

ERCC best practices in support of settlement efficiency

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This is a compilation of best practices extracted from the [ERCC Guide to Best Practice in the European Repo Market](#) which are deemed most relevant in the context of the ongoing ERCC discussions on settlement efficiency. This list has been published alongside the [ERCC's discussion paper: Optimising Settlement Efficiency](#) to draw particular attention to existing best practices on the topics covered in the paper, including: (i) Shaping of settlement instructions, (ii) Partial settlement and auto-partialling, (iii) Auto-borrowing, and (iv) Other relevant issues (netting and recommendations related to settlement instructions). Please refer to the full Guide for further context.

The ERCC Committee endorsed this list of best practices at its meeting on 25 January 2022, highlighting the commitment of member firms to follow these recommendations for the benefit of the wider market and to encourage other firms to do the same.

1. Shaping

Recommended delivery size (shaping)

2.70 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 limit the economic impact of settlement failures. Accordingly, it is recommended that parties in the European repo market should agree to shape transactions into multiple deliveries of 50 million nominal value in EUR, GBP and USD, and the nearest equivalent in other currencies or the amount mandated or generally accepted in other currencies. Note that shaping does not break up a transaction into smaller contracts. It is a purely operational process. Accordingly, confirmations (which are post-trade but pre-settlement verifications) should be sent for the whole amount transacted, not separately for each shape.

Best practice recommendation. It is best practice to divide instructions for the delivery of large amounts of collateral into 'shapes' but confirmations should be sent for the whole transaction, not for each shape.

2. Partial settlement

Partial delivery

2.71 Partial delivery can be defined as the practice of not rejecting delivery of less than the contracted amount of a security purchased in a cash trade or repo. However, a partial delivery does not satisfy the contractual obligation of the seller. It just reduces the adverse economic impact of a failure to deliver the full amount. The seller remains obliged to complete full delivery. Partialling should not be confused with *shaping*, which is an operational mechanism by which a large delivery of securities is broken up into smaller deliveries by the seller or his agent. Like partialling, shaping is intended to reduce the economic impact of a failure to deliver. The difference is that partialling is a decision by a buyer and shaping is an action by a seller, its agent or a market infrastructure such as a securities settlement system or a CCP.

2.72 It is best practice for partial deliveries to be accepted in mini close-outs (see paragraphs 4.2-4.4 below), given that there will be no prospect of further deliveries because of the termination of the transaction, but without leaving an untradeable balance.

Best practice recommendation. It is best practice to accept partial deliveries in a 'mini close-out' under paragraph 10(h) of the GMRA 2000 or 10(i) of the GMRA 2011 provided partial delivery will not leave an untradeable balance.

2.73 Where (1) a Seller has failed to complete full delivery to the Buyer on the Purchase Date but the Buyer has not terminated the repo or (2) a Buyer has failed to complete full delivery of collateral to the Seller on Repurchase Date but the Seller has not executed a mini close-out, it is very desirable that the party expecting to receive the delivery should accept partial delivery. Such 'partialling' reduces the economic impact of fails on the counterparty as well as on the liquidity of cash and repo markets. It also mitigates the cost of penalties for failed settlement. Partialling is a requirement of the EU Central Securities Depositories Regulation (CSDR) where a mandatory buy-in cannot be completed following failed settlement on an EU CSD, although this requirement is not yet in force.

2.74 Partialling tends to be an involved manual process, requiring one party to request and secure agreement to a partial settlement bilaterally and for both parties to then instruct the partial settlement, re-instruct the settlement of the residual quantity of securities, match the new instructions and cancel the original instructions. Operational difficulties may also arise because a request to partial can only be made once a delivery failure has been discovered and is therefore likely to happen on or shortly before the intended settlement date. The party being asked to accept partial delivery may therefore not have time or the operational capability to reorganise his funding or collateral inventory before the settlement deadline. Or, if the party being asked to accept partial delivery is buying for clients, he may not be able to secure their permission in time.

2.75 Partialling has often been resisted by settlement agents operating omnibus accounts, because of the risk of 'pilfering' the securities of one client to settle the transactions of another. It may also not be possible in all situations, for example, because the Buyer is the intermediary in matching transactions and his other counterparty refuses to partial.

2.76 However, partialling is a highly desirable means of enhancing settlement efficiency to the benefit of all users of securities markets. It is therefore best practice for parties to agree to accept partial deliveries wherever practicable. Parties should encourage counterparties and settlement agents should actively encourage clients to accept partial delivery. All parties should make best endeavours to eliminate operational obstacles to partial settlement within their own firm, standardizing and automating the process wherever possible.

2.77 If partial delivery is accepted, care must be taken to adjust the relevant records, in particular, where partial delivery is accepted in response to a margin call. It is important to note that agreeing to partial delivery does not remove the rights that parties have

under the GMRA to take action in respect of those securities that have not been delivered on time. In particular, agreeing to partial delivery of securities in response to a margin call does not change the fact that the failing party has still committed an Event of Default.

