

# Intraday Liquidity – ERCC analysis and recommendations

19<sup>th</sup> AMI-SeCo HSG CMH-TF meeting  
24 November 2020



### Problem statement

- Intra-day liquidity (IDL) pressures are **not new** to our market. The ERCC has cited intra-day liquidity challenges for over 3-4 years.
- Challenges also highlighted in May 2017 [EPTF Report](#), which identified “Issues regarding intraday credit to support settlement” as one of the potential post-trade barriers:  
*“The increasing focus on intraday and overnight liquidity... has created the need to better understand the related drivers and impacts, as a basis to assess whether **further action is required to reduce the overall usage of intraday and overnight credit...**”*
- To address the intraday liquidity challenge, finding ways to **optimise settlement** has become a major focus for the industry. This will also help prepare the industry for the upcoming implementation of CSDR settlement discipline.
- The **ERCC is not alone** in focussing on intra-day liquidity usage and settlement best practice. AFME and the LMMA are also working on related agendas.

### ERCC response to the challenge

2018

- ERCC hosted IDL workshop
- Sell and buy side, CSDs, ICSDs, CCPs and the ECB attended
- **Follow up actions** – focus on use of shaping and partialling

2019

- ERCC ask ERCC Ops to lead IDL workstream
- **ERCC Ops sub-group formed** with cross industry representation
- Goal to present update to new ERCC committee in early 2020

2020

- Full findings presented to ERCC in July 2020
- **Clear recommendations** to enable reduction in IDL usage and improve settlement rates
- **But questions remain** – why is so little settling in the T2S overnight settlement cycle?

(a) Existing ERCC best practices – need to highlight or reinforce?

Enabler	Recommendation
Technical netting	<p><b>Guide (paras 2.83 and 2.85):</b> <i>It is best practice for parties to co-operate to maximise both bilateral and multilateral netting opportunities. This includes the use of pair-offs to reduce settlement cost and risk.</i></p>
Partialling	<p><b>Guide (para 2.58):</b> <i>It is best practice for partial deliveries to be accepted whenever there has been a delivery failure, provided that the party expecting delivery would not be disadvantaged (...) that partialling is operationally feasible for both parties. Market users should make best endeavours to eliminate operational obstacles within their own firm and encourage customers to also accept partial delivery.</i></p>
Shaping	<p><b>Guide (para 2.55)</b> <i>It is best practice to divide or ‘shape’ instructions for the delivery of a large amount of collateral into smaller deliveries or ‘shapes’, so as to reduce the economic impact of settlement failures. A typical shape in the European market is currently about EUR 50 million or the equivalent in other currencies.</i></p>

### (b) Possible new best practices

Enabler	Recommendation
<b>Hold and Release</b>	<ul style="list-style-type: none"><li>• Guide (para 2.54) currently focuses on the benefits of H/R. The text could be extended to explicitly call out inappropriate uses.</li></ul> <p><b>Proposed addition (para 2.54):</b> <i>(...) Hold-and-release facilities can be used inappropriately. Their purpose is to reduce settlement failures due to mismatched settlement instructions by allowing early matching of instructions. They should not be used primarily, actively or routinely to manage a firm's aggregate intra-day liquidity by reducing the priority of payments for securities settlement in favour of other calls on intra-day liquidity. (...)</i></p>
<b>Transparency</b>	<ul style="list-style-type: none"><li>• ECB's CMH-TF working on consistent usage guidance/ best practice for the use of the transaction type identifier in settlement instructions (field 22F)</li><li>• Once the proposed usage guidance/ best practice is finalised, it could be incorporated into the <b>ERCC's Guide to Best Practice</b> to encourage implementation</li></ul>

