International
Capital
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Association

News from the International Capital Market Association (ICMA)

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New market buy-in regime threatens European bond market liquidity

The International Capital Market Association (ICMA) has today published a study on the expected impact of the new mandatory buy-in regime, to be introduced in 2020 under the EU Central Securities Depositories Regulation (CSDR), on bond markets in Europe.

The results of the survey of ICMA members, representing buy-side firms, sell-side firms and repo and securities lending desks, show that the new regime will negatively impact bond market liquidity and efficiency. The new measure will force a change in the behaviour of market makers, who are the principal providers of liquidity in bond markets, affecting pricing across a broad range of fixed income asset classes as well as their willingness to show offers. This effect will be felt most at the lower end of the credit spectrum, for example corporate bonds.

Survey respondents from the buy-side of the market – pension funds and asset managers – are concerned that they will bear the increased costs of widening bid-ask spreads and decreased liquidity. The survey confirms the generally accepted view that the introduction of the CSDR mandatory buy-in regime will be most detrimental to end investors.

The study also shows that the mandatory buy-in framework, indirectly, creates additional risks for lending securities. This is expected to impact pricing and liquidity in the repo and securities lending market, most notably with respect to less liquid bond sub-classes, such as credit and emerging markets.

Martin Scheck, ICMA Chief Executive said: *"We have already indicated to our members that we will be consulting them about a change to the ICMA Buy-in Rules, which they have relied on to set best practice for decades, in response to concerns about problematic anomalies in this new regime. We expect the ICMA Buy-in Rules to continue to provide a contractual framework and best practice for executing buy-ins, while also addressing some of the issues presented by the regulation."*

Download Mandatory buy-ins under CSDR and the European bond markets – impact study

Buy-ins are an established tool for market participants to manage settlement risk where one party to a trade fails to deliver the bonds the purchaser, in which case the purchaser has the right to go into the market and 'buy-in' the bonds from another party. Any differences in the cost are then settled between the two original parties.

Buy-ins are currently used with discretion due to the fact that they can create unpredictable costs.

The new regime makes settling a failed trade mandatory (rather than voluntary as it is now.) This creates more risk than the existing buy-in processes operated under ICMA Rules. This, and anomalies in the design of the regulatory buy-in, create a disincentive to market-makers to provide offer-side liquidity and potentially result in higher costs for the buy-in.

The ICMA Buy-in Rules will be updated to provide a legal framework and market best practice to support implementation of the new measure in the international bond markets. However, challenges for bond market liquidity and efficiency will remain.

The impact study also demonstrates that there is low awareness in the industry of this new measure which will affect all bonds that settle in Euroclear and Clearstream and other EU CSDs. In particular, the buy-side of the industry and firms outside the EU may be surprised to find that they are in scope.

More information about buy-ins and mandatory buy-ins under CSDR

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International Capital Market Association (ICMA)

ICMA is the trade association for the international capital market with over 580 member firms from 62 countries, including issuers, banks, asset managers, central banks, infrastructure providers and law firms. It performs a crucial central role in the market by providing industry-driven standards and recommendations for issuance, trading and settlement in international fixed income and related instruments. ICMA liaises closely with regulatory and governmental authorities, both at the national and supranational level, to help to ensure that financial regulation promotes the efficiency and cost effectiveness of the capital market.

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