

ICMA CSDR-SD Working Group

Call on Mandatory buy-ins: February 11, 2020 Summary notes and action points

Buy-ins (General)

1) Industry Pass-on Proposal– update

ICMA updated the Group that jointly with AFME they presented the cross-industry proposal to ESMA at a meeting on January 27. The proposal had been well received, and there was a clear desire from the authorities for an effective pass-on mechanism that could operate under the CSDR provisions. Based on the discussion with ESMA, the sense was that establishing a same-ISD mechanism ('Approach 1' in the proposal) may be easier from the perspective of regulatory approval, while a multi-ISD mechanism ('Approach 2' in the proposal), would be more challenging. It was also noted that the proposal would likely need to be approved by the Commission. It was therefore suggested to submit two separate Q&As: one for the same-ISD approach and another for the multi-ISD approach.

ICMA and AFME were in the process of finalizing the draft Q&As and would share them with their respective WGs in the next few days. As the approval process was expected to be lengthy, the plan was to submit the Q&As relatively soon.

❖ *ICMA to circulate the draft Q&A submissions for a pass-on mechanism*

2) Cash Compensation Workstream – update

ICMA reminded the Group that a separate workstream focused on best practice for establishing the cash compensation reference price had been rolled out, and that the notes from the first meeting had already been circulated. The next meeting (which would be a call, rather than a physical meeting), was scheduled for February 13 at 3pm GMT.

While the original intention had been to create a product agnostic process, the initial meeting was focused primarily on less liquid bonds, where the provisions outlined in the RTS would be mostly irrelevant or inappropriate. While the discussions were very much at an exploratory stage, the initial thinking was to establish a dealer-poll, or auction process, which would take place during the defined deferral period.

Liquid vs illiquid

A question was raised as to the process for establishing the appropriate extension period (and buy-in timeline) for a security and the whether or not it was 'liquid'. ICMA responded that the liquidity determination was only relevant with respect to equities, as per Articles 36 and 37 of the RTS. It was further explained the source for the MiFIR liquidity classification was the ESMA FITRS (Financial Instruments Transparency System) database.

It was also explained that the liquidity classification was relevant to the penalty calculation, and that the ECSDA *CSDR Penalties Framework* cites FITRS as the source for this information. AFME updated that they had prepared a Q&A seeking clarification that in the case of the liquidity status changing during the duration of a fail, the classification at the trade date should be applicable. It was also noted that given that liquidity determinations were updated by ESAM on a quarterly basis, such instances would be relatively rare.

Buy-in agents

The question was raised as to the extent of concern among the market groups, and the authorities, about the dearth of declared buy-in agents. It was confirmed that this issue had been raised frequently in both the ICMA and AFME forums and has also been identified by ESMA as a potential issue. There was clearly an underlying assumption in the regulation that buy-in agents would exist, and there was hope that firms would put themselves forward. Not only was there a need for competition, but there was also a requirement for specialist knowledge, networks, and market access across a range of asset classes and market segments, which also suggested that multiple buy-in agents would be desirable. It was noted that a second vendor had recently indicated their intention to provide a buy-in service, which may give some hope that other firms will see a commercial case for acting as a buy-in.

It was further noted that the cash compensation workstream had expressed a preference for a buy-in agent to take responsibility for establishing the cash compensation reference price. If a fail goes to cash compensation because there is no suitable buy-in agent, then it is unlikely that a third party will be well-placed to manage the cash compensation process.

3) Timing for canceling the original trade instructions

A question had been raised ahead of the call relating to paragraph 11 of RTS Articles 27/29/31 requiring that the settlement instructions of the failed trade are cancelled at the end of business day on which they receive the bought-in securities (which, according to Article 25, is when the securities are settled on the relevant CSD). Assuming T+2 settlement, this potentially creates two positions in the trading book until the trade is settled: the original purchase and the buy-in. This has risk and potential funding/capital implications for the receiving party. This raised the question of what the appropriate booking/cancellation process should be to reflect the true economics of the buy-in remedy, and whether this required best practice, or even regulatory guidance.

It was suggested that this was really an issue for individual firms to resolve, from the perspective of their own internal accounting and risk management. It was also felt that until the buy-in settled, there was a

risk that the trade could go to deferral or cash compensation, in which case it would be desirable to keep the original transaction instructions.

The Group did not feel that this required best practice and did not warrant regulatory guidance; particularly in light of more pressing issues requiring clarification. One participant shared that their firm was looking at the possibility of booking an offsetting trade at the time the buy-in executed, until the instructions for the original trade are canceled.

SFTs

4) Q&A submission on open (and open-like) SFTs – update

ICMA confirmed that it had circulated the final proposed Q&A submission clarifying an exemption for open, and open-like, SFTs on the basis that they are viewed from the perspective of the earliest contractual termination date for the purposes of risk and other regulatory treatments (such as liquidity metrics). If there were no further comments, the Q&A would be submitted along with the results of the supporting survey of ICMA/ISLA members.

❖ *ICMA to submit the Q&A clarifying a buy-in exemption for open and open-like SFTs*

Margin and collateral movements

The question was raised as to whether the AFME Q&A relating to ineffective trades was also due to be submitted. AFME updated the Group that they had separated out the requests under the previously circulated draft and were now composing individual Q&As. These included requests for exemptions in the case of margin transfers and collateral movements, internal movements that did not result in a change of beneficial owner, the ETF redemption and creation processes, and movements related to specific corporate actions. They added they were happy for these to be circulated among the ICMA and other WGs for comments and feedback.

ICMA confirmed that it had already circulated the redrafted AFME Q&A relating to margin and collateral movements with its Legal WG and would do the same with the markets WG.

❖ *ICMA to circulate the latest version of the AFME draft Q&A on margin and collateral movements*

5) Recap of urgent commercial questions/considerations related to the GMRA/GMSLA Annex

ICMA reminded members that it was still awaiting responses to a number of important commercial and operational questions intended to inform the update of the GMRA (and GMSLA) CSDR Annex, and urged those who had not done so already to respond by the deadline of February 12. Where firms needed a few more days, ICMA confirmed that it would accept responses up until the end of the week (February 14).