EUROPEAN CENTRAL BANK

EUROSYSTEM

T2S CHANGE REQUEST FORM

General Information (Origin of Request)
☐ User Requirements (URD) or GUI Business Functionality Document (BFD)
☒ Other User Functional or Technical Documentation (SYS)

Request raised by: Iberclear	**Institute:** CSD	**Date raised:** 27/05/2022
Request title: Counterparty leg of a failing instruction due to reason code "LINK" should not be penalised.		**Request No.:** T2S 0786 SYS
Request type: Common	**Classification:** Scope Enhancement	**Urgency:** Fast track[1]
1. Legal/business importance parameter[2]: High		**2. Market implementation efforts parameter[3]: Low**
3. Operational/Technical risk parameter[4]: Low		**4. Financial impact parameter[5]: Medium**
Requestor Category: CSD		**Status:** Implemented

Reason for change and expected benefits/business motivation:

The Penalty Mechanism comprises the processes necessary for the daily Calculation and Reporting of Penalties on Matched Settlement Instructions which are not settled on their intended settlement day and following business days.

When a Matched Settlement Instruction fails to settle on or after its Intended Settlement Date, the Penalty Mechanism evaluates whether there is a Penalty to be imposed to the relevant party of the Settlement Instruction, or not. The eligibility for a penalty is derived from the reasons for failing that the instruction has at the end of the applicable cut-off. These reasons for failing are checked against the Failing Reasons Dictionary. As soon as one reason for failing has a positive eligibility result, the Settlement Instruction is eligible for a penalty.

When one of the instructions of a transaction is linked (but not the other), and the transaction fails in its ISD due to the link, a message status (PENF) is sent to both counterparties, with the reason code 'LINK'. Before the entry into force of the Penalty mechanism this was not a major issue, since the participant who hadn't got its instruction linked could derive that the operation hadn't settled because its counterparty had its instruction linked to another instruction in failure. There was no need to enrich the information.

But now, after the Penalty Mechanism entry into force, the settlement failure reason code 'LINK' is not granular enough to allow to differentiate between the party responsible of the failure and its counterparty. This leads, in the above-described scenario, to penalise an instruction which is not responsible for the non-settlement of the transaction.

Description of requested change:

In a linkage scenario where an instruction fails to settle because it contains a link to another instruction which also fails to settle regardless of the reason for the failure, the counterparty of the first instruction should not be penalised. The penalty should be applied only to the instruction that contains the link, as this instruction is the one responsible of the failure. The following example illustrates the scenario described.

Example:

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[1] Fast track approach is requested due to the urgency of this change since some CSDs are facing unexpected operational efforts to solve this issue.
[2] Legal/business importance parameter was set to High because it is a regulatory requirement for some markets
[3] Market implementation effort parameter was set to Low because it does not require any implementation by the T2S actors
[4] Operational/technical risk parameter was set to Low because the addition of this functionality is not deemed to imply significant operational or technical risks
[5] Low < 100kEUR < Low-Medium < 200 kEUR < Medium < 400kEUR < High < 700kEUR < Very high

Faling instructions						
Instruction	Instructing party	Counterparty	Transaction type	Linkage	Failed?	Fail reason
SI1	Party A	Party B	DVP		YES	LACK
SI2	Party B	Party A	RVP		NO	CLACK
SI3	Party B	Party C	DVP	SI2	YES	LINK
SI4	Party C	Party B	RVP		YES	LINK

In this example there are three parties involved:
- Party A – short of securities in SI1. Offender of the first pair of instructions
- Party B – short of Securities in SI3. Actual offender of the second pair of instructions
- Party C – Actual damaged of the second pair of instructions

The penalties that are currently calculated by T2S (amounts are examples only) are the following:

Penalties						
Penalty ref.	Common ref.	Party	Counterparty	Underline instruction	Fail reason	Amount
F001	001	Party A	Party B	SI1	LACK	-1000
N001	001	Party B	Party A	SI2	CLACK	1000
F002	002	Party B	Party C	SI3	LINK	-100
N002	002	Party C	Party B	SI4	LINK	100
N003	003	Party B	Party C	SI3	LINK	300
F003	003	Party C	Party B	SI4	LINK	-300

