<u>**EUROPEAN REPO COMMITTEE**</u>

ESMA Discussion paper on the CSD Regulation (ESMA 2014/299)

A response by the International Capital Market Association (ICMA) and the ICMA European Repo Council (ICMA ERC)

Summary and key points

1. *We comment only in respect of investment grade corporate bonds and government bonds, traded internationally, which are the core products for the ICMA and the ICMA European Repo Council respectively.*

2. *ICMA members recommend that buy-ins for fixed income securities should be transacted only after the receiving party has chosen whether or not to receive cash compensation. In the event that the buy in fails or is not possible, the right to receive cash compensation should arise once more.*

3. *To ensure the smooth and orderly functioning of the markets, we suggest that:*

    a. *the mandatory buy-in extension periods start initially on SDD+7 for all securities; and*

    b. *Once MiFID II transparency and the various settlement system re-engineering projects (including T2S) have been delivered, the authorities and the market can then review settlement performance in the light of experience and recommend a move to a shorter cycle only where justified by the evidence.*

4. *It would be helpful for the new buy-in regime to have the following features;*

    a. *Administrative support from the CSD in identifying which settlement failures can be resolved by a buy-in;*

    b. *This administrative support will include identifying 'chains' of settlement fails;*

    c. *Co-operation between trading venues, CCPs and CSDs, though these infrastructures should oversee, not transact, buy-ins;*

    d. *Infrastructures should delegate the transaction of a buy-in to a bank or securities dealer;*

    e. *Buy-ins should be transacted by banks or securities dealers with the appropriate authorisation. We expect that most buy-ins will be transacted by a market maker in the security being bought in but this should not be a mandatory feature of the regime;*

f. The same buy-in agent should transact the buy-ins for all settlements in a chain;

g. Buy-ins should be executed for 'guaranteed delivery'; and

h. A best execution obligation should apply.

5. *We are planning further work in a number of areas and stand ready to assist the authorities further as their work proceeds. The three main areas are the practical requirements for co-ordinating multiple buy-ins (Q15), the treatment of different operations in relation to 'ineffective' buy-ins (Q16) and the information required to be sent by the CSD to the trading venue (Q20).*

Q1: Which elements would you propose ESMA to take into account / to form the technical standards on confirmation and allocation between investment firms and their professional clients?

Members of ICMA feel strongly that efforts should be made to confirm and allocate on T+0. T+0 affirmations are highly effective in contributing to both the confirmation and allocation processes inherent between investment firms and professional clients. Active steps are already being taken by the industry to use existing affirmation processes, both internally and with the use of matching vendors. The ICMA ERC operations group encourage affirmation and confirmation practices within repo operations. The definitions of these practices are outlined in the newly published European Repo Guide to Best Practice. Please see, in particular, paragraphs 2.33 and following. We note, however, that resources will be required to invest in these practices, whether internally or through a vendor. Allocation practices within the secondary market involve distribution standards and timings from buy-side on a technical level.

Q2: In your opinion, are there any exceptions that should be allowed to the rule that no manual intervention occurs in the processing of settlement instructions? If so please highlight them together with an indication of the cost involved if these exceptions are not considered? Do you consider that this requirement should apply differently to investment firms? If so, please explain.

ICMA members note that a hybrid system, made up of both automatic and manual processes currently exists. Although steps are being made towards full automation, manual processes in certain cases may persist, particularly for bilateral transactions where the manual input is a function of the end client. Allocation, affirmation and confirmation are all front-loaded processes. STP is only done once transactions are matched on the value date. It is noted that some CSDs are moving away from repair services, which then provides for the agent to re-instruct with complete messaging. Manual processes should help facilitate settlement repair in some cases; to penalise them would be counterproductive and would not help liquidity provision. ICMA members agree that manual intervention should be allowed in contingencies, particularly in circumstances such as corporate events with short deadlines for event management.

Q3: ESMA welcomes concrete proposals on how the relevant communication procedures and standards could be further defined to ensure STP.

