

Settling in a Direct Holding system

In an intermediary direct holding system the end-investors are known by the CSD - not as participants but as account owners.

This introduces a great number of benefits for investors, issuers and participants of the CSD in question.

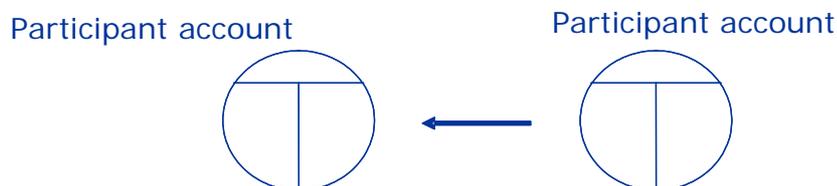
It introduces however, some differences when settling in and out from an end-investor account. In principles there are no differences in settling a trade between two participants or between a participant and an end-investor.

It is important to bear in mind that a set of settlement instruction can be defined as

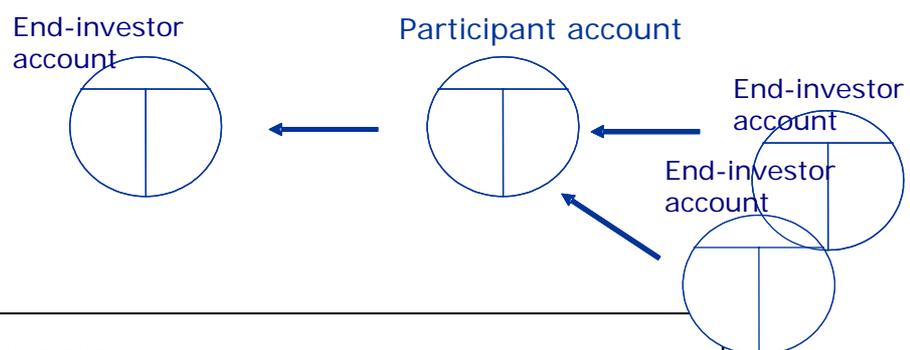
- an instruction to transfer a specific holding provided receipt of money and
- an instruction to transfer a specific sum of money provided receipt of a holding

Settlement instructions can be entered in multiple ways but all in the same format.

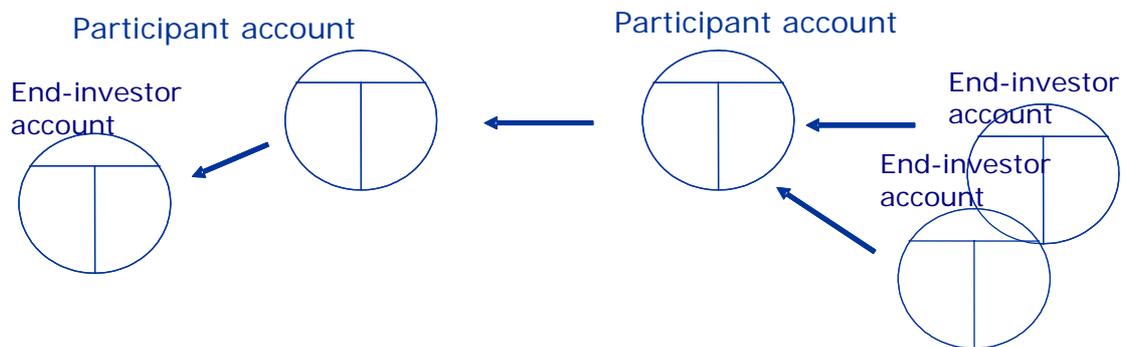
Example 1: A trade between two participants is settled - similar to trades in an omnibus or non-direct holding account system. Each party enters his part of the trade.



