Keeping the lights on

Although CSDR may not be top of mind for firms right now, Will Stevens of IHS Markit says it is necessary to prioritise your preparedness for this looming regulatory requirement

Many European settlement participants welcomed the extra time to prepare for the Central Securities Depositories Regulation (CSDR) settlement discipline regime, following the announcement from the European Securities and Markets Authority (ESMA) postponing the implementation date to 1 February 2021. However, since this announcement, something bigger and more immediate now dominates almost everyone's priorities. It's fair to say that no one could have foreseen a situation of this magnitude, a global pandemic which right now, is undoubtedly the only thing that investors, asset managers and banks alike are concerned about.

While the situation presents a multitude of challenges, business as usual must continue. Working from home while juggling video conference calls and a host of other new tasks has quickly become the norm. Keeping the lights on remains the priority, but inevitably, the need to manage change must not be forgotten and regulatory requirements continue to be a priority.

Panic has triggered unprecedented volatility, with volumes of risk-off activity exceeding those seen during the global financial crisis of 2008. The selling of equities across all sectors and regions has pushed many

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markets into bear territory. Managing trade settlement across even the most liquid stocks is a daily struggle, with many organisations seeing their back-office working into the early hours. Securities lending agents have experienced abnormal activity as their clients offload riskier assets, driving up loan recalls, but also fueling demand to cover stocks that are hard to locate. Settlement fails, cash penalties and buy-ins are in sharp focus for anyone working in the post-trade space.

While initiatives like CSDR may not be at the forefront of everyone's mind, post-trade operations need to continue to function with minimal disruption throughout the post-trade chain, from the end investor to the CSDs. But, maybe now, regulation like CSDR is more important than ever, when calm and order in the markets are crucial. It's times like this when post-trade platform consolidation really matters, reducing inefficiency and risk associated with fragmented legacy software.

In this environment of high volatility and increased trading volumes, settlement discipline must be a key consideration. With no end in sight for the COVID-19 pandemic, it's hard to know when economies and markets will begin their recovery.

As businesses adapt to function in a new format, it's crucial for them to revisit the prioritisation of their investment initiatives. With time running short, regulatory items must move to the top of the list. Strict delivery timetables must be put in place and re-engagement with solution providers should occur without delay.

One thing is certain: when we reach a turning point and confidence returns, buyers will regain control and a further surge in trading volumes will occur. This could mean an increase in failed trades where asset managers, institutional and retail traders attempt to pick up bargains as they rescue their portfolios. After crisis, comes opportunity.

CSDR has many components across data, software, integration and interface. New penalty processing functionality within the existing interbank messaging framework will require adoption, and therefore changes to message management and user interface. Posting of debits or credits to client accounts must be automated, with the ability to accrue, waive and pass fees on an ad-hoc basis when required. Foreign exchange transactions will also require automation to ensure risk and inefficiencies associated with manual processing are avoided. While reconciliation of fees and penalty dispute handling appear challenging, they will be necessary for institutions to correctly and transparently attribute the correct monies to their underlying clients.

CSDR aims to balance the responsibility between buyer and seller, ensuring both parties have equal motivation to fulfil their obligations. Net fees derived from a combination of matching and failing penalties on the same transaction may result in unexpected outcomes. For example, a buyer being charged a larger penalty than the seller because they failed to match a trade for a greater number of days than the seller was short to deliver beyond the intended settlement date. Different calculation methods across asset classes will also require sophisticated software enhancements, as well as new data models in order to source and generate the correct rates for calculation. Solutions for managing CSDR will only provide real value if they offer front-to-back coverage across the process with a high level of automation.

Preparing for CSDR is more important now than ever. Time to prepare in these challenging times is limited, and whether it's a third-party standalone solution or an integrated solution, CSDR must not introduce new operational risk or inefficiencies. There is no time to waste.

IHS Markit delivers multi-asset class solutions across the post-trade landscape, with integrated regulatory components enabling clients to better manage headwinds faced in an ever-evolving and uncertain environment. Our post-trade solution IMSecurities provides the foundation for supporting CSDR. With a team of industry experts who collaborate with clients to deepen our understanding of their requirements so that when CSDR arrives, they are equipped with an integrated solution, offering automated features that maintain efficiency and transparency.