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LSEG RESPONSE TO ESMA CONSULTATION ON BUY-IN PROCEDURE

London Stock Exchange Group

LSEG Response to ESMA Consultation on the Operation of the Buy-in process

INTRODUCTION

London Stock Exchange Group (LSEG) welcomes the opportunity to respond to the discussion paper on ESMA's draft technical standards for the Regulation on securities settlement and central securities depository (CSD-R).

LSEG supports the objective of seeking to strengthen the efficiency of settlement processes and of establishing a European regulatory framework for CSDs. We believe that efficient competition between post-trade providers with harmonised standards is the best way to ensure that post-trade service providers can, and will, respond to a dynamic and rapidly changing market place, and enable the EU financial market to remain competitive, attractive and accessible to international investors.

LSEG has significant experience of operating neutral, well regulated, fair and efficient settlement and custody services provided by Monte Titoli, the Italian Central Securities Depositary.

The Group also provides clearing services through LCH.Clearnet Group Ltd (with regulated CCPs in France and the UK) and Cassa di Compensazione e Garanzia (CC&G), a regulated CCP in Italy.

This submission represents the views and experience of those trading and post-trading services providers within the LSEG.

For this Discussion Paper, we have also contributed to the response submitted by the European Central Securities Depository Association (ECSDA) and European Association of Clearing Houses (EACH). We broadly support the views expressed and the responses to the questions contained in those submission.

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General Comment

We welcome ESMA's changed approach as regards the role of trading venues and CSDs in the context of the buy-in procedure.

We believe that the proposed amendments to the previous version of the RTS are more in line with CSDs and trading venues' regulatory responsibilities to the extent that they are not required to intervene in the buy-in process but have a role that is restricted to receiving notifications provided by the party executing the buy-in. This approach ensures that the buy-in procedure will not entail any unnecessary risk taking by the CSDs or trading venues.

We do not have strong views on the proposed options. However, we believe that the final choice is likely to be between Option 1 and 3. In this regard we acknowledge that Option 1 has attracted the larger consensus among industry stakeholders who consider it the less disruptive from an operational point of view. On the other hand Option 3 leverages on the accountability on settlement agents – on which lies the actual delivery obligation – to act promptly in the interest of their client to discharge delivery obligations through either bilateral cancellation or buy-in execution. However, this could have an unpredictable impact in terms of cost and financial arrangements with their clients.

In light of the above, the LSEG response mainly highlights some aspects of the proposed procedure that in our view need to be clarified or slightly amended.

LSEG Comments on the details of the procedure

1. Definition of party and application of article 17

The definition of "party" which also includes trading member, clearing member and CCPs could create uncertainty as to the interpretation of article 17. Indeed the RTS should clarify that the pass-on process described therein should not involve the CCP so that the buy-in procedure should take place between the failing and the receiving clearing according to CCP rules.

2. Details of buy-in procedure for cleared trades

In respect to buy-ins for cleared trades, we believe it is important to ensure that CCPs remain in control of the procedure in all cases. CCPs should be allowed to determine the technical details of the buy-in and in particular:

- as regards the notification listed in paragraph 1 of article 13, we believe that CCPs should be allowed to define their content;
- as regards the cancellation of the original unsettled instruction (referred to in paragraph 15 (2) (a)). Indeed the current proposal does not take into account the existence of different buy-in models used by CCPs, which work effectively. There should be cases where CCPs do not cancel the original settlement instruction and settle it with the bought-in securities while other CCPs provides for the cancellation of the original fail and the delivery of the bought in securities from the buy-in agent directly to the receiving clearing member.

This approach is in line with the level 1 text that puts CCPs in charge of "executing" the buy-in procedure and do not preclude CCPs from continuing to use existing buy-in models which are effective. In the meantime this would not prevent the harmonisation of the main steps of the procedure.