- Party A: valid debit penalty in the first transaction
- Party B:
  - o Valid credit penalty in the first transaction
  - o Valid debit penalty in the second transaction
  - o Not valid credit penalty in the second transaction
- Party C:
  - o Valid credit penalty in the second transaction
  - o Not valid debit penalty in the second transaction (it could be even higher than the previous penalty N002)

The change should put the focus on the internal reporting between the Penalty System and T2S Settlement to solve the issue. In particular, at cut-off time a new process should be implemented to analyse all failure reasons "LINK" and provide them to the Penalty Mechanism module so that it can avoid computing penalties under the aforementioned linkage scenario. Therefore, it is not requested to change the external reporting.

Submitted annexes / related documents:

Outcome/Decisions:

*CRG on 6 July 2022: the CRG agreed to recommend CR-0786 for authorisation by the T2S Steering Level, following a fast-track approach.
*AMI-SeCo on 27 July 2022: the AMI-SeCo agreed with the CRG recommendation of CR-0786 for T2S Steering Level Authorisation.
*NECSG on 28 July 2022: the NECSG agreed to authorise CR-0786.
*CSG on 28 July 2022: the CSG agreed to authorise CR-0786.
*MIB on 22 August 2022: the MIB agreed to authorise CR-0786
*PMG on 31 August 2022: the PMG agreed to launch the detailed assessment of CR-0786 with a view of scoping in Release R2023.NOV.
*CRG on 16 November 2022: the CRG agreed to recommend to the PMG the inclusion of CR-762 in the scope of R2023.NOV.
*OMG on 16 November 2022: the OMG identified no operational impact from the inclusion of CR-786 in R2023.NOV.
*PMG on 18 November 2022: the PMG agreed to recommend the inclusion of CR-786 in the scope of R2023.NOV.
*CSG on 28 November 2022: the CSG approved the inclusion of CR-786 in the scope of R2023.NOV.
*NECSG on 28 November 2022: the NECSG approved the inclusion of CR-786 in the scope of R2023.NOV.
*MIB on 1 December 2022: the MIB approved the inclusion of CR-786 in the scope of R2023.NOV.
*CRG on 27 April 2023: the CRG agreed to include in CR-786 the additional SDD impacts provided by 4CB in the Detailed Assessment.

Documentation to be updated:

UDFS v7.2:

The following UDFS v7.2 sections should be modified

1.6.1.14.4 Penalty Eligibility
(…)

Eligibility for a Settlement Fail Penalty (SEFP)

-    Add a footnote in the Failing Reasons Dictionary to clarify that the eligibility result for a Settlement Instruction with the below mentioned Business Rules but not having any links will be 'FALSE'.

TABLE 140 - FAILING REASONS DICTIONARY

Reason Code	Description of the Error	Eligibility Result
(…) LINK	(…) SXAA018 - Failure of the settlement attempt due to a link with a settlement instruction or a settlement restriction in failure	(…) TRUE^{XXX}
(…) LINK	(…) SPST011 - Settlement Instruction is unsettled because another instruction which is suspended (due to cut-off reached) states a link WITH or BEFORE this instruction.	(…) TRUE^{XXX}
(…) LINK	(…) SPST019 - Settlement Instruction is unsettled because it states a link WITH or BEFORE an instruction that is al-ready settled because its reciprocal link was not stated by the party.	(…) TRUE^{XXX}

