

T2S adaptation plan

For Fixed income and repos markets

LCH.Clearnet SA CCP Clearing Services

3 September 2014 - version 1.0

Table of Contents

Table of Contents	2
Abbreviations	3
1 Introduction	4
2 WAVE 1: June 2015 Changes	6
2.1 T2S account structure for the security accounts in Monte Titoli	6
2.2 Operating model under Monte Titoli infrastructure	6
2.2.1 Netting and sending of net balances	6
2.2.2 Strange nets:	7
2.2.3 Same day repo: gross settlement in the T2S real time window and shaping	7
2.2.4 Already matched transactions (for both cases: net balances and gross settlement)	8
2.2.5 Settlement instructions priority (for both cases: net balances and gross settlement)	8
2.2.6 Hold and Release (for both cases: net balances and gross settlement)	8
2.2.7 Partial settlement (for both cases: net balances and gross settlement)	8
2.2.8 Auto collateralisation mechanism (for both cases: net balances and gross settlement)	9
2.3 Cancellation	9
2.4 Fails recycling	9
2.5 Corporate Actions on flows (market claims and transformation)	9
2.5.1 Interest payment	9
2.5.2 Reimbursement at maturity date	9
2.6 Mandatory Buy in and cash compensation	10
2.7 Change of settlement Agent within MT	10
3 WAVE 2: March 2016 Changes	11
3.1 French debt	11
3.1.1 The current SLAB facilities will be decommissioned by EF.	11
3.1.2 Cash payment related to cleared debts on the DCA when possible	11
3.1.3 Transformation at record date	11
3.2 Italian debt	12

Abbreviations

APMT	Against Payment
CA	Corporate Actions
CASG	Corporate Actions Sub Group
CMF	Clearing member firm
CSDR	CSD regulation
DCA	Dedicated Cash Account in T2S
DEAG	Delivery Agent
DVP	Delivery versus Payment
DWP	Delivery with Payment
FICs	Fixed Income Clearing system of LCH
FoP	Free of Payment
ISD	Intended Settlement Date
LCH.SA	LCH.Clearnet SA
MT	Monte Titoli
PFoD	Payment Free of Delivery
POA	Power of Attorney
REAG	Receiver Agent
SA	Settlement Agent
T2S	Target 2 securities

1 Introduction

24 CSDs among them Monte Titoli, Euroclear and Iberclear signed in June 2012 the framework agreement to outsource the settlement of securities transactions to the new European Settlement platform T2S.

LCH.Clearnet SA (LCH.SA) clears various OTC and MTF transactions related to **bonds and repos** in particular the Italian, French and Spanish government debts stemming from MTS, Broker Tec, ETCMS. The settlement of these transactions takes place in the Issuer CSD i.e respectively in MonteTitoli, Euroclear France and Iberclear in Central Bank money.

This document has the objective to inform our Clearing membership of LCH.SA adaptation to T2S and to highlight the opportunities offered by T2S for an efficient settlement of CCP transactions. It is also relevant for the settlement agent / paying agent who provide custody support to the clearing member. This paper is also interesting for the trading community around the clearing activity.

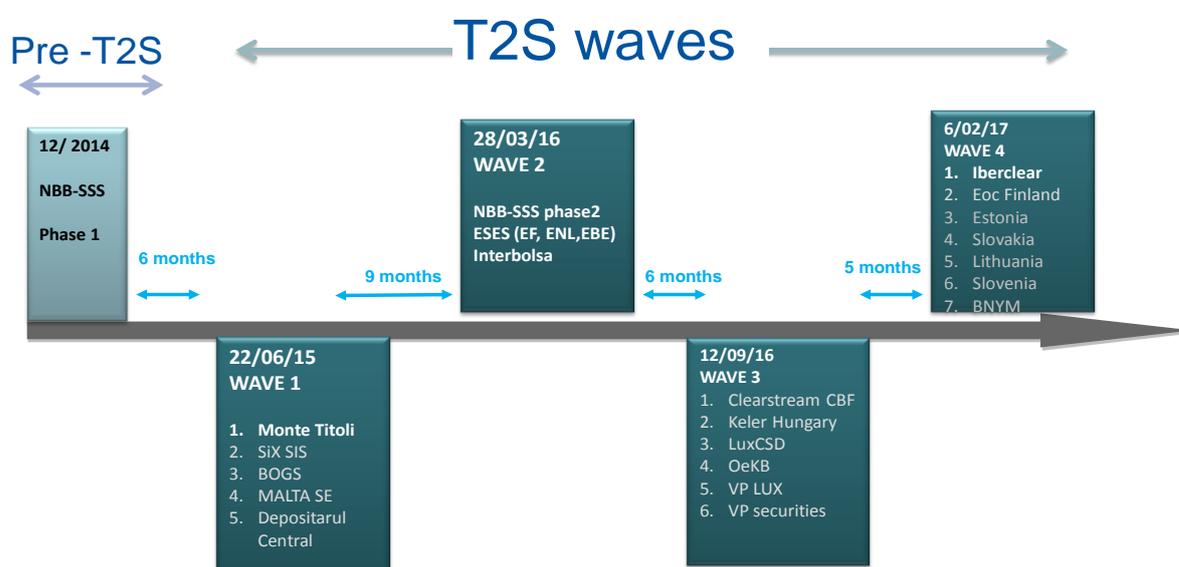
This document has not the intention to duplicate the various CSD's documentation that the CSDs are issuing to their participants 'community. It would mainly focus on the adaptation of the settlement of cleared transactions against LCH.SA. However some overlap of information cannot be avoided. Additional communication tools such as general presentation, meetings will be organised by LCH.SA along with the migration waves