Best practice recommendation. 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 by an incomplete delivery and provided 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 accept partial delivery.

2.78 Where partial settlement remains a manual process, parties should aim to complete the process as swiftly as possible.

Best practice recommendation. It is best practice for partial settlement to be completed as swiftly as possible.

2.79 CSDs may offer automatic partial settlement facilities, commonly called ‘auto-partial’ facilities. Auto-partial facilities automatically identify the availability of securities for partial settlement and optimize and implement such settlement. As an automatic process, auto-partialling enhances the efficiency of settlement across the market. It is therefore best practice to opt into such facilities where they are offered. Where a party does not opt to use auto-partial facilities, they should make this clear to their counterparties and explain their reasons. Settlement agents should actively encourage their clients to allow use of auto-partialling for the settlement of their instructions. Where parties have the choice, auto-partial settlement should not be for less than the minimum tradeable amount in the market for the security being partially delivered.

Best practice recommendation. It is best practice for parties to opt into the use of auto-partial facilities at CSDs. Auto-partial settlement should not be for less than the minimum tradeable amount in the market for the security being partially delivered.

3. Auto-borrowing

Participation in auto-borrowing facilities at (I)CSDs

2.80 The two ICSDs and some CSDs operate auto-borrowing or automatic pool lending facilities. These are pools of securities made available for lending by participants to fill complete or partial shortfalls where sellers have insufficient securities to meet their delivery obligations. Lenders earn a share of the fees charged to borrowers. Fees tend to be higher than in the securities lending market in order to discourage over-reliance on these facilities at the expense of internal settlement efficiency. Participation as a lender or a borrower is voluntary. The (I)CSDs typically indemnify lenders and take liens on the securities accounts of borrowers. Lending is anonymous and subject to limits related to holdings. Auto-borrowing plays a key role in reducing settlement failures but its efficacy depends on

participants signing up to these facilities as both lenders and borrowers. It is desirable for all CSDs to offer auto-borrowing facilities. It is best practice for all participants to sign up as borrowers to such facilities and, where practicable, for participants to sign up as lenders. As full use as possible should be made of these facilities.

Best practice recommendation. It is best practice for all participants in (I)CSDs to sign up as borrowers to auto-borrowing or automatic pool lending facilities and, where practicable, to sign up as lenders. As full use as possible should be made of these facilities.

4. Other relevant issues

a) Technical netting or 'pair-offs'

2.107 An important example of netting to reduce the cost and risk of settlement is the 'pair-off'. This is the action of netting instructions for payments of cash and transfers of securities for repos, reverse repos that are not managed by a tri-party agent and cash transactions, where those transactions are with the same counterparty, of the same currency, against the same security held at the same custodian or depository, by agreement with the counterparty to eliminate or reduce the cash payments and securities transfers required for settlement. Pair-offs can be between multiple instructions. Pair-offs are particularly helpful when rolling over a transaction, in which case, the parties would agree not to instruct securities settlement but instead pay or receive an agreed net cash payment.

Best practice recommendation. 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.

b) Settlement instruction

Settlement

2.59 In order to successfully implement a transaction, both parties or their agents must send accurate and complete instructions for the payment of cash and/or the transfer of securities to their settlement institution in good time for those instructions to be matched and implemented on the intended settlement date. In the case of a repo, a settlement instruction from each party typically needs to be sent for each leg. Delaying instruction of the repurchase leg until closer to the repurchase date reduces the time to correct any problem highlighted by a mismatch at the settlement institution (although Confirmation and affirmation should limit such problems to operations errors). Where a repo has a long term to maturity, there is also the risk that impact of any undetected problem may be compounded during any delay in discovery. In the case of a forward repo, these considerations also apply to the purchase leg. However, it may not be possible to immediately instruct the repurchase leg of a repo, where

it is a floating-rate or open transaction, unless the settlement institution allows instructions to be updated. Similarly, it may not be possible to instruct the purchase leg of a forward repo where only the class of collateral securities rather than the specific issue(s) has been agreed at the start (see Annex I, Part 2). It is therefore best practice for parties to instruct settlement of both legs of a repo as soon as possible after execution of the transaction and no later than the end of the transaction date, provided all the settlement details are known at the start or the settlement institution allows instructions to be updated when known. If, for whatever reason, the repurchase leg is not instructed at the same time as the purchase leg, it is best practice for parties to make it clear in the instruction of the purchase leg whether the transaction is for term or is open. It is also best practice for parties to use the :22F indicator field in SWIFT messages, or the equivalent field in other messaging standards, to identify an instruction which is for the settlement of a leg of a repo.

Best practice recommendation. It is best practice for parties to instruct settlement of both legs of a repo as soon as possible after execution of the transaction and no later than the end of the transaction date, provided all the settlement details are known at the start or the settlement institution allows instructions to be updated when known. If the repurchase leg is not instructed at the same time as the purchase leg, parties should try to make it clear in the instruction of the purchase leg whether the transaction is for term or is open. It is also best practice for parties to use the relevant indicator field in instructions to identify the settlement of a leg of a repo.

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