We believe that encouraging more widespread adoption of international standards, rather than prescribing specific standards for use in ESMA jurisdictions, is the way forward.

STP requires real-time continuous settlement and we encourage ESMA to consider how this can best be pursued. For our part, we expect triparty repo settlement interoperability to be in service between Euroclear Bank and Clearstream Banking Luxembourg from June 2015 at the latest.

Q4: Do you share ESMA's view that matching should be compulsory and fields standardised as proposed? If not, please justify your answer and indicate any envisaged exception to this rule. Are there any additional fields that you would suggest ESMA to consider? How should clients' codes be considered?

We consider that there are three steps involved in trade matching and confirmation. The first step is the affirmation of the terms of the trade between trading counterparties. The second step is establishing the chain of additional market participants to be involved in settlement of the trade. These may include CCPs and general clearing members; agent banks; and custodians. The additional participants must be instructed by the counterparties to the trade; they will typically enrich the instructions received with the addition of standard settlement instructions.

Since T2S does not currently support the repo and securities financing business, it is clearly desirable that additional fields should be available to support the needs of this business.

The term 'client code' is ambiguous. Client codes drawn from a standard source, such as SWIFT 'BIC codes', could be of value; but unless internal client codes are widely shared, they cannot be used for matching. We do not recommend the sharing of internal client codes.

Q5: Do you agree with the above proposals? What kind of disincentives (other than monetary incentives such as discounts on matching fees) might be envisaged and under which product scope?

In relation to the proposal in paragraph 23 that settlement instructions not received by the end of ISD-2 should be subject to disincentives, we strongly disagree.

ICMA and the ERC are concerned with the international market; securities intended to be traded globally. Since trading can take place up to 6pm CET (5pm in London) and even later with clients based in non-European time zones, and the process of transforming trades into settlement instructions is not instant, for trades on the new normal settlement cycle of T+2, trades entered into on ISD-2 cannot always be submitted on that day. Secondly, trades may be entered into for shorter settlement cycles; in such cases, ISD-2 will fall before trade date.

We support the provision of full functionality for managing pending settlements, including "hold and release" and bilateral cancellation. As the discussion paper seems to suggest, these services must be complemented with the swift and accurate provision of information relating to the status of the settlement instruction to the counterparties.

Q6: In your opinion, should CSDs be obliged to offer at least 3 daily settlements/batches per day? Of which duration? Please elaborate providing relevant data to estimate the cost and benefit associated with the different options.

We believe that the concept of 'batch' processing in the settlement field is increasingly seen to be out of date, even with the meaning 'possibility to settle' used in footnote 8 on page 13. At the very least, *large volume settlement systems should be able to offer so many batches during the working day that the user experience emulates real time settlement. We recognise that T2S will help; and we also think that non-T2S markets should be encouraged to align their daily timetables with the T2S timetable. In addition, we expect settlement cycles within a pre-defined timescale to become the norm. Reasonably frequent daily settlements during the trading day are important for repo markets and also serve a valuable role in settlement repair.*

ICSDs are already moving in this direction. Market participants need to be able to on-transfer collateral received to their clients and the wider market efficiently. Collateral management is key to the implementation of EMIR where same day settlement is needed (for variation margin as an example);

The principal benefit of this approach is that market participants will have multiple opportunities to repair failed settlements during settlement due date; and settlements which require multiple steps have more probability of occurring, which should reduce the need for resource-hungry algorithms to look across all settlement instructions in a particular IT system to build chains of dependent settlements.

We are not able to estimate the benefits of such an approach, but a daily settlement timetable which helps to reduce settlement fails, daily penalties and costly, complex buy-ins seems to us to be wholly aligned with the objectives of the CSDR and will help to build safer, more resilient markets.

Q7: In your view, should any of the above measures to facilitate settlement on ISD be mandatory? Please describe any other measure that would be appropriate to be mandated.