(…)	(…)	(…)
LINK	SPST021 - Settlement Instruction is unsettled because another instruction stating a link WITH or BEFORE this instruction is 'On Hold'	TRUE<u>XXX</u>
LINK	SPST023 - Settlement Instruction is unsettled because another instruction stating a link WITH or BEFORE this instruction is 'CoSD On Hold'	TRUE<u>XXX</u>
<u>LINK</u>	SPST025 - Settlement Instruction is unsettled because another instruction or restriction which is 'Cancelled' states a link WITH or BEFORE this instruction.	TRUE<u>XXX</u>
LINK	SPST028 - Settlement Instruction is unsettled because it states a link WITH, BEFORE or AFTER an instruction that is under CoSD Hold without any links to this instruction.	TRUE<u>XXX</u>
LINK	SPST032 - Settlement Instruction or settlement restriction is unsettled because it states a link WITH or BEFORE an instruction or a restriction that is not eligible for settlement	TRUE<u>XXX</u>
(…)	(…)	(…)
LINK	SPST033 - Settlement Instruction or Settlement Restriction is unsettled because it states a non-reciprocal link to a Settlement Instruction or Settle-ment Restriction that is partially set-tled.	TRUE<u>XXX</u>
LINK	SPST034 - Settlement Instruction or Settlement Restriction is unsettled because it states a non-reciprocal link "WITH" to a Settlement Instruction or Restriction with a different Intended Settlement Date.	TRUE<u>XXX</u>
LINK	SPST035 - Settlement Instruction or Settlement Restriction is unsettled because it states a non-reciprocal link "AFTER" to a Settlement Instruction or Restriction with a later Intended Set-tlement Date.	TRUE<u>XXX</u>
LINK	SPST036 - Settlement Instruction or Settlement Restriction is unsettled because it states a non-reciprocal link "BEFORE" to a Settlement Instruction or Restriction with an earlier Intended Settlement Date.	TRUE<u>XXX</u>

- The wording of the new foot note should be the following:

<u>XXX:</u>   <u>The eligibility result will be 'TRUE' if the Settlement Instruction having received this reason 'LINK' has failed to settle due to being linked to another instruction. However, the eligibility result will be 'FALSE' if such Settlement Instruction receives reason 'LINK' but has no links and fails to settle because of its counterparty which is linked in failure to (an)other</u>

instruction(s).

29~~3~~4   ~~In case a Settlement Instruction, had at the end of the applicable cut-off, a reason for failing that is not in the "Failing reasons Dictionary" an alarm is raised to the T2S Operator.~~ Together with PRSY (System on hold) it is the reason and description provided when the instruction is on COSD Hold.

-    Add new example in order to illustrate the new behavior:

In order to illustrate how the eligibility result is determined, ~~4~~ 6 examples are provided hereafter. All of the examples relate to a pair of Matched Settlement Instructions that having reached its ISD, fail to settle in T2S before the completion of the relevant cut-off.

(...)

I Settlement Instruction A is not exempted because of its ISO Transaction Code, hence, T2S analyses the reason for failing at the EFOP cut-off, i.e.: "LINK" and checks that Settlement Instruction A has a link with another instruction in failure. Consequently, according to the Failing Reasons Dictionary, the result is that Settlement Instruction A is eligible for a Penalty.

I Settlement Instruction B is not exempted because of its ISO Transaction Code, hence, T2S analyses the reason for failing at the EFOP cut-off, i.e.: "LINK" and checks that Settlement Instruction B has no link. Consequently, the result is that Settlement Instruction B is not eligible for a Penalty, as it failed to settle because its counterparty Settlement Instruction A was linked in failure to (an)other instruction(s).
(...)

Preliminary assessment:

n.a.
Detailed assessment:

EUROSYSTEM ANALYSIS – GENERAL INFORMATION			
T2S Specific Components		**Common Components**	
LCMM			
	Instructions validation		
	Status management		
	Instruction matching		
	Instructions maintenance		
X	Penalty Mechanism		
Settlement			
X	Standardisation and preparation to settlement		
	Night-time Settlement		
	Daytime Recycling and optimisation		
	Daytime Validation, provisioning & booking		
	Auto-collateralisation		
Liquidity Management			
	Outbound Information Management		
	NCB Business Procedures		
	Liquidity Operations		
T2S Interface *(as of June 2022 without Static Data Management, Communication for SDMG, Scheduler, Billing)*		**Eurosystem Single Market Infrastructure Gateway** (from R6.0 June 2022)	
	Communication		Communication
	Outbound Processing		Outbound Processing
	Inbound Processing		Inbound Processing
Static Data Management *(until June 2022)*		**Common Reference Data Management** *(from R6.0 June 2022)*	

