Feedback on: Financial markets – central securities depositories (review of EU rules)

April 1, 2021

Introduction

On behalf of its wide and diverse international membership (including asset managers and investors, banks and broker-dealers, as well as market infrastructures), the International Capital Market Association (ICMA) would like to take this opportunity to highlight the importance of including Settlement Discipline, in particular the provisions for mandatory buy-ins (MBI), in the Review of CSDR. ICMA's members firmly believe that in its current form, the MBI framework is not fit for purpose and is in urgent need of substantive revision before attempting implementation. Furthermore, even if amended, the mandatory nature of the buy-in requirement is likely to have adverse impacts on bond market liquidity, functioning, and stability.

Considerations

In its recent response to the European Commission's Targeted consultation on the CSDR Review (which is submitted with this feedback), ICMA argues that buy-ins, whether regulatory or contractual, should be discretionary and not mandatory. Mandating buy-ins will have adverse impacts for European bond market efficiency and liquidity. The response presents quantitative analysis to illustrate the scale of the costs that market participants (particularly investors) are likely to incur.

ICMA also provides analysis using settlement efficiency data that illustrates not