Subject	CSDR second consultation- buy-in procedures ESMA/2015/1065
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Memo

To	European Securities and Markets Authority
From	Rabobank

1 Introduction

Rabobank has reviewed the ESMA Consultation Paper 2015/1065 regarding regulatory Technical Standards on the CSD Regulation for the Operation of the Buy-in Process and herewith provides its comments for review by ESMA.

2 Findings

ESMA has asked to focus the feedback on the three models for buy-ins. All three models for the buy-in process have severe shortcomings.

A few of the shortcomings we see:

1) Scenario one will result in multiple buy-ins down the chain. That means the security that is probably already "special"[1] will be squeezed even further. This will subsequently have an effect on the costs of buy-ins and the resulting long positions. Should this option be selected, it is strongly advised to mandate the notices, as a key part of the communications infrastructure required, to the CSD. There is an existing message flow via SWIFT that would be most fit for purpose.
2) A key issue when executing buy-ins in the current environment is finding a buy-in agent. Generally dealers are not keen to commit to deliveries in already "special" securities.
3) In scenarios one and two, the CSD participant is liable for an action in which it takes no part. That appears odd from a legal standpoint.
4) We do not see how collateralisation would work under scenarios two and three. It would thus create risk for the participants. Should collateralisation be required however, it would mean a further drain of collateral from the system.

The main concerns focus on the practicability of buy-ins and the described processes. A longer extension period on the trade, for example 10 working days, would already result in some relief.

More in general however, the regulation is expected to have a detrimental effect on collateral availability and liquidity in the markets. We urge ESMA to also review the ICMA

[1] Special means securities are no longer considered General Collateral (GC). ICMA defines it as follows: "A *special* is an asset that is subject to exceptional specific demand in the repo and cash markets compared with very similar assets."

documents on the CSD regulation[2] as well as on collateral fluidity[3]. Furthermore, the Dutch Central Bank has also issued two papers on collateral scarcity[4] and collateral optimisation that review the availability of collateral. Rabobank currently already sees this reduction in liquidity in the markets. Due to the increased regulatory requirements, BIS III and recently specifically the Quantitative Easing (QE) by the ECB[5], certain (government) securities are becoming less available and more difficult to borrow/ repo in. The General Collateral or GC-level has already risen from an approximate 17 bps to an approximate 25 bps in the last (two) months. Further pressure on liquidity may mean that certain market making activities can no longer be pursued, the risk of loss on a buy-in is too great in comparison to the benefits. This effect will appear even stronger in less liquid markets such as corporate bonds or smaller issue sizes. This pressure on collateral will increase when the additional EMIR risk mitigation techniques come into force for variation margin and again for initial margin. Spreads will of course increase as a result but the main concern is the lack of liquidity.

Of particular concern in this respect is the balance between this specific regulation in relation to the Capital Markets Union intentions. Whilst the Capital Markets Union intends to increase liquidity for small and medium sized enterprises (SME), we are certain that the buy-in regulation will have an adverse impact on liquidity for exactly those less liquid securities.

The adverse effect may be partially reduced by introducing a mandatory cash compensation as the principal remedy. It would at least avoid double buy-ins and an additional squeeze on securities available. The recipient will be compensated for the fail, the "culprit" is the last in the chain and all parties in between are treated as they are: intermediaries. It would also possibly lift some of the operational burden. Buy-ins may of course still be available to trading parties that have contractual arrangements to do so.

Furthermore, whilst settlement discipline may benefit from regulation, we believe it would be helpful to have consistent regulations globally. For US treasuries, the TPMG fails charge applies for example. We believe a diffferent approach in Europe will unnecessarily complicate processes and will create an uneven playing field. See the link to the relevant rules for US treasuries http://www.newyorkfed.org/research/epr/10v16n2/1010garb.pdf

We believe the regulation must be aimed at avoiding asymmetry at all cost. Hence a party that is being bought in should always have the right to pass on the cost, irrespective of

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[2] http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/icma-european-repo-market-reports-and-white-papers/csdr-mandatory-buy-ins-and-the-treatment-of-sfts-an-icma-erc-briefing-note/ and http://www.icmagroup.org/News/news-in-brief/buy-ins-how-they-work-and-the-challenge-of-csdr-an-icma-briefing-note/

[3] Collateral is the new cash, ICMA, http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/icma-european-repo-market-reports-and-white-papers/collateral-fluidity/

[4] http://www.dnb.nl/binaries/DNB_OS_1001_WEB_tcm46-268455.pdf and http://www.dnb.nl/binaries/415234_DX0_DNB_OS_12-05_eng-WEB_tcm46-309555.pdf

[5] Whilst it is possible to repo in securites from the central bank, there are some significant limitations: 1) the repo has to be versus securities, so whilst one can cover one security, there is no relief on the overall collateral shortage. The repo is in principal on term (minimum one week) and can be quite costly- approx 40 bps from ECB. 2) In the overnight securities may be borrowed from the central bank via the Euroclear programme. This costs an excessive 1.5% and is not available around any type of corporate action.

notices sent etc. This also means that CCP cleared securities transactions should specifically, clearly and unequivocally be included in the regulation.

3 Clarifications

Clarifications are sought for the following items:

- The definition of "securities transaction". The scope of the RTS is unclear. The term "securities transaction" is not defined either in the Regulation itself or in the RTS. A clear definition should be made to ensure for legal certainty and consistency.
- Exceptional circumstances are not described anywhere: for example where securities are frozen, where securities have been redeemed.
- How is cash compensation calculated when no prices are available in the market? For example the mortgage backed securities during the Lehman crisis.
- Some framework should be given to determine how the buy-in and the cash compensation will be calculated by the relevant parties, for example by applying best execution rules to ensure that parties will not apply unreasonable/own discretion prices/calculations.
- Partials create difficulty for parties that have multiple trades. If one recipient has multiple deliveries, then which client ought to receive securities and which client will have to face the buy-in process. And more in general, how to distinguish which receipt is intended for which securities delivery.
- Some articles of the RTS require parties to ensure for contractual arrangements (for example in paragraph 14a, 18 and 32 of the document). Leaving too much discretion to parties and imposing contractual arrangements will create legal uncertainty and inconsistency whereas the scope of a regulation and its RTS is to be mandatory and to provide for certainty and consistency.

4 Concluding

Rabobank urges ESMA to reconsider the buy-in rules, starting with an elongation of the extension period. The suggested buy-in processes are likely to cause spreads and liquidity to be impacted severely and will discourage dealers from a market making role.

In addition, there are profound concerns over the timing of this initiative, in particular given the simultaneous effects of Quantitative Easing, the pending introduction of Risk Mitigation Techniques, Basel III, all compounding the need for collateral assets and resulting in reduced availability, as well as undermining the stated policy objectives of the Capital Markets Union.

Should the rules be implemented, we suggest a cash settlement which is both more practicable and more fit for purpose. It will also not cause a further squeeze on the liquidity in a specific security. Furthermore, a notice function through the CSD to ensure transparency for this cash compensation, that already sends settlement messages, would be most fit to communicate through the chain.