

Thomas Murray - Webcast Series

1. Failure at T2S - the price of harmonisation

In Thomas Murray's new series of webcasts, our analysts will provide you with timely, unique market insight and analysis on post-trade financial markets and operational counterparty risk.

In this edition, **Panagiotis Kiziris**, Senior Analyst, Europe, takes a look at the recent T2S disruption and the impact this had on European Settlement. During this 7-minute briefing, he explains:

- Why the T2S outage on 26th May was exceptional;
- The impact on CSDs and settlement across Europe;
- Why CSDs should be concerned by T2S's response and what it suggests about post-trade harmonisation in Europe.



Thomas Murray maintains profiles of capital markets and their infrastructures, providing essential real-time news and analysis to our bank, fund and FMI clients.



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Video transcript

Hello everyone,

Welcome to a new edition of Thomas Murray webinars and podcasts. Thomas Murray gives you insightful commentary and analysis on a range of issues in the custody and post-trading industry.

My name is Panos and I'm a Senior Analyst in Thomas Murray's Global Network Management European team, and today I'll be talking about the T2S incident that happened in late May this year.

As you may know, T2S, or TARGET2-Securities, is the pan-European integrated platform for the settlement of securities in central bank money, operated by the ECB. Currently, there are 21 European CSDs who have outsourced their settlement function to T2S. In addition, several major global custodians have become Direct Connected Parties to T2S. The May incident impacted many of them.

In the early morning of May 26th, there was a technical disruption at T2S. In an attempt to contain the impact of a misalignment between the operational and informational databases, the T2S governing body decided to stop the settlement processing until the incident was resolved.

T2S is generally a robust system. Its service level performance was above 99.7% in 2019. Outages like this are not frequent occurrences but are not unheard of either. In 2019, T2S experienced six major incidents. During one these incidents, the close of the settlement date was delayed by 3.5 hours. The incident affected the connected CSDs' end-of-day reconciliation activities for several days.

The incident this May was exceptional for two reasons:

One, it caused settlement to come to a complete halt for several hours. It is not clear exactly what time the incident started, but it must have been a short time after the start of real-time settlement at 5am. Settlement in T2S resumed after 10am the same day. In addition, and because of the backlog that had been created, the start of next-day settlement was delayed for several hours, eventually starting at 11pm instead of 8pm. By next morning, the platform was operating as normal.

The second reason this incident was exceptional was that it was handled in such a way that severely impacted certain T2S CSDs for some days after the incident.

Something irregular happened on the day of the incident. After settlement resumed, a number of partial settlement confirmations were not produced by the settlement module. Most worryingly though, a number of securities accounts and the cash accounts balances were impacted by negative balances.

The T2S operator confirmed that these negative balances were not possible to correct via the standard tools and operational procedures on the day of the incident, as the settlement had taken place when the root cause materialised, the transactions had reached their final status and the confirmation messages had already been sent out.

Several CSDs reported settlement stops during the day of the incident, among them Clearstream Banking Frankfurt in Germany and Nasdaq CSD in the Baltics. None of them however was as severely impacted as VP Securities in Denmark.

The day after the incident, VP Securities had to preclude a large number of ISINs from settlement because of the ongoing issues with T2S reconciliation. These ISINs included the majority of the Danish blue-chip companies and banks.

The issue stemmed from a number of missing confirmations that had not been received from T2S, something that could potentially have created discrepancies on holdings. In addition, VP decided not to allow the reflection of negative positions created by T2S as this was something not allowed by the CSD. Because of unreconciled holdings, VP decided to pause settlement for a number of securities that reached 99 ISINs at the height of the incident.

The reasoning behind this decision is debatable. On the one hand, VP Securities acted prudently and according to CSDR requirements which stipulate that settlement must stop if the integrity of an issue cannot be verified. Also, the avoidance of negative balances is in accordance with international standards. On the other hand, as far as we are aware, VP Securities was unique in its decision to preclude ISINs from settlement and cause severe disruption in its home market.

The preclusion lasted for three days. Finally, on the 29th of May, and after VP Securities had received correct confirmations from T2S, the CSD decided to lift all preclusions and allow settlement to go forward.

VP Securities, unlike T2S, was publicly transparent during the incident. It sent regular updates during the event and held three market calls, albeit on the last day of the incident. According to VP itself, communication with T2S was poor during this situation. T2S took too long to provide correct data to VP and did not give a good explanation of what had happened. T2S still has not revealed what was the root cause of the incident; a post-mortem has been promised but it could be weeks before a review is published.

For its part, VP is also doing an examination of the root causes in its own system. The CSD was unable to delve deeper during the crisis and has now started its own post-mortem. The CSD has escalated the issue within T2S and hopefully lessons can be learnt.

Thomas Murray monitored the situation closely from the first day of the incident until its final resolution. We advised clients continuously with timely critical newflashes. We sent over 16 newsletters during four days as the situation unfolded.



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For me, the incident revealed the underbelly of the European harmonisation efforts in the post-trading space. I will not dispute the benefits of addressing the fragmented settlement landscape of Europe, or the efficiency of having a single set of rules and procedures. However, what this incident has exposed is that by placing their main function on a platform beyond their reach, CSDs have ultimately given up control and have been left with inadequate tools to quickly manage an extraordinary event. The unsatisfactory response by T2S and, perhaps a hint of European bureaucracy only compounded the problem.

I hope you enjoyed this presentation. We look forward to welcoming you next time. If you want to know more, drop me a message. Thank you for listening.