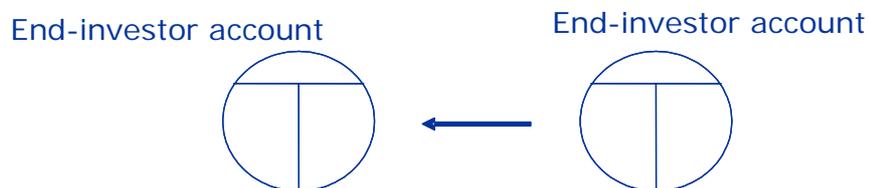
Example 2: The typical settlement in an end-investor account system. Typically the end-investors are customers of the participants who probably also acts as the account operator. But it's possible for a participant to enter a DvP trade with an end-investor he previously has no relations with. If the later situation the paying agent of the end-investor in the situation where the end-investor is the buying part then has to report an instruction (release of money) into the system



Example 3: Similar to the Swedish model except that the participants not necessarily need to act as commissionaires - they should be allowed to settle trade on their own behalf.



Example 4: Similar to example 1 with the difference that the trade has been entered directly between two end-investors. It is however, from a transactional point of view not that different from the situation where two participants are trading. The account operator of the selling part has to release the holding and the paying agent of the buyer has to release the money.



Need for cash account information.

In a direct holding system the private account holders are not able to achieve a T2-cash account and are therefore forced to settle via a participants' cash account if the end-investor wants to settle DvP. The question now is how this is to be handled and how can ECB get needed permission to use a participant's account.

T2S foresee trades can be settled in full night-time settlement batches, small day-time settlement cycles as well as RTGS. No matter which type of settlement chosen, if the trade is expected to settle DvP information on which T2-cash account to be used for the settlement must be available. The model as described so far indicates, that participants can dedicate as many cash accounts for settlement purposes as they wish. Therefore all these accounts should be stored in the static reference data of the participant. In order to offer the participant free choice he should be allowed to indicate in the settlement instruction which cash account he wish to use for this specific trade.

This model will also solve all problems for end-investors participating in DvP settlement and offer the end-investors free choice with who he wants to trade. The paying agent simply has to instruct the settlement (reference is made to page 1: a trade can be defined as

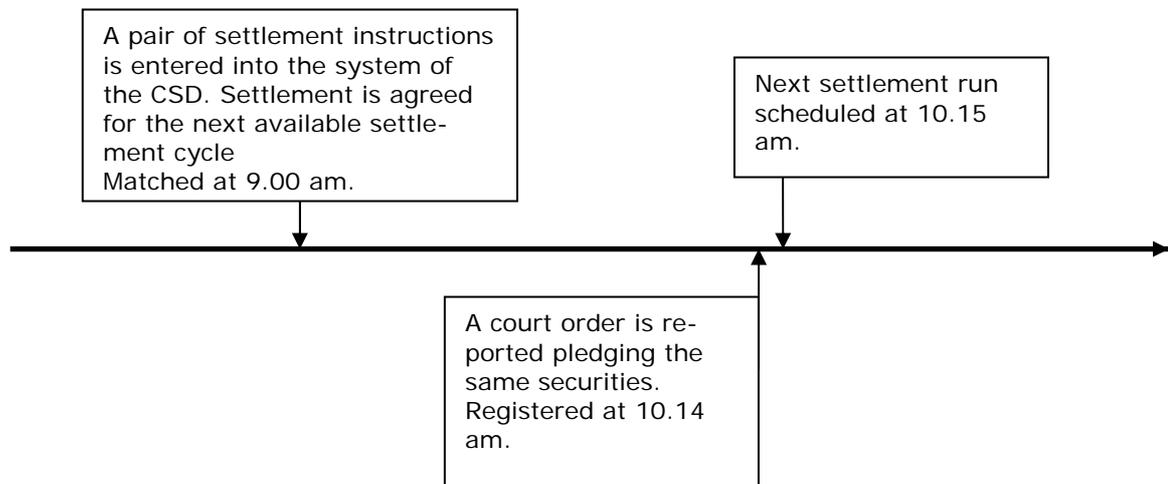
- an instruction to transfer a specific holding conditioned receipt of money and
- an instruction to transfer a specific sum of money conditioned receipt of a holding)