	Party data management		Party data management
	Securities data management		Securities data management
	Cash account data management		Cash account data management
	Securities account data management		Securities account data management
	Rules and parameters data management		Rules and parameters data management
Statistics and archive		**Statistics and archive**	
	Statistical information (until June 2022)		Short term statistical information
	Legal archiving (until June 2022)		Legal archiving (from R6.0)
			Data Warehouse (from R6.0)
Information *(until June 2022 containing reference data)*		**CRDM business interface** *(from R6.0 June 2022)*	
	Report management		Report management
	Query management		Query management
			Communication
			Outbound Processing
			Inbound Processing
Operational Services			
	Data Migration (T2S DMT)		Data Migration (CRDM DMT, from R6.0)
	Scheduling (until June 2022)		Business Day Management (from R6.0)
			Business Day Management business interface (from R6.0)
	Billing (until June 2022)		Billing (from R6.0)
			Billing business interface (from R6.0)
	Operational Monitoring		Operational and Business Monitoring
	MOP Contingency Templates		

Impact on major documentation		
Document	**Chapter**	**Change**
Impacted GFS chapter	No impact.	
Impacted UDFS chapter	1.6.1.14.4 Penalty Eligibility - Eligibility for a Settlement Fail Penalty (SEFP)	Add a footnote in the Failing Reasons Dictionary in section *Eligibility for a Settlement Fail Penalty (SEFP)* to clarify that the eligibility result for a Settlement Instruction with reason 'LINK', but having no links, will be 'FALSE'. A new example has been added to illustrate this new business case.
Additional deliveries for Message Specification (UDFS, MyStandards, MOP contingency templates)	No impact.	
UHB	No impact.	
Other impacted documentation (FA Sch. 05, FA Sch. 07)		
Impacted GDPR message/ screen fields	No impact.	
Links with other requests		
Links	Reference		Title	

OVERVIEW OF THE IMPACT OF THE REQUEST ON THE T2S SYSTEM AND ON THE PROJECT

Summary of functional, development, infrastructure and migration impacts

When the Penalty Mechanism evaluates whether a Settlement Instruction that failed to settle on the previous business day is to be imposed with a SEFP Penalty or not, it is based on the reason(s) for failing that such Settlement Instruction received at the end of their relevant cut-off in the previous business day.

In some scenarios, when one Settlement Instruction is linked but its counterparty is not, both Settlement Instructions receive the failing reason code 'LINK' together with the same business rule as a result of the eligibility check failure. In this case both Settlement Instructions are imposed with a SEFP penalty because the eligibility result of this failing reason code is 'TRUE' and this reason code is not granular enough to allow to differentiate between the party responsible of the failure (for being linked to another instruction) and its counterparty (who has no links and is not responsible of such failure).

The following changes are needed to not penalize in a linkage scenario a Settlement Instruction not bearing a link when the same business rule applies to both Settlement Instructions of a linked transaction at the end of the applicable cut off:

i)   SETT will retrieve once daily at the End of Day the relevant information related to matched Settlement Instructions linked in failure due to reason code "LINK" and identical Business Rules for both matched Settlement Instructions (i.e.: business date, the references of the matched instructions, the available business rule determined at the latest settlement attempt, whether the instruction is bearing the link or not,…). The Reason Code to be considered must be the latest one before the end of the cut-off process and the link/unlink situation of the instruction must be the one available at the point in time by when the business rule, (i.e.: the reason code 'LINK') was assigned to the instruction (i.e. at the point in time by when the last settlement attempt was performed).

In case of unlink instructions executed during the cut-off, the penalty rules will not change. If an instruction is bearing a link at the beginning of the cut off but an unlink instruction is executed during the cut-off without being attempted to settle, this instruction should be eligible for a penalty. For this purpose, the information regarding the existence or not of a link is the one available at the last settlement attempt of the instruction performed. This means that if the failing reason code at the end of the cut off is one of the before mentioned 'LINK' business rules, the information provided by SETT regarding the existence of the link will be the one available before the execution of the unlink instruction, hence a SEFP penalty is to be imposed.

The links to be considered are WITH, BEFORE, AFTER or POOL regardless whether these links have been set up by the Instructing Party or automatically by T2S.

In case of a chain of linked transactions, SETT will not analyse the full depth of the chain (e.g.: if the transaction failed due to a "LINK" Reason Code is itself linked to a third one, the latter will not be considered).

Once extracted, SETT will store the data so that LCMM may retrieve the needed information from the service, using the references of the matched settlement instructions and the relevant business date.