LCH.SA declared its access to T2S as Direct Connected Party both for securities and cash management and will use the ISO20022 messaging standards. LCH.SA will connect as DCP as from the first migration wave and retained SWIFT as value added network (VAN) to connect to T2S engine

Here below the overall T2S program for LCH.SA clearing activities related to both the cash and bonds/repos markets. In bold LCH.SA as current direct participant in the CSD). The NBB-SSS changes of December 2014 are considered as a pre-T2S wave ahead of the 4 waves defined by the Eurosystem.

With regards to the Fixed income activity, LCH.SA will be impacted by 3 migration waves (wave1, wave2 and Wave4). The first LCH.SA cleared market to migrate is related to the **Italian debt** which LCH.SA relies on the current **Monte Titoli Infrastructure**, followed by the French one in the second wave and then the Spanish debt in the 4th wave.

T2S Time line



3

2 WAVE 1: June 2015 Changes

2.1 T2S account structure for the security accounts in Monte Titoli

For settlement purposes, the BIC id of LCH.SA will be BACFRPPXXX. It shall be used as “DEAG” or “REAG

The current securities account “**21323**” and “**60099**” respectively open with MT for standard settlement and buy-in/default management will be adapted and will follow the new MT / T2S coding standard

- Char 1 - 4 the first 4 character of the BIC of Monte Titoli, “MOTI”.
- Char 5 - 15 BIC of the account owner.
- Char 16-20 current Monte Titoli account number.(ABI code)
- Char 21-22 two digits, balance type usually “00”
- Char 23-35 13 characters for free text.

LCH.SA will therefore use the following adapted securities account structure in T2S:

- “MOTIBACFRPPXXX**21323**00” for the standard settlement
- “MOTIBACFRPPXXX**60099**00” for the Buy-in and default management.

2.2 Operating model under Monte Titoli infrastructure

2 types of settlement instructions will be sent to T2S:

- The ones resulting from the netting ([see 2.2.1 and 2.2.2](#))
- The ones sent in “quasi” real time and related to the first leg of the Same Day repo ([see 2.2.3](#))

The instruction type will always be “APMT” for all the netted and gross settlement instructions ensuring that settlement is final at the end of the DVP cut off of 4pm and not beyond (even if the result of the netting is functionally a free of payment).

2.2.1 Netting and sending of net balances

At the launch of wave 1, LCH will continue to outsource to MT the netting process, based on the following criteria:

1. Intended settlement date (ISD) ¹
2. ISIN,
3. Clearing member,
4. Compartment (House or Client).

After the closure of the trading venues (currently 6:30 pm), MT will create the final netted balances against LCH.SA and the related settlement instructions with an ISD equal to the next business day. Late trade with a “T+1” settlement cycle entered on T a few minutes before the trading cut-off will then be part of the final netted balances to settle the next business day.

¹ The trading date is not a netting criteria and could be from ISD-1 (trade with short settlement cycle of 1 day) or ISD – n business days (classic buy-sell, long term repo).

The sending of settlement instructions will be triggered so that the validation and settlement can effectively take place no later than the specific sequence for DVP transactions in the first T2S night batch (currently the announced timing being 7:30 pm) after the change of accounting day from S-1 to S.

2.2.2 Strange nets:

A large majority of netting results are DVP. Nevertheless some strange nets may occur like:

- A “Payment free of Delivery” (PFoD) when the clearing member has bought and sold the same quantity of a security but at different prices.
- A “Delivery with payment” DWP or “Receive with payment” RWP when both securities and cash have the same direction.
- A “Free of payment” FOP when the net obligation is only a quantity of securities with no associated cash
- “Zero securities and zero cash”: As there are neither securities nor cash transfer, there will be no settlement instructions to send to T2S.

