



Response from the ABBL to the ESMA Consultation on The Operation of the Buy-in Process

Information about the ABBL:	
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Introduction

The ABBL¹ welcomes ESMA for consulting stakeholders on this complex operational issue.

Firstly we understand that the process of designing technical measures is bound by the framework of the level 1 prescriptions. However, in order to ensure a smooth and efficient process, the option retained shall address responsibilities where they are best handled. In our views the buy-in procedure shall be reserved for “an extreme case scenario” in otherwise manageable processes. To be efficient, we think that the decision to trigger the buy-in shall be taken by the parties most aware and at stake for the trade and who bear responsibility for its performance.

The Association would thus lend strong support for the option 1 requiring trading parties to trigger the buy-in. In addition, we consider that option 3 namely putting the burden of the triggering of the buy-in on the CSD is not appropriate mostly because CSDs are not in position to know in advance/early enough potential failure of a trade, they have to rely on information provided by other parties at an earlier stage. And because this is likely to lead as consequence of need to manage the unknown to higher demand of collateral, a cost to the economy.

¹ The Luxembourg Bankers' Association (ABBL) is the professional organisation representing the majority of banks and other financial intermediaries established in Luxembourg. Its purpose lies in defending and fostering the professional interests of its members. As such, it acts as the voice of the whole sector on various matters in both national and international organisations. The ABBL counts amongst its members' universal banks, covered bonds issuing banks, public banks, other professionals of the financial sector (PSF), financial service providers and ancillary service providers to the financial industry.

Answers to specific questions

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.

From a conceptual and practical point of view, trading parties are the ones who have the most interests in the performance of the trade as a finality and not only as intermediaries earning a remuneration for processing the transaction. They shall be the best placed to have access to information and to better understand the dynamic of the trade. Accordingly, they shall be the first ones to be able to trigger the buy-in. In other scenarios the different entities will have to rely on information provided by these parties in any case.

The Association considers that one of the weakness evidenced in the consultation paper vs. option one, namely the non-cooperation between trading parties in a different MS than CSD may only be for a transitory period, most notably under the ECB T2S project where the euro area may be seen as a block rather than competing jurisdictions. Furthermore, we do not think that trading parties will simply let a trade fail if it is under another jurisdiction as they have a vested interest in securing long-term business.

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.

The logic we would follow is that trading parties are the one having the maximum number of information on the trade and the most reasons to ensure it goes through. Other intermediaries are either infrastructures or intermediary brokers for example who do provide facilities but have “no personal” interest in the performance of a given trade. Regarding intermediaries in the chain, as they will act upon instructions from the counterparties to the trade we are unsure if they may really lack securities as they would pass on the order and securities to the next one layer furthermore their performance may be tracked by the trade counterparties to ensure the deal is performed.



In addition if one takes the issue from a different angle, notably through the future MiFID II, most information upon a trade will be filled by the trading parties and transmitted along the execution chain, which reinforces the idea that key information and potential updates of it will be at trading counterparties level.

The Association considers further that in case of breach in the chain the trading counterparties may in any case claim or try to claim (on a contractual basis or in court) against a failing entity, but the advantage being that the case will be handled by the entity most able to solve it and who will bear the real risk of a failed trade.

Furthermore in an environment post EMIR, post MiFID II/MiFIR significant parts of the markets if not all from basic plain vanilla product to derivatives will be traded on exchanges, which shall again reduce the risks of need of buy-in as presented in the CP (paragraph 25).

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.

Under a scenario where as an intermediary may be faced with unexpected risk upon which it has very few means of control, probably that one of simplest approach to buy a protection is in form of collateral to ensure the finality of a transaction. The criteria retained are likely to be based on perceived risk and volume, but as of today there are to our knowledge few data to build a sound scenario, except that it is likely that part of the current collateral may be “transferred” or topped to/by intermediaries in the chain, which will in any scenario create a dead pile of investable moneys set aside just in case a high cost for the economy.

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.

Conceptually option 1 is aligning responsibilities with capacities of actions, namely if a fail occurs it should be detected at that level (directly or indirectly). It would be odd to go instead for the next participant in the chain, most likely a custodian, hoping that big pockets may cover the trade. Unless this custodian requires full collateralisation this appears to be a licence to fail if a different party than the one failing then supports the cost. The Association notes further that participants may not have as direct information as trading counterparties and may as a consequence support additional costs compared to the ones faced by trading parties. This said this option 2 is a better option than option 3 where stakeholders are further remote from the transaction management.

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.

Based on our understanding, there are not enough fail trades leading to buy-ins to present it as a credible option at this stage.

That being said, we would nevertheless have two diverging analysis from the ones presented in the paper.

- We do not share the analysis under paragraph 30, if indeed the relationship between participants and CSD is very close both are at the end of the transaction chain and in most cases will act as simple intermediaries fully dependent upon preceding layers. The impact of a fail has no major consequences for them beyond being unable to satisfy a client. We consider that the risk of cascade of fails is reduced, most notably under the future MiFID II/MiFIR on exchange transactions.
- The concept of prudent participation under paragraph 32 may end up by adding complementary collateral at various layers and does not take into account the situation of settlement on the T2S platform, where risks may be further reduced in any way due to the involvement of NCBs at least on the cash leg.

To conclude, the Association has some concerns whereas the opportunity to opt for rules that will increase the requirement to collateralise transactions across the chain as it would be the



only tool by which CSDs/participants may increase their security in the system. That would be even more penalising if the collateralisation procedures are different from the ones T2S requires (on stock vs. on flow collateralisation). We therefore conclude that we have a strong preference for option 1.