In other words. By NOT having the cash account information as part of the securities account, but as part of the participant static reference data and/or the settlements instruction, the bonus will be

- Investors are free to choose with whom he wants to settle without informing his account operator in advance
- Participants only have to maintain cash account information once
- Account operators doesn't need to change cash account each time an investor decides to trade through an other broker than his account controller.
- When allowing Direct holding systems directly in T2S a great majority of the securities accounts will be non-participants accounts, and therefore without the cash account information.
- If a credit line is attached to the cash account you anyhow has to store this information (cash account number and credit line) on the participant since you can't store credit line on individual accounts
- And more in relation to the credit line. A participant can have a number of cash accounts denominated for settlement and the idea in TG3 is, that if not sufficient funds in one cash account T2s will automatically seek information on the participant (!) to see if he has additional credit facilities on another denominated cash account
- Storing the cash account on the securities account will lead to tons of redundant data.
- If a participant changes his cash account he only have to change the cash account information in his reference data. If cash accounts stored on securities accounts you risk miss to change one, two or more securities accounts resulting in defaults when trying to settled via a non-valid cash-account.

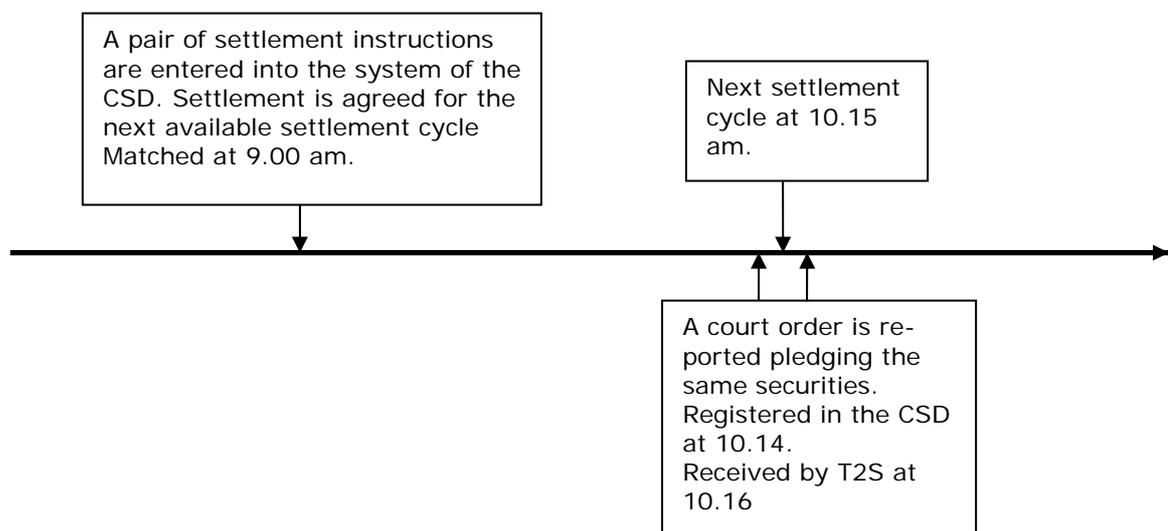
Legal effect time

In many systems registration is legal protection towards 3. party. In end-investor systems the legal protection is registration in the CSD. The typical example is when the account owner wants to sell his holding and a court issue a pledge of the same holding. Question is: Who are entitled to the holding? The time line below illustrates how end-investor systems operate.



Even though the settlement instructions is reported and matched before the court order is issued it has still not settled and therefore at the time of the settlement run the securities are blocked if the court order is registered.

Settling through T2S will not change the legal concept and we must assume that legal effect for a pledge still is when the transaction is approved by the CSD.



The court order still has precedence over the trade even though T2S only received the pledge after the trade has been and the trade has been settled. Therefore a mechanism has to be agreed with end-investor systems (and other systems where the register is the legal protection) in order to preclude trades from being settled if its not best in legal effect time.

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