2.2.3 Same day repo: gross settlement in the T2S real time window and shaping

The Same day repo (first leg) will continue to be sent in real time to T2S.

MT will add the “trade reference” in the settlement instruction message sese.023: this will be in the tag Common Identification sese.023. /SettlementTypeAndAdditionalParameters/CommonIdentification. The second leg will be netted with the other trades sharing the same netting criteria: (same ISIN, ISD, clearing member and compartment House or Client).

Currently MT applies a shaping of 5 mio€ on the first leg, which has the positive effect to request a minimum of liquidity to settle the cash leg of the settlement instruction. However the shaping increases significantly the number of settlement instructions between the CCP and the clearing member, hence the settlement costs.

LCH extracted several settlement days’ activities and computed the ratio between the theoretical number of settlement instructions before shaping and the number of settlement instructions after shaping. Several shaping sizes have been tested among which the current size of 5mio€ applied by MT.

It is interesting to note that the actual volume of settlement instructions (2900) could be divided by 8 for a shaping size of 100Mio€ and by 10 if the shaping would be removed. This would lead to substantial settlement savings.

Shaping (M€)	5 current	10	25	50	100	NO
Nb. Instructions	2700	1424	678	440	338	290
% added inst.	831%	391%	134%	52%	17%	0%

In addition, since T2S jointly with MT and BdF and Bol will offer the auto-collateralisation on flows and stocks, the cash liquidity on the DCA will become marginal (in particular, for transaction on Italian debt products eligible to the auto-collateralisation on flows).

LCH SA, MT and CC&G reached an agreement to remove the shaping at the time MT will migrate to T2S.

However the re-introduction of shaping and the new size of the shaping can be envisaged between LCH.SA, MT and CC&G if some clearing members faced liquidity issue depending of the service they will use on the cash side: direct or indirect payment bank, use of the auto collateralisation with a central bank and / or use of client auto collateralisation with their payment bank (see point 2.2.8 auto collateralisation).

2.2.4 [Already matched transactions \(for both cases: net balances and gross settlement\)](#)

At this stage, none of our clearing members / settlement agent expressed a demand to move their securities accounts in another CSD that will also migrate to T2S in wave 1.

At the launch of the wave 1, the CCP security account and its counterpart securities account are expected to remain in MT and the 2 legs of the settlement instructions will be “intra CSD”. Therefore, MT (on behalf of LCH.SA) will use as much as possible the facilities offered by T2S ISO20022 and use “already matched instructions” unless there would be technical constraints preventing to use them.

2.2.5 [Settlement instructions priority \(for both cases: net balances and gross settlement\)](#)

LCH.SA as CCP will settle with the top priority (level 2) as foreseen by T2S for CCP / stock exchange transactions. The top priority (level 2) is set up by default on the MT- CCP account in T2S.

2.2.6 [Hold and Release \(for both cases: net balances and gross settlement\)](#)

All settlement instructions will receive the “**release** status”.

As per the current MT rules, stock exchanges and CCP settlement instructions cannot be modified by the counterpart. Therefore none of the following unilateral modification should be allowed: The “hold and release” facility, the change of priority and the change of the flag allowing deviating from the partial settlement which is the T2S default rule.

2.2.7 [Partial settlement \(for both cases: net balances and gross settlement\)](#)

LCH.SA and their counterparties will participate in the 3 partial settlement windows to maximise the settlement of transactions from the seller to the CCP and the CCP to the buyer.

MT will indicate “PART” in the partial parameter meaning that the partial settlement will be triggered based on the cash threshold defined by the Eurosystem for euro-denominated securities. This threshold is equal to 100 000 EUR.

2.2.8 Auto collateralisation mechanism (for both cases: net balances and gross settlement)

LCH.SA as direct participant in T2S with a payment bank status will participate in the auto collateralisation function on flows and on stocks in T2S with MT and the “Banque de France”.

As the French CSD (Euroclear France) will have not migrated yet at the time of the first migration wave, MT, EF and BdF worked jointly to a workaround solution allowing a French Bank to take part in the auto collateralisation process as from wave 1.

LCH.SA requested MT to flag its securities account on which the settlement will take place as “earmarked for autocollat”.

LCH.SA strongly supports and recommends all their payment banks settling the Italian debt to participate to the auto collateralisation as it will substantially decrease the liquidity need.

2.3 Cancellation

With the PoA given by the CMF to LCH.SA, the cancellation request of LCH.SA will apply to both legs at once, with no intervention of the counterparty. This function will be triggered for the following needs:

- buy-in procedure
- change of settlement agent
- management of a default / bankruptcy

2.4 Fails recycling

All fails at the end of the DVP window, will be recycled automatically by T2S. When recycling fails, T2S will keep the original references of the settlement instructions and the original ISD.