### (c) Further analysis and/or engagement with other stakeholders required:

Enabler	Recommendation
Settlement cut-off times	<ul style="list-style-type: none"> <li>Significant improvements over the past years</li> <li>Scope for <b>further upgrades</b> could be explored with custodians and (I)CSDs</li> </ul>
Timing of settlement	<ul style="list-style-type: none"> <li><b>Delaying of instructions (“throttling”)</b>: Is there any scope for best practices or other tools to achieve (from a market-wide perspective) better sequencing of settlement?</li> <li><b>Increasing the use of NTS</b>: Further analysis required on current use of night-time batch settlement in the context of bonds and related obstacles.</li> </ul>
Partialling	<ul style="list-style-type: none"> <li>Further analysis required on <b>obstacles to auto-partialling</b></li> <li>Ultimately, introduce <b>mandatory (auto-)partialling</b> at (I)CSD level?</li> </ul>
Shaping	<ul style="list-style-type: none"> <li><b>Automatic shaping</b>: Instead of applying shaping on a voluntary basis, it could be implemented on a binding basis at the level of the settlement infrastructure, i.e. CSDs could automatically and systematically shape all transactions (similar to US)</li> </ul>
Operational efficiency	<ul style="list-style-type: none"> <li>Various ICMA initiatives to facilitate further <b>automation</b> and <b>standardisation</b> of the repo market</li> </ul>

# Key enablers to reducing IDL usage

## Reinforce existing best practice

- **Shaping**
  - Encourage a standard shape size
  - Explore potential for CSDs and ICSDs to automatically shape
- **Partialling and auto-partialling**
  - Emphasize best practice to take partial delivery
  - Understand barriers to further uptake and adoption
- **Settlement netting**
  - Counterparties should co-operate to reduce settlement risk through pair-offs

## Introduce new best practice

- **T2S Hold and Release**
  - Introduce best practice on use
  - Highlight appropriate and inappropriate uses of H & R
- **Settlement “throttling”**
  - Firms may optimize intraday liquidity by “throttling”, effectively pushing settlement towards end of day
  - Throttling may negatively impact firms that try to settle early and have negative repercussions for overall settlement efficiency

## Optimise settlement behaviour

- **Timing of settlement**
  - Understand why only a small value of transactions settle in the T2S night cycle and how this cycle can be used more optimally
- **T2S and ICSD ecosystems**
  - Much bank to client flow settles in ICSDs, while a large % of bank to bank flow settles in T2S
  - This can cause timing frictions when realigning securities, leading to delayed settlement
  - Opportunities to improve the connections between these ecosystems

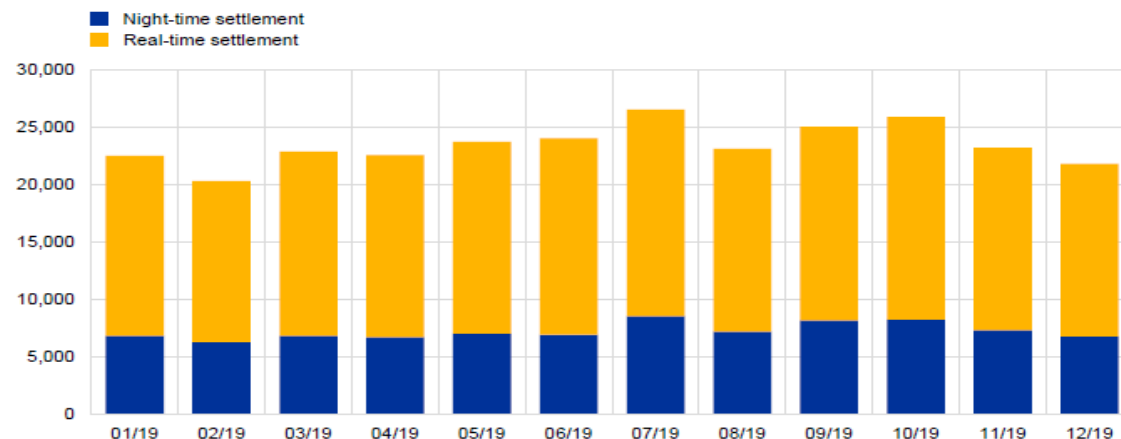
## Timing of settlement – Observations

**We need more data!!**

- The data in the top chart shows value of settlements settling in the Night Time Cycle (NTS) and Real Time Cycle (RTS)
- Many participants purposefully instruct their repo settlements to be included in the NTS, as settlement is cheaper
- However, from 2019 data, **an average of only ~ 30-35% settled in the NTS. Why?**
- To better understand this, **we need more data**