We believe that the following functions should be supported by the CSD:

- *(i) Recycling settlement instructions so that instructions which have not yet settled can do so either (a) later on settlement due date or (b) after settlement due date but before a buy-in is instructed or executed;*
- *(ii) Shaping a trade upon input of the instructions, so that partial settlement can take place in accordance with the agreement between the parties to the trade; the parameters should be defined by market practice or by the parties to the trade; and tariffs should not discourage shaping;*
- *(iii) Partial settlement, under which a balance remains outstanding; this should be carried out either in accordance with the agreement between the parties to the trade or as defined by market practice; clear communication with the parties to the trade is essential; and*
- *(iv) Securities lending, both in its own right and as a tool for settlement repair.*

The use of optimisation algorithms which identify chains of dependent settlements need not be compulsory where settlement performance is satisfactory without them. These algorithms require careful design and testing as they can immobilise resources in the IT system and make it harder for participants to manage their settlements. Where the use of optimisation algorithms is permitted or mandated, the competent authorities should ensure that the CSD (a) understands the operation of the algorithm and its costs and benefits and (b) has robust IT governance in place to manage changes to the IT system or the algorithm.

Q8: Do you agree with this view? If not please elaborate on how such arrangements could be designed and include the relevant data to estimate the costs and benefits associated with such arrangements. Comments are also welcome on whether ESMA should provide for a framework on lending facilities where offered by CSDs.

ICMA members believe that centralised lending should not be obligatory, which would see a bank function set up alongside a notary function.

All (I)CSDs should, however, provide the necessary functionality to support the securities lending and borrowing business, including repo and the associated securities financing trades.

We value the securities lending services offered by the ICSDs today, whereby participants can place some or all of their securities in an 'available for lending' pool; the ICSD arranges the loan, but does not, crucially, take risk in respect of it; and the borrower is responsible for the return of equivalent securities. We expect that this will continue to be offered. Eventually, it will need to be supported by T2S; but we understand this is unlikely to happen until the migration is complete, unfortunately.

Q9: Do you agree with the above monitoring system description? What further elements would you suggest? Please present the appropriate details, notably having in mind the current CSD datasets and possible impact on reporting costs.

As a minimum, participants in a settlement system should have access to settlement fails data on a transaction by transaction basis, either real time or by timely file transfer. This settlement fails data should enable participants to identify and analyse the age of fails.

For monitoring by the CSD of the performance of participants, we expect trading venues, CCPs and CSDs in consultation with their participants to agree an appropriate regime with the authorities. The level of monitoring involved in a jurisdiction with many liquid securities and a competitive trading and clearing landscape will be different from the effort required where there are a small number of securities traded on a single low-volume trading venue/CCP/CSD infrastructure optimised for domestic needs.

For monitoring by the national competent authorities and ESMA, we believe that aggregated, anonymised data showing settlement performance each day should be provided to ESMA on a weekly basis. We attach the Monte Titoli weekly report by way of example. A second page, analysing failed settlements by asset class and age, should be added, to complement the data provided to individual participants above.

The fields detailed are rightly identified. ICMA members agree that ESMA should not be overly prescriptive without evidence, and that the authorities should consider whether to establish a group to monitor settlement fails after the implementation of CSDR based on values of transactions. Information should be given to market participants on whether the absence of matched instructions is causing settlement fails or not.

We also believe that where large volume settlement systems provide more data than is required under these proposals, they should continue to do so. It would be unfortunate if the effect of European harmonisation was to reduce the level of data and insight available to the authorities as a result of requiring from all CSDs only the data available from the least sophisticated.

There is a specific technical question relating to the practice of CCPs in some markets. We understand that upon a failure, the CCP cancels and re-instructs the trade, rather than the instruction being recycled. In markets where this occurs, it would be helpful for CCPs and CSDs to co-operate so that useful operational data is not masked by this practice.

Q10: What are your views on the information that participants should receive to monitor fails?

As a minimum, participants in a settlement system should have access to settlement fails data on a transaction by transaction basis, either real time or by timely file transfer. This settlement fails data should enable participants to identify and analyse the age of fails.