2.5 Corporate Actions on flows (market claims and transformation)

LCH SA and their counterparts will participate in the process of corporate actions on flows of MT.

The specific additional marching fields such as “opt out” or no “market claim” will remain blank.

MT will apply the standard rules and procedure defined by the “CASG”.

The CA on flows against the CCP will be created and sent to T2S in “released” status”.

2.5.1 Interest payment

MT will detect and create a market claim transaction on fails at Record date. A new outturn will be generated and will receive as ISD the Payment date of the Corporate action.

2.5.2 Reimbursement at maturity date

MT will detect and operate a transformation on fails at Record date. A cancellation of the original transaction followed by a new cash outturn (PFoD) will be sent to T2S. This new transformed transaction will receive as ISD the payment date (PD) of the corporate actions (CA).

2.6 Mandatory Buy in and cash compensation

Currently the buy-in delay on the Italian debt is fixed at 10 business days.

LCH.SA will adapt and follow the rules of new CSDR published end of August 2014² and the incoming level 2 details to be provided by ESMA for fixed income securities transactions.

Additional information related to the new timing and technical procedure will be given in the coming months

2.7 Change of settlement Agent within MT

LCH.SA and MT agreed to improve the procedure in case of change of settlement agent (portfolio transfer) operating the securities account of the clearing member. This new procedure is dealing with the holding but also the pending positions (already sent to the settlement platform and future positions still to be created in the netting process). The business date on which these transfers occur require specific process by MT. For sake of clarity let's define the parameters:

- D-1 is the last day of settlement with the old settlement agent (SA1).
- D the first day of settlement with the new settlement agent (SA2).

Firstly, for the opening of the business day D, the balances in the old account of the SA1 need to be transferred to the new settlement agent SA2.

Secondly, all pending transactions in fails (ISD < D) need to take place in the new security account of the new settlement agent (SA2) as from day "D".

Thirdly, all open positions with a settlement date in the future (already registered both and Xtrm and FICs) but for which the settlement instruction is not yet created will also be re-allocated to the new SA2.

Consequently, all fails in T2S and open positions with a ISD equal or greater that "D" already registered in MT in the old account need to be cancelled and replaced with the new securities account. The original ISD and trade date do not change.

² : http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2014_257_R_0001&from=EN

3 WAVE 2: March 2016 Changes

A subsequent update of this document will be produced in the coming months with the additional details related to the second wave

One important feature is that as from the second migration wave, LCH.SA will offer to their clearing member the choice to settle their transactions in their preferred CSD already migrated to T2S.

It is indeed expected that Issuer CSDs will extend the scope of securities eligible in their accounts under their new role of investor CSD. For instance, MT could extend the eligibility of French securities in their CSD, thus allowing a Clearing member to settle the French debt in MT. Or alternatively, EF would allow to settle both French and Italian debts in their CSD.

LCH.SA would remain neutral and would allow for a flexible choice, provided that no technical, nor legal constraints (identified by the Market specific Attributes (MSA)) prevent cross-CSD settlement.

3.1 French debt

Here below, we give you a flavour of the main changes:

3.1.1 The current SLAB facilities will be decommissioned by EF.

LCH.SA will send to T2S either:

- Already matched instructions when both LCH.SA and the counterpart settle in the same CSD,
- or
- "To be matched" instructions when LCH.SA and the counterpart settle in different CSDs. In this case, the matching will take place in T2S.

3.1.2 Cash payment related to cleared debts on the DCA when possible

Currently, LCH.SA computes the cash adjustment of each open position when there is a change of EONIA rate. All cash differences ISIN per ISIN are then sum up in one cash book entry which is netted into the daily margin call debited / credited through Target2. The objective is to privilege the payment of these cash movement on the DCA of the clearing member.

3.1.3 Transformation at record date

With regards to the transformation of the second leg of the repo into cash due to the reimbursement of bonds a maturity date, we are still investigating the more optimal solution given some technical constraints in T2S. (CSD only, are allowed to send settlement instructions on maturity date).

3.2 Italian debt

LCH.SA expressed its objective to harmonise and rationalize as much as possible the post trade processing in its Fixed Income system (FICs) and will optimize its DCP role by internalising the netting and sending of settlement instructions related to the Italian debt outsourced to MT in wave 1.

An immediate advantage of such internalisation would be a fully harmonised clearing service irrespective of the market and in addition a possibility to centralise and clear additional trading venues related to the same ISIN, reducing the net exposure of the clearing member and associated margins.

*

* *