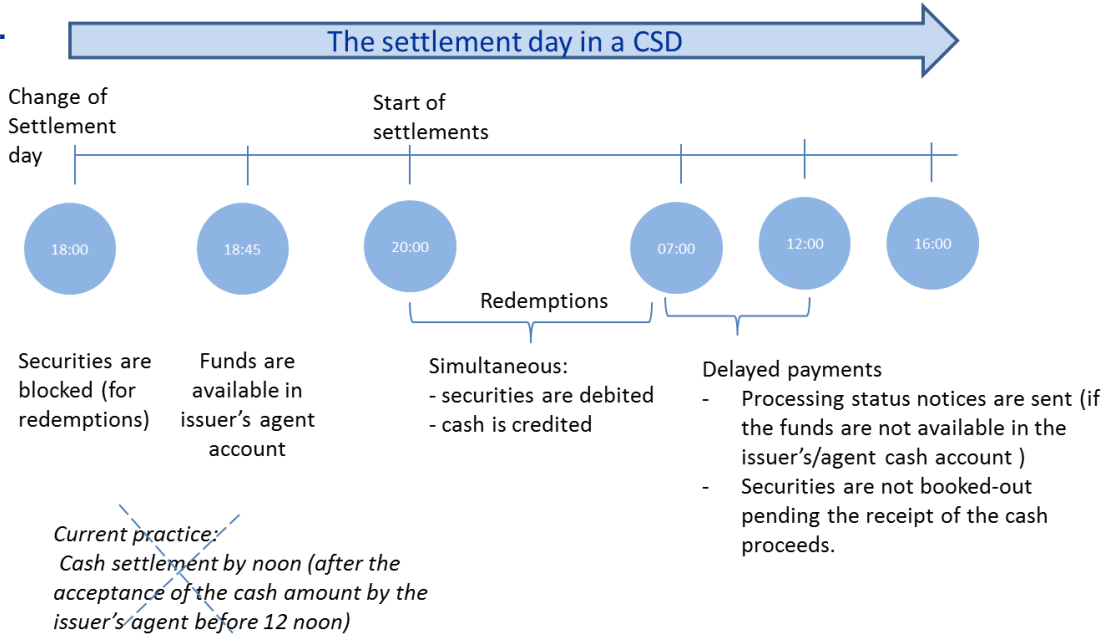
Guidance Standard 6 – Business Day Rule

Reallocation procedure is being considered to handle existing securities (unadjusted)



Guidance Standard 8 – Business Day Rule

Expert group will discuss the distribution of CA cash proceeds & redemption of securities/collateral.



Standard 8: Cash proceeds of a corporate action should be distributed as early as possible.

Guidance Standard 8 – Business Day Rule

Feedback

- Agreement that all CA associated cash settlement should be done within the start of day on payment date (for all types of events without distinction). In order to apply this, the issuers should deliver the relevant cash proceeds to the settlement agents before the start of day. There could be also an exceptional procedure for specific situations for which settlement would not be able until cut-off.
- Others agreed, but see difficulties to achieve the goal. The distribution until noon provides reduces constraints on issuer, to make funds available on day before payment date.
- In the international capital market, there are major differences compared with the European domestic markets (a distinction could be made). Clarity is needed on what should happen if a payment is received after cut-off (processing notifications).
- CSDs are able to process at the start of day (need to ensure compliance by the Issuers/Agents). Ensure alignment with other AMI-SeCo corporate action standards.
- Analyse the change of the Minimum Settlement Amount at end of business on the day preceding the redemption date (in T2S).

Guidance Standard 8 – Business Day Rule

Cash distributions should take place until 07:00 a.m. CET. To comply with Standard 8, the following steps should occur:

- Securities subject to redemption should be blocked after the end of the settlement day (i.e. at around 18:00 CET).
- For partial redemptions (PCAL events), issuers (of government and corporate debt) must transfer the cash proceeds to their agents' accounts by approximately 18:45 CET in order to ensure that CSDs can perform a simultaneous booking of the securities and cash movements at the same time that the new minimum settlement amount is applied).
- For all other CA events, issuers should transfer the cash proceeds to their agents' accounts at approximately 18:45, and at very latest by 07:00 a.m. CET.
- For corporate actions involving a cash and security movement, the distribution of cash proceeds and the securities booking must take place simultaneously.

Guidance Standard 8 – Business Day Rule

After 07:00 a.m. CET, if funds are not made available by issuers to paying agents, a processing status notification should be sent to the security holder.

