

T2S Advisory Group

ECB-PUBLIC

5 August 2015

AG Reply on ESMA Consultation Paper on CSDR RTS on the Operation of the Buy-in Process

AG responses to buy-in consultation

Q1: Please provide evidence of how placing the responsibility for the buy-in on the trading party will ensure the buy-in requirements are effectively applied.

Please provide quantitative cost-benefit elements to sustain your arguments.

AG response to Q1:

As noted in the reply to the ESMA Consultation Paper - Technical Standards under the CSD Regulation (19 February 2015), the AG believes that for transactions which are neither executed on a trading venue nor cleared by a CCP, the trading parties have, or could have access to, all necessary information regarding settlement fails. In addition, trading parties have good incentives to initiate a buy-in process in case of a settlement fail or to claim for cash compensation if buy-in is not possible.

Placing the responsibility for the buy-in on the trading party would require efficient information flow between trading parties and through the chain of intermediaries from the CSD up to the trading party.

The AG therefore supports option 1 (trading party executes the buy-in)

Q2: Please indicate whether the assumption that the trading party has all the information required to apply the buy in would be correct, in particular in cases where the fail does not originate from the trading party, but would rather be due to a lack of securities held by one of the intermediaries within the chain.

AG response to Q2:

AG believes that trading parties should and could be informed about the fails by the CSD through the intermediary chain.

Each intermediary, in particular CSD participants in the context of T2S, will be made aware of the failed transactions by the CSD. This is standard practice today in all CSDs.

The CSD participant will have to ensure that the information it receives from the CSD is passed on to its client on a timely basis. Each intermediary in the holding chain should do the same, resulting in the information eventually reaching the trading party. The trading party is in fact the sole entity which has all the information required to apply the buy-in process: e.g. date of the transaction, quantity, amount, identity of the defaulting seller.

All three Options impose a double flow of information: upstream from the CSD and up to the trading party and downstream back to the CSD participant and the CSD.

Q3: Should you believe that the collateralisation costs attached to this option are significant, please provide detailed quantitative data to estimate the exact costs and please explain why a participant would need to collateralise its settlement instructions under this option.

AG response to Q3:

A CSD participant may need to collateralise its settlement instructions/positions especially under options 2 and 3 in the proposed RTS.

Under option 2, a CSD participant may have to collect collateral equivalent to the potential cash compensation needs.*

** Feasibility and impact of collateralisation would have to be properly assessed first, as it raises conceptual issues (e.g. who should provide collateral? To whom? To cover which risk?), risk issues (e.g. which collateral would be acceptable?) as well as operational issues (e.g. when would the collateral have to be deposited?).*

Q4: If you believe that option 1 (trading party executes the buy-in) can ensure the applicability of the buy-in provisions are effectively applied, please explain why and what are the disadvantages of the proposed option 2 (trading party executes the buy-in with participant as fall back) compared to option 1, or please evidence the higher costs that option 2 would incur. Please provide details of these costs.

AG response to Q4:

Option 2 makes a delivering CSD participant liable for payment of the cash compensation in the event of inaction by the purchasing trading party (the underlying purchaser) with whom the CSD participant may have no contractual relationship, and of whose identity the CSD participant may be unaware. This creates uncertainty for CSD participants and requires implementation of risk mitigation tools. The CSD participants are not aware of the trading level party information and need to receive information both from the CSD (settlement) level and the counterparty (trading) level before initiating any buy-in action.

Options 2 and 3 raise certain concerns compared to option 1 and could introduce new risks and liabilities on CSDs having links with other CSDs in T2S. Indeed, when a CSD acts as investor CSD, i.e. becomes a participant in an issuer CSD, it is subject to the same terms and conditions as any other CSD participant. For example, if option 3 were to be implemented, there could be a risk that the investor CSD would be required to manage buy-ins on behalf of a trading counterparty in case one of its own participants does not deliver securities on time. The investor CSD would then have to collect margins from its own participants in order to protect itself, like any other custodian/participant in the issuer CSD framework. The risk that an investor CSD might be liable to pay for the cost of buy-ins of its own participants' securities would increase CSDs' risk profile and may dis-incentivise cross-CSD links in T2S.

Q5: Please provide detailed quantitative evidence of the costs associated with the participant being fully responsible for the buy in process and on the methodology used to estimate these costs.

AG response to Q5:

Not available in such short consultation period