We think it is helpful for market participants to have access to the aggregated performance of their peers as a group. For example, private banks and wealth managers should compare themselves to each other, not to global firms; and the global firms should also be compared. In markets where dis-aggregated data cannot be circulated for other public policy reasons (perhaps because there are few banks involved in the settlement business) then the performance of the system as a whole (minus the performance of the recipient) should be provided as a benchmark.

We note that the Monte Titoli weekly report (see question 9) is published weekly, on Monday in relation to the previous week.

Q11: Do you believe the public information should be left to each CSD or local authority to define or disclosed in a standard European format provided by ESMA? How could that format look like?

In addition to the data set described after paragraph 41 (see question 9) which should be capable of aggregation and publication on an annual basis, we believe that an analysis of the number and value of 'late' settlements on a country-by country, asset class by asset class basis would be valuable. For example, knowing the value and number of late settlements in Italian domestic equities and in German bunds would be useful; whereas an aggregate number which blended these very different products would be of little value.

In line with our recommendation in our answer to Q9 above, we would like to see this data broken down by categories, such as settlement due date (SDD); SDD+1; SDD+3; SDD+5; SDD>5.

There are a number of other data series which CSDs and ICSDs produce. We hope you will agree that one possible constructive approach is for ESMA to prescribe the data set described after paragraph 41, together with our proposed enhancements, and to agree a (non-exhaustive) list of data series which CSDs and supervisors may publish on a consistent basis.

Q12: What would the cost implication for CSDs to report fails to their competent authorities on a daily basis be?

We believe that only the CSDs would have access to this data. However, based on our members' experience of aggregating data, which we use for business purposes, for the purposes of regulatory reporting in this sphere, we would expect the cost of aggregation to be limited, particularly once the requirements are well understood and the process can be automated.

Please also see our answer to Question 21 below.

Q13: CSDR provides that the extension period shall be based on asset type and liquidity. How would you propose those to be considered? Notably, what asset types should be taken into consideration?

We comment only in respect of investment grade corporate bonds and government bonds, traded internationally, which are the core products for the ICMA and the ICMA European Repo Council respectively.

First, for the same reasons as given under 11 above, products in different asset classes are not capable of being classified into a singular liquidity matrix. For corporate bonds, our observation is that these typically find their way into the portfolios of long-term holders quite soon after issue; and thereafter they rarely trade. Trading in government bonds is significantly impacted by the size and credit quality of the issuer. Furthermore, where primary dealers have a quoting obligation (obligation to stand in the market offering to buy and sell securities, sometimes in specified quantities and at specified maximum spreads), this can mask the lack of natural liquidity of these government bond markets. However, we understand that quoting obligations are considered necessary for the overall performance of this asset class.

We believe that the smooth and orderly functioning of the markets in investment grade corporate bonds and government bonds would be adversely affected by an extension period of only 4 days. This is because these markets depend on market makers to provide liquidity. The ability of market makers to source bonds which they have sold as principal but which they do not have in possession at the time of sale is a function of time. If buy-ins are implemented after only 4 days, this will increase the cost and complexity of market making, compared to implementing mandatory buy ins after 7 days as permitted by the Regulation. As a result, banks may be less willing to extend liquidity to the markets through market making and repo; this in turn will affect the smooth and orderly functioning of the markets and will likely increase the cost of capital to end users, such as governments and corporates who use the bond markets to raise capital. Unintended market consequences may also arise from two exemptions provided for in the CSDR (a) for ineffective buy-ins (for example, short term repurchase transactions) or (b) where failing CCPs are exempt from buy-in; these exemptions could shift the consequences of settlement failures on to cash market liquidity providers, market makers and other market participants, which will in turn have an adverse effect on liquidity in cash markets.

We suggest the following as a possible way forward. First, start mandatory buy-ins on SDD +7. Once MiFID II transparency and the various settlement system re-engineering projects (including T2S) have been delivered, the authorities and the market can review settlement performance in the light of experience and recommend a move to a shorter cycle only where justified by the evidence.

Q14: Do you see the need to specify other minimum requirements for the buy-in mechanism? With regard to the length of the buy-in mechanism, do you have specific suggestions as to the different timelines and in particular would you find a buy-in execution period of 4 business days acceptable for liquid products?

