

CSDR - SETTLEMENT DISCIPLINE: IS IT MORE THAN JUST BUY INS AND PENALTIES?

In July 2014, the European Parliament and Council issued Regulation (EU) No 909/2014 (CSDR) with the aim to harmonize and improve efficiency of securities settlement across EU markets. The focus so far has been on the imposition of a harmonized settlement cycle and more recently the delivery of settlement internalization reporting with the first report to the relevant National Competent Authorities due in July 2019. The next big item on the agenda is Article 6 & 7 of the regulation, commonly referred to as Settlement Discipline Regime or SDR.

Settlement Discipline mandates a set of measures to prevent and address settlement fails. In particular, it introduces penalties for late settlement and mandatory buy-ins. These two punitive elements of the regulation, specifically their operational implications, have been heavily discussed amongst market participants through industry forums and numerous publications.

However, in order to form an appropriate response to Settlement Discipline – one that complies with the regulatory requirements, aligns with strategic business objectives and uses the regulation to unlock new opportunities - a wider lens should be applied.

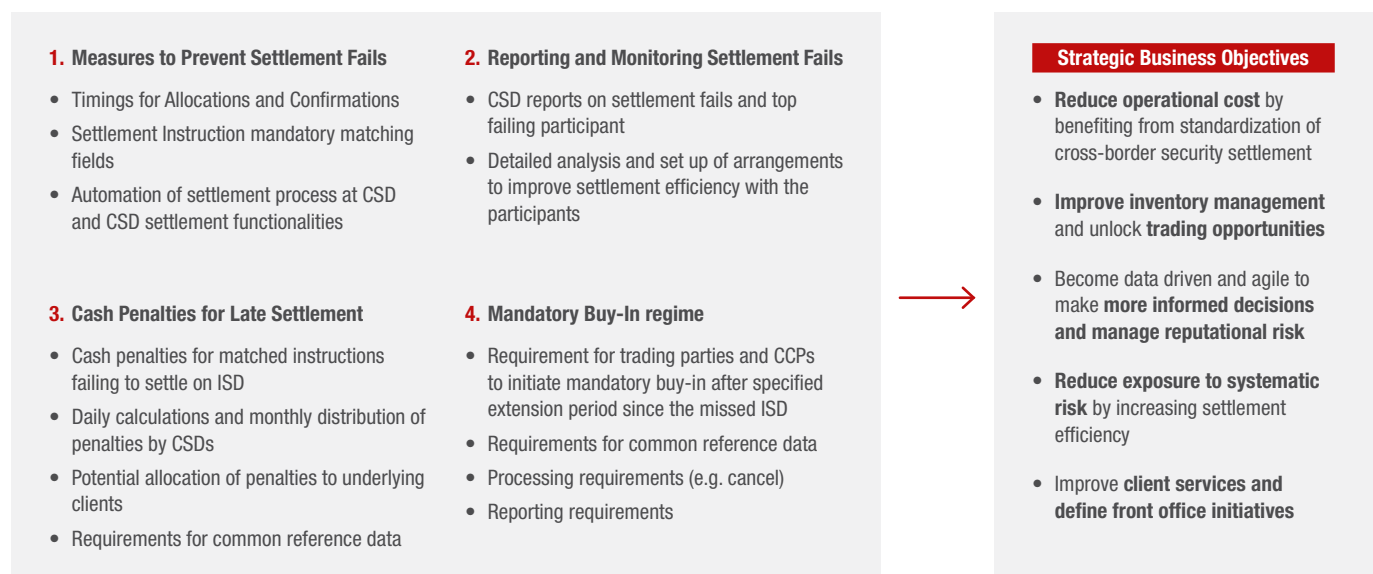


Figure 1 – Alignment of CSDR requirement and strategic business objectives

EVALUATING DIRECT AND INDIRECT SETTLEMENT DISCIPLINE IMPACT

The direct impact of Settlement Discipline will be a negative pressure on P&L, resulting from high premiums for bought-in securities, cash penalties for late settlement, and increased operational cost due to processing of buy-ins and penalties.