3. Transaction concluded on the market that do not use STP

In respect to the procedures for trades concluded on a trading venue, we would welcome further clarification on the management of transactions executed on trading venues that do not offer STP. Indeed these transactions are concluded on the market but are also entered into the settlement system by CSD participant. Hence from a pure settlement perspective this transaction could not be distinguished from other OTC transactions unless the trading venue code (MIC) is specified.

In the case of our platform, BondVision (MTS market), for example, trades are executed by market participants but then in terms of settlement they may be instructed into the SSS on accounts not directly owned by the BondVision participants, e.g. the accounts owned by the various funds in favour of whom the trade was split.

Further, even if the participant would input the transaction specifying the trading venue code, the transaction entered into the settlement system could be the result of an aggregate or split balance of trades. In this case it would be difficult to reconcile the information on fails that CSDs will pass on to the trading venues with transactions concluded on the market. Therefore, with respect to these trades, we believe that ESMA should consider the possibility of applying the option prevailing for OTC transactions or at least require trading venues to give participants the obligation to specify the trading venue code (even if, considering that trading venue code will not be a matching field, the enforcement would be challenging).

4. Cases in which buy-in "is not possible".

In relation to Article 15(4), we note that securities are often temporarily unavailable owing to actions of trading venues in their role as market operators such as suspension of trading, a lack of free floating shares or other market circumstances outside the control of issuer. This is reflected in the requirements under MiFID for trading venues to have rules to monitor and ensure the compliance of participants with market operator rules and other legal obligations such as market abuse rules (See Article 26 for MTFs, Article 43 for Regulated Markets and Article 41 in general). In our previous responses to ESMA, we have indicated concerns about potential consequences of short cash out periods for less liquid securities, including price bubbles, irregular market behaviour and further erosion of any remaining liquidity, leaving securities without a functioning secondary market or exposing parties to a potential vehicle for market abuse.

In our 22 May 2014 response we expressed support for allowing CCPs and trading venues, where relevant and in accordance with their rules, to make a decision as to the availability of instruments on its venue (including for the purposes of buy-in, amongst other things). This would allow parties or participants (whichever it is decided by ESMA) to determine whether a buy-in would be permanently or temporarily impossible at any given time, without having to move straight to cash out. We believe trading venue and CCP rules would provide a transparent and suitable framework to define cases in which buy-in is not possible in relevant market circumstances. We remain convinced this approach is necessary to ensure the effective management of settlement failure of less liquid securities whilst maintaining orderly markets and meeting trading venue obligations in MiFID and MAD.

5. Mandatory partial settlement at the end of the extension period

We understand ESMA's intention to minimise the impact of buy-in by allowing it to be executed only for the missing part of a partial delivery of securities. However, we believe that parties already have enough incentive to opt for partial settlement if they wish to minimise the need for buy-ins. Indeed most CCPs already mandate partial settlement on a contractual basis. For transactions not cleared by CCPs, there are different reasons why CSD participants might choose to opt out of partial settlement. It can be because of technical limitations of their system or to avoid the "withdrawal from the pool" issues related to omnibus accounts. Imposing partial settlement on CSD participants who deliberately decide to opt out would go against their contractual choice and could create difficult situations. In operational terms, CSD systems also often do not make it possible for the CSD to amend the partial settlement indicator in an instruction. CSDs would then be forced to create an amendment message to change the partial settlement indicator, thus intervening in participants' transactions flows.

Hence we believe the partial settlement functionality should be subject to rules of a relevant CCP, trading venue mandating or restricting partial settlement of transactions. Imposing partial settlement on CSD participants who deliberately decide to opt out would go against their contractual choice and could create difficult situations.

6. Notification from CCP/Trading venues to CSDs (article 13 (2) and (3))

ESMA suggests that trading venues and CCPs send notifications received by its participant / trading member to CSDs. We would like ESMA to clarify what is the rationale behind this additional information flow and would encourage it not to require redundant exchange of information where the CSDs already have them.