We believe that the buy-in execution period should be no shorter than the settlement extension period for any given security (e.g. if a security was subject to S+7 extension period, there would be a minimum of 7 days to complete the buy-in).

ICMA members are concerned by the proposed buy-in mechanism outlined in paragraph 52 of the ESMA discussion paper and recommend that buy-ins be transacted on behalf of the receiving party by an agent. As explained in this answer below, we think that market infrastructures have an important oversight role but should not transact buy-ins. This is because only the market participants to the transaction will know the details underpinning the transaction and the reason for its failure. In current practice, CSDs make efforts to request information from the participant. It should also be known that trading venues, CCPs or CSDs will not necessarily know whether a security needs to be 'bought-in'.

According to MiFID 1 and re-inforced for non-equities in MiFID 2 a healthy competitive landscape in Europe has emerged. Linked to other European harmonisation initiatives we have now multiple CSDs, Trading venues and CCPs. It is therefore impossible for any of those 3 identified actors to have any certainty of the position of each participant. Only the two parties involved in the trade will have a clear understanding of their own positions. The ERC has held discussions with members of ECSDA and EACH in the early consultation process of CSDR. Similar expressions of impossibilities to identify exactly who is short have been made.

Members are also concerned that the mandatory buy-in mechanism has been designed around a single approach, even though the regulation allows for three different arrangements under Article 7 (10) of CSDR. ICMA members recommend that buy-ins for fixed income securities should be transacted only after the receiving party has chosen not to receive cash compensation. In the event that the buy in fails or is not possible, the right to receive cash compensation should arise once more.

We think the following aspects of a buy-in regime are highly desirable:

a. *Administrative support from the CSD in identifying which settlement failures can be resolved by a buy-in;*

b. *This administrative support will include identifying 'chains' of settlement fails, referred to in the ICMA Rules and Recommendations as a 'pass on situation';*

c. *Co-operation between trading venues, CCPs and CSDs, though these infrastructures should oversee, not transact, buy-ins;*

d. *Infrastructures should delegate the transaction of a buy-in to a bank or securities dealer;*

e. *Buy-ins should be transacted by banks or securities dealers, with the appropriate authorisation, who are not, and are not connected to, the parties to the failed trade; We expect that most buy-ins will be transacted by a market maker in the security being bought in but this should not be a mandatory feature of the regime.*

f. *The same buy-in agent should transact the buy-ins for all settlements in a chain;*

g. *Buy-ins should be executed for 'guaranteed delivery'; and*

h. *A best execution obligation should apply. For this to be wholly effective, transparency will be required.*

Consideration should also be given to declaring a buy-in 'not possible' when the relevant securities are not available at a reasonable price, or at all.

If our recommendations for co-ordinated administration and the appointment of a single agent for all settlements in a chain are not followed, we foresee a deeply sub-optimal situation, in which multiple buy-ins are attempted on an un-co-ordinated basis in the same security. We would be happy to discuss this aspect with you further. We note that a significant rise in buy-ins would add operational and financial risk.

Q15: Under what circumstances can a buy-in be considered not possible?

The ICMA Secondary Market Rules and Recommendations, which govern trades in the international market, provide that the buy-in provisions do not apply where the entire issue of the securities in question have been called for redemption. It is a question of judgement whether or not a buy in is 'not possible' in other circumstances; this will depend on technical factors relating to the market for the securities in question, such as the number and nature of the holders; a security predominantly held in long-term portfolios, which would suffer a tax penalty if they sold, is an example of such a technical factor. Other technical factors include a lack of market liquidity caused by events such as a futures contract expiry or the insolvency of a participant in the market.

There are a number of other circumstances in which a buy in might not be possible and we would welcome the inclusion of a (non-exhaustive) list of examples in the appropriate technical standard.

For example, where the buy-in agent cannot buy securities, having taken all reasonable steps to do so, the buy in should be regarded as not possible.

