CSDR settlement discipline: mandatory buy-ins

By Andy Hill

ICMA remains in ongoing discussions with ESMA and the European Commission with respect to a number of questions regarding the application of CSDR mandatory buy-ins and is hopeful that much needed Level 3 guidance will be provided to the market soon.

Mandatory buy-ins

Resolving the buy-in/cash compensation asymmetry: ICMA is hoping that the asymmetry in the price differential payment process in CSDR, related to both buy-ins and cash compensation, can be "fixed" through contractual arrangements between trading parties (such as by using the ICMA buy-in rules).[1] This will be essential to ensure that both sellers and lenders of securities do not face additional undue risks as the result of what appears to be an error in the Level 1 Regulation.

Applying the buy-in framework to securities financing transactions (SFTs): ICMA would expect that open-SFTs (and "open-like" SFTs) are deemed out of scope of the mandatory buy-in regime on the basis that either party can effectively terminate such transactions with less than 30 business days' notice (in most cases only one business day is required). ICMA is also recommending that basket SFTs (including triparty and delivery-by-value structures) are also deemed out of scope, even if the transactions are termed for 30 business days or longer. This is on the basis that attempting to buy-in multiple, substitutable securities underlying such transactions is impractical.

Finding buy-in agents: ICMA is concerned that it may be difficult for firms to appoint buy-in agents, particularly within the tight timeframes for buy-ins prescribed by the CSDR. Appointing willing buy-in agents is a challenge in today's international bond markets, and this is the reason for ICMA's revision to its buy-in rules in 2017 which allows initiating firms to execute the buy-in (or sell-out) themselves, within specific criteria protecting that failing party.

The feedback from ESMA seems to confirm that the Level 2 Regulation is quite specific in that a buy-in agent must be appointed by the initiating party (in the case of transactions not cleared by a CCP) as part of the buy-in process, and so parties cannot execute the buy-in themselves.

Utilising pass-ons: Pass-on mechanisms, such as under the ICMA buy-in rules, allow for a single buy-in to settle an entire failing transaction chain, and are therefore important from both a market efficiency and stability perspective. CSDR does not provide for a pass-on, however the regulatory recitals suggest that pass-ons may be possible. ICMA is currently holding the pen for a cross-industry initiative to design a potential pass-on mechanism to complement CSDR, which will be put to the regulators for consideration. The proposed mechanism would apply to all security types. It is important to note that for a pass-on mechanism to work, the asymmetry in the buy-in and cash compensation processes will need to be resolved.

Updating the ICMA buy-in rules

Once there is some clarity on these and a number of other critical issues related to the application of the CSDR buy-in framework, ICMA will, in consultation with its members, look to update its buy-in rules to provide a contractual framework

1. The ICMA buy-in rules are part of the ICMA Secondary Market Rules & Recommendations which apply automatically between ICMA members transacting in international securities.

and market best practice to support compliance with, and implementation of, CSDR. This will be effective from the date of application of CSDR settlement discipline, which is expected to be in November 2020.

Members interested in learning more about ICMA's work on CSDR settlement discipline, in particular the application of mandatory buy-ins, may wish to join ICMA's CSDR Settlement Discipline Working Group.

CSDR mandatory buy-in impact study

Following its 2015 bond market impact study, ICMA is conducting a more granular study to ascertain market awareness, preparedness, concerns, and expected impacts on bond market pricing and liquidity. The survey-based study targets sell-side and buy side trading desks, as well as repo and securities lending desks. The results of the impact study will be published in a publicly available report in Q4. The objective of the report will be to provide useful market intelligence as firms finalise their preparations and develop business strategies for implementation in late 2020, to underpin ICMA's ongoing advocacy work related to Level 3 guidance, and to inform ICMA's review of its buy-in rules to support implementation and provide market best practice. Firms wishing to participate in the survey can find the relevant links on the ICMA CSDR-SD webpage.

Contact: Andy Hill
andy.hill@icmagroup.org