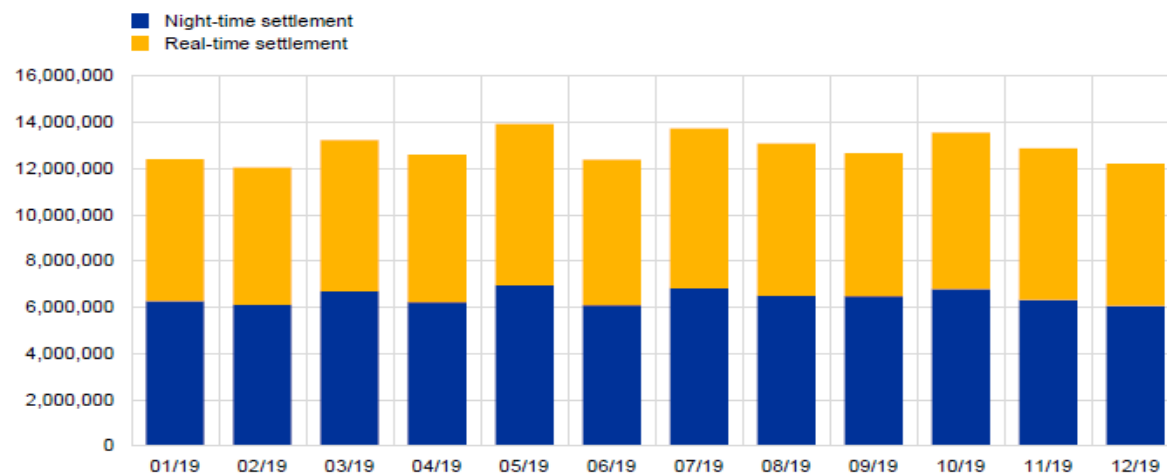
### Night-time and real-time settlement values

(EUR billions, monthly totals)



### Night-time and real-time settlement volumes

(number of transactions, monthly totals)