Another example would be where the agent cannot purchase securities at a reasonable price; please see below for a suggestion that ESMA might issue guidance on this.

The effect of a buy-in and the payment of cash compensation should be broadly similar. We would therefore encourage ESMA to consider giving guidance as to the circumstances in which a buy-in should be considered 'impossible' because securities are offered to the buy-in agent only at prices above a reasonable level. This proposal would serve to avoid damage to liquidity from frequent buy-ins at extremely high prices. We would not expect ESMA to engage in transaction-by-transaction price setting but it would be helpful for ESMA to set standards in relation to 'reasonableness' or to publish a non-exhaustive list of factors to be taken into account. Our proposals for a best execution obligation and a transparent buy-in process in our answer to Q14 should also help in this regard.

Would you consider beneficial if the technical standard envisaged a coordination of multiple buy-ins on the same financial instruments? How should this take place?

We believe that a technical standard which envisaged the co-ordination of multiple buy-ins in the same financial instrument is highly desirable. We would like to see a variety of approaches which address the different market structures and liquidity characteristics of different product markets, developed in collaboration with relevant market experts.

This approach is in line with the policy goals expressed in the Recitals to the Regulation.

We are planning to contribute to industry work developing the different approaches in more detail. For now, we note two important characteristics of market practice under ICMA rules.

The ICMA Secondary Market Rules and Recommendations provide that the buy-in agent instructed to execute the buy-in shall be the same for the whole chain.

The ICMA Secondary Market Rules and Recommendations also allow for the recipient of a buy-in notice to pass it on.

The ability to pass on a buy in notice is particularly important for market makers, where the failure of a seller to deliver is likely to cause the market maker to fail to deliver to a buyer; this problem is especially acute in illiquid securities.

Q16: In which circumstances would you deem a buy-in to be ineffective?

For a buy-in to be effective, the receiving party should be put in the position she would have been in if the original transaction had completed in accordance with its contractual terms.

In relation to the exemption in Article 7.10 (b) regarding short-term repos and stock loans, we are continuing to consider how this could best be implemented in practice. We would welcome further dialogue with ESMA and the authorities. We are seeking to develop proposals which respect the provisions of the Level 1 text and provide for the least adverse impact and additional risk on the financing market and the greatest protection for the smooth operation of financial markets more generally.

How do you think different types of operations and timeframes should be treated?

We plan to consider this further and may wish to provide additional evidence.

Q17: Do you agree on the proposed approach? How would you identify the reference price?

We would like to see the following refinements to the proposed approach:

a. *Unless a buy-in is impossible or ineffective, a buy in should not be deemed to have failed until at least SDD + 8 (where the buy-in is initiated on SDD+4) or SDD+14 (where the buy-in is initiated on SDD+7); and*
b. *The receiving party should be put in the position she would have been in if the original transaction had completed in accordance with its contractual terms.*

The business of identifying the reference price will vary depending on the market structure and product characteristics of the relevant market. The process should therefore be adapted to current market conditions and is likely to require revision following changes to the market structure, whether as a result of MiFID II or for other reasons. In some circumstances, such as when the last traded price is clearly 'stale', the obtaining of a valuation from a suitably qualified firm might need to be considered.

Q18: Would you agree with ESMA's approach? Would you indicate further or different conditions to be considered for the suspension of the failing participant?

ICMA members agree in principle the means to generate more visibility on consistently failing counterparties. While it must be noted however that the overall number of fails in fixed income securities do not currently exist at unsustainable levels, an appropriate incentive regime is still required. There is no reason to suggest why a penalty regime cannot act as a suitable deterrent. Formulating these mechanisms correctly are a preferred alternative to mandatory buy-ins. The impact of the Short Selling Regulation (SSR) should also be taken into account.

ICMA members do not wholly agree to the suspension of the failing participant. Consideration should be given to the end client, and the level of risk that has been left in the financial system as a result of the suspension.