But who should bear these increased costs?

The CSDs will charge penalties to direct participants who were the last to amend instructions or short to deliver, but the reason for late matching or settlement fails could lie in fact with the end-client. Market participants will need to decide whether to absorb the cost or perhaps pass it to the end-client, depending on their position in the settlement and custody value chain

For example, although Settlement Discipline does not specify consequences for not adhering to the stipulated allocation and confirmation standards, could passing on late matching penalties where the client provided allocations late be the answer?

The consideration of passing cost up the value chain reveals an indirect impact of CSDR, namely its effect on client relationships, and the opportunity for the Bank's to revisit their client offering that stems out of it. Adopting a client-centric view and recognising the need for cooperation across the value chain, Banks can re-define their client strategy, services offered and re-consider how they interact with their clients. The focus should lie on the ability to work with clients to prevent settlement fails and provide them with a timely and accurate information.

Managing the reputational impact of being reported by CSDs as the top failing participant, needs to be also considered. Although, it is not clear what consequence this would bring from regulatory perspective, 'the name and shame' practise could have a damaging effect on a bank and its client and counterparty relationships.

USING DATA EFFECTIVELY TO TACKLE SETTLEMENT DISCIPLINE

The starting point in forming a response to Settlement Discipline that reaches beyond operational aspects of buy-ins and cash penalties is the availability of settlement data. From internal efficiency to trend analysis of settlement behaviours across clients, counterparties and markets to inform business strategy, data analytics will be the entry point to unlock value at every point in the settlement chain. We call this data commercialisation¹.

Here are the main three areas of focus for application of data analytics in the context of CSDR:

- 1. Prevention of Settlement Fails:** while the topic of settlement efficiency is not new and major transformation was brought in by T2S, Settlement Discipline gives yet another, quantifiable, incentive to prioritise that effort within the organisation. SSIs management, inventory management, late allocations are all known reasons for fails, however, what is the monetary impact in light of Settlement Discipline? The ability to identify and quantify root causes of settlement fails will allow to prioritise areas that will need to be addressed to effectively reduce risk and cost in preparation of Settlement Discipline go-live. Similarly, availability of data will be pivotal in decisions to pass on or absorb cost by allowing to substantiate and evidence these decisions.
- 2. Data as a client service:** data analytics can also augment existing services and become an offering in itself, contributing to better client settlement performance and cooperation across market participants.
- 3. Business Strategy:** trend analysis and validation of hypotheses around settlement performance that can be embedded into the business strategy. Knowing the top failing clients and counterparties and identifying trends in their settlement behaviour can reveal important findings that can help inform front office initiatives such as client and cost strategies or types of services offered.

¹ Full Capco report on Data Commercialisation as a source of competitive advantage is available here: <http://capco.com/Intelligence/Capco-Intelligence/Data-Commercialisation>



CONCLUSION

Capco are a strong believer in 'strategic compliance' and using regulatory programmes as a driver to deliver on wider business objectives. In case of Settlement Discipline, the operational readiness to process cash penalties and buy-ins is undoubtedly a fundamental part in responding to the regulation, and in fact similar processes exist today but not on the same scale (for example CCP penalties). However, long term solutions that address root causes of settlement fails and improve business profitability are required to solve for the wider impacts of Settlement Discipline on client relationships, contractual obligations and type of services offered, as well as reputational risk. Data commercialisation will be the driving force in defining those solutions and prioritising them to meet regulatory obligation while taking a full advantage of the transformational potential of Settlement Discipline.

HOW CAN CAPCO HELP?

Capco can support your organisation with the interpretation and quantification of regulatory impacts on your business by helping you identify key opportunities and threats, along with estimating deviation from target compliance state.

We can also help you identify the key requirements and support solution design activities to reach compliance state in the most efficient and cost-effective manner, that is by identifying synergies and ensuring alignment with your wider business objectives.



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ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward. Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and investment management, and finance, risk & compliance. We also have an energy consulting practice. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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