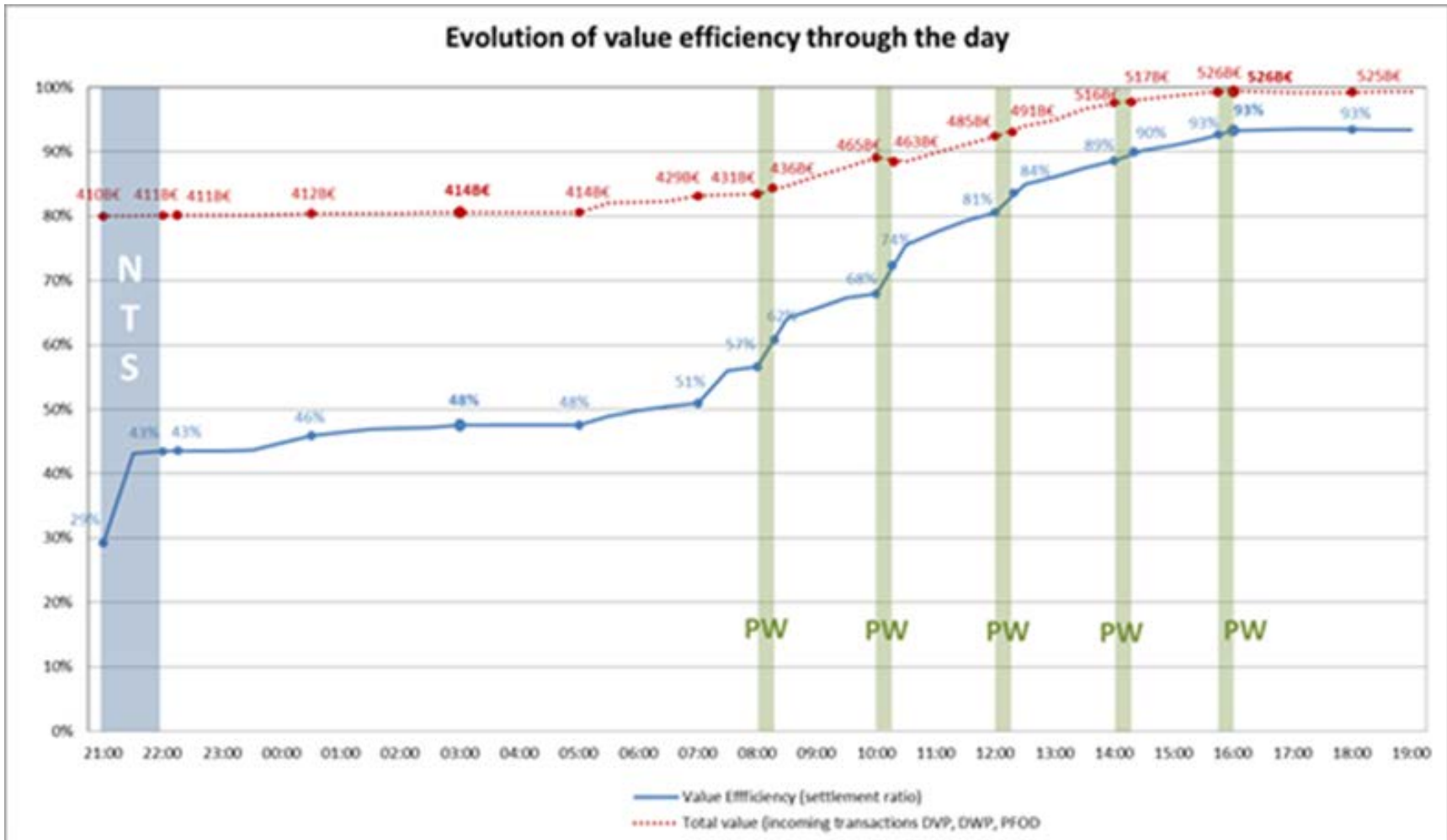




- To enable and influence more use of the night time cycle, we need more granular data. This should include:
  - An **asset class** (fixed income and equity) and **product** (repo and cash) breakdown of what is instructed into NTS, with **reasons as why a large % of instructions are not settling in NTS:**
    - Counterparty not matching
    - Securities lacking
    - Cash lacking
    - Other
  - A **participant breakdown (sell side, buy side, custodian, CCP, other)** of what is instructed into NTS, with **reasons as why a large % of instructions are not settling in NTS**

# The ask for more data

## Evolution of value efficiency through the day



Source: ECB analysis prepared in the context of CSG workshops on settlement efficiency

Submitted on 17 November 2020:

1. “Evolution of value efficiency through the day” (see graph above – could you please share an updated version of the graph based on latest available figures (total across all instruments)?
2. “Evolution of value efficiency through the day” - the same graph calculated only for **fixed income/debt**

For **fixed income** only:

3. “Evolution of value efficiency through the day” - calculate the graph for **CCP-cleared trades only**
4. *Fail reasons*: Is it possible to provide for each of the data points covered in the graph the share of settlement fails that is due to instructions “on hold”, lack of securities, linked instructions, etc?
5. *Instruction size*: Share (in terms of number and value) of fixed-income instructions of a size (=nominal amount) (i) > EUR 50 mio, (ii) = EUR 50 mio, (iii) < EUR 50 mio (if possible, for each of the data points covered in the main graph – otherwise on average per day)

In addition, but more directly related to settlement efficiency and CSDR:

6. *Settlement fails*: Settlement fail rate (volume and value calculated according to CSDR methodology) on ISD+0, ISD+1, ISD+7 and ISD+30, per asset class (at least equities vs bonds, but ideally also splitting out different bond categories, eg SSA bonds vs corporate bonds).