The Business Rules identical for both matched SI and bearing the LINK Reason Code to be considered are listed below:

Business Rule ID	Error description
SXAA018	Failure of the settlement attempt due to a link with a settlement instruction or a settlement restriction in failure
SPST011	Settlement Instruction is unsettled because another instruction which is suspended (due to cut-off reached) states a link WITH or BEFORE this instruction.
SPST019	Settlement Instruction is unsettled because it states a link WITH or BEFORE an instruction that is already settled because its reciprocal link was not stated by the party.
SPST021	Settlement Instruction is unsettled because another instruction stating a link WITH or BEFORE this instruction is 'On Hold'.
SPST023	Settlement Instruction is unsettled because another instruction stating a link WITH or BEFORE this instruction is 'CoSD On Hold'.
SPST025	Settlement Instruction is unsettled because another instruction or restriction which is 'Cancelled' states a link WITH or BEFORE this instruction.
SPST028	Settlement Instruction is unsettled because it states a link WITH, BEFORE or AFTER an instruction that is under CoSD Hold without any links to this instruction.
SPST032	Settlement Instruction or settlement restriction is unsettled because it states a link WITH or BEFORE an instruction or a restriction that is not eligible for settlement
SPST033	Settlement Instruction or Settlement Restriction is unsettled because it states a non-reciprocal link to a Settlement Instruction or Settlement Restriction that is partially settled.

SPST034	Settlement Instruction or Settlement Restriction is unsettled because it states a non-reciprocal link "WITH" to a Settlement Instruction or Restriction with a different Intended Settlement Date.
SPST035	Settlement Instruction or Settlement Restriction is unsettled because it states a non-reciprocal link "AFTER" to a Settlement Instruction or Restriction with a later Intended Settlement Date.
SPST036	Settlement Instruction or Settlement Restriction is unsettled because it states a non-reciprocal link "BEFORE" to a Settlement Instruction or Restriction with an earlier Intended Settlement Date.

ii) Penalty Mechanism will retrieve the necessary information from SETT during the Eligibility process (i.e. NTS) for being able to identify which Settlement Instruction(s) bear(s) the link and therefore is(are) to be imposed with a SEFP Penalty. In order to differentiate which of those matched Settlement Instructions is to be penalised with a SEFP and which one not, the Penalty Mechanism will assign a new internal error code to those matched Settlement Instructions having received failing reason 'LINK' but bearing no links. This error code will be used only for the processing of the Penalty Mechanism (i.e. it will not be informed neither in the status advice messages nor in the Daily Penalty List or in the List of Modified Penalties). This new internal error code will be added in the Failing Reasons Dictionary with eligibility result 'FALSE' so that the instruction not bearing any link will not be imposed with a SEFP penalty. The Settlement Instructions linked with another instruction will continue being assigned the current Business Rule and therefore will be penalised.

Cost Drivers

- New process to allow LCMM to retrieve the settlement instructions in failure for a LINK Reason
- Improvement of the Penalty Mechanism module in order to identify, if a settlement instruction having received failing reason 'LINK' is bearing a link or not, in order to impose a SEFP penalty only to the settlement instructions effectively bearing a link.
- Testing of the Penalty Mechanism to confirm that a SEFP penalty is imposed only to those settlement instructions effectively bearing a link.
- Non regression testing regarding the abovementioned functionality.

Impact on other TARGET Services and projects
No impact has been identified on other Eurosystem systems and projects (Target2, CSLD, TIPS or ECMS)
Summary of project risk
No risk has been identified during the detailed assessment
Security analysis
No adverse impact has been identified during security assessment.

27 October 2022

Cost assessment on Change Requests

T2S-786-SYS – Counterparty leg of a failing instruction due to reason code "LINK" should not be penalised			
One-off	Assessment costs* - Preliminary - Detailed	2,000.00 10,000.00	Euro Euro
One-off	Development costs	357,184.61	Euro
Annual	Operational costs - Maintenance costs - Running costs	 28,732.15 0.00	 Euro Euro

*The relevant assessment costs will be charged regardless of whether the CR is implemented (Cf. T2S Framework Agreement, Schedule 7, par. 5.2.3).