- After 7:00 CET (for government and corporate debt), *CSDs should send a notification* of processing status to its participants informing them that the cash and/or security payment is pending (see page 50 of the SCoRE CA Rulebook for more details).
- After 12:00 CET, *CSDs should do additional checks* to resolve the issue
- If the payment is still not received by 16:00, the securities booking and the payment of the cash proceeds *should be postponed* to the next business day. Securities remain in the participants' accounts even if the maturity date has been reached but no settlement can take place (settlement will only take place with the availability of the cash funds with DvP Settlement instructions). The ISIN code is blocked for settlement.

Upcoming work

- Submit guidance notes to HSG/AMI-SeCo for endorsement.
- Further regular meetings planned with a focus on the following topics:
 - Update of CA rulebook
 - Production of FAQ.
 - Support market wide implementation of the Standards by providing common guidance on all questions raised.
 - Commence work on reflecting additional aspects relevant beyond debt-instruments in the Rulebook.
 - Billing Processes

Annex: Guidance Standard 6 – Business Day Rule

Additional clarifications on the Reallocation procedure

Further details on the Reallocation procedure to be specified/agreed by CMH TF:

Q1: Who should initiate the reallocation?

- A: If there is a bilateral mechanism, for trades executed on Weds 27/05 that settle on Fri 29/05, on the anticipated payment date the cash proceeds are paid to the seller and not to the buyer because on the record date the securities are still on the seller's securities account. In this case, a reallocation of cash proceeds shall be handled initiated by the buyer (the buyer receives the payment 2 days later on Monday 01/06).
- If there is a central mechanism then the CSD should initiate the reallocation.

Guidance Standard 6 – Business Day Rule

Q2: How to ensure that the party entitled to receive the proceeds is compensated in due time?

- A: In case of a centralised solution, the CSD shall create a mechanism that allows timely processing of cash settlement (i.e. debit the seller in favour of the buyer). In case of bilateral solution between counterparties, the Buyer will claim the due amount from the Seller as already happens in some markets for market claims and transformations that are not automatically handled at CSD level.

Q3: What are the mechanisms to limit the risk of not being compensated as the proceeds can be already sold or the receiver can go into default?

- A: As in any other SFT, if the Buyer holds legal title at the time of the scheduled payment time, it should receive the accrued interest . It is also important to bear in mind that this mechanism is the same as that used for market claims and transformations.

Guidance Standard 6 – Business Day Rule

Q4: Who would be liable if a (I)CSD has paid the proceeds but the reallocation does not take place?

- A: In case of bilateral solutions (i.e. absence of central solution), it is up to the Buyer to initiate the reallocation by requesting a payment of the due amount from the seller. *In case of a centralised solution, the CSD ensures that reallocation takes place.*

Q5: *As per MFBDC logic, when the payment falls on a non-business day and the next business day falls in another month, the legal owner is supposed to receive its proceeds on the day preceding the non-business day. However, will the proceeds only be paid next business day at earliest?*

- A: No, in case of a centralised solution, cash proceeds are indeed paid to the seller at the start of the business day of the day preceding the non-business day (29/05) and the reallocation amount could then also be paid.

Guidance Standard 6 – Business Day Rule

Q6: Does the difference in the value dates between the original issuer's payment and the final payment to a legal owner via reallocation raise additional questions on how and whom to manage the late values claims if any?

- A: In case of bilateral solution, the counterparties will agree on the most effective value date for reallocation of payment. It is important to bear in mind that these principles are already valid for market claims and transformations. In case of centralised solutions, the reallocation is contingent to the actual settlement of the underlying trade i.e. from the Seller to the Buyer.

Q7: Could the reallocation be subject to tax in some jurisdictions and should it therefore be reported with appropriate messages?

- A: The reallocation is a post-trade mechanism to ensure that the Buyer receives the full accrued interest (to which it is entitled as the legal owner of the title). It is important to bear in mind that, like market claims and transformations, the reallocations are always handled gross.

Guidance Standard 6 – Business Day Rule

Q8: Why can the cash and security movements not be booked simultaneously for existing securities bearing the unadjusted convention?

- A: The non-simultaneity between cash credit and security debit is due to the inefficiency that MFBDC brings to post-trading processes.

Q9: Is the reallocation process similar to a market claim/coupon compensation?

- A: There are some similarities, in that the post-trade process generate an outcome in which part of an interest payment is paid to the wrong person/amount, so that there is a need for a re-transfer. But there are also differences: in this case a reallocation procedure is needed due to the inefficiency that MFBDC brings to post-trading processes; in case of market claims the trigger is the presence of failing settlement transactions at record date.