ICMA members agree that it is imperative to gather visibility on failing counterparties <u>before</u> determining penalties. It is also unwise to consider benchmarks and suitable thresholds until this data is analysed. Authorities should also take noted concern of the time period to which the data corresponds. For example it would not be sensible to set the timeframe over the near future with the onset of T+2 and T2S, affecting settlement of financial instruments. Efforts need to be made to ensure that proposed regimes for fixed income are calibrated accordingly, based on statistical data over a suitable time period where markets are not experiencing undue financial stress.

It may be that a failing participant is suffering from the failure of a client who is not itself a participant in the settlement system, such as a non-clearing member settling through a clearing member.

The authorities should also be obliged to consider the effect on the market of the suspension of a participant who is providing services to other market participants, such as a market maker providing liquidity or an agent bank providing settlement services to market participants who do not participate directly in the relevant CSD.

Q19: Please, indicate your views on the proposed quantitative thresholds (percentages / months).

We think it is essential that the thresholds should be set on the basis of known facts. The level of settlement failures under the new regime could be very different from that prevailing today.

We think that quantitative thresholds will vary significantly across product types. For example, transaction sizes vary significantly between equities and fixed income; and failed settlements in centrally cleared markets may have wider ramifications for other market participants than failed settlements in bilateral markets. The appropriate thresholds for different types of market participant will not necessarily be identical.

Another approach which might be helpful would be to rank each market participant by reference to the average performance of a benchmark group, either the whole market or their peers, so as to seek to drive improvements in settlement efficiency.

Q20: What is in your view the settlement information that CSDs need to provide to CCPs and trading venues for the execution of buy-ins? Do you agree with the approach outlined above? If not, please explain what alternative solutions might be used to achieve the same results.

The fixed income markets for which ICMA and the ICMA ERC are responsible are a combination of cleared and uncleared markets. In the sovereign bond markets, the largest of which are Eurozone and UK sterling, a growing share of both cash and repo trading is cleared by CCPs; while in corporate bond markets, bilateral OTC trading is still the norm.

CCPs are considered counterparties to all, so they have the right to perform buy-ins, but since a lot of transactions are netted, this may be complicated and every chance should be given for the failing counterparty to explain and rectify before any buy-in can be performed. The Global Master Repo Agreement (GMRA) provides a standard contractual basis for bilateral trades; CCPs have developed their own contractual structures, which provide similar arrangements to the GMRA in a number of areas.

Trades which are not centrally cleared may be formed bilaterally or on a trading platform. In the first case, responsibility for settlement lies with the parties; they instruct settlement, using agents where required. If settlement of the trade fails, the two parties to the trade will be informed of the settlement failure by the CSD. If an agent is involved, it is the agent's responsibility to report to his principal.

Where a trading platform is involved, its responsibility is limited to transmitting details of the trade to the CSD; settlement remains the responsibility of the parties to the trade. It is not clear what the practical benefits are of the CSD providing information to the trading venue.

The position is further complicated by the fact that a chain of failing transactions may have been transacted on a number of competing trading venues. Please see the third paragraph of our answer to Q14.

We propose to do further work to identify and develop the scenarios in which co-operation between trading venues, their participants and CSDs and their participants is needed to identify the trades in a given security which can be satisfied by a single buy-in.

The data used for monitoring and reporting (to participants and supervisors) and the data provided by CSDs to CCPs and trading venues should both be consistent with the data provided in this case. The data may need to be more granular and failing participants and their counterparties may need to be involved in piecing together the chain of instructions.

In relation to the proposal in paragraph 68 to prescribe one settlement account per participant per CCP per geographic market, we see this as a significant additional complication. We believe that transitioning to and implementing such a system would of itself cause settlement fail rates to rise. We do not recommend it.

We therefore recommend the approach outlined in this section. We believe that daily penalties provide a significant incentive to co-operate.

Q21: Would you agree that the above mentioned requirements are appropriate?

If quarterly reports within five days of the end of the quarter are good enough for settlement internalisers, it is not clear why this regime is not good enough for CSDs. Five days seems to us to be a relatively short period; would 10 business days for quarterly reports be acceptable?

Questions 22-54 are out of scope for ICMA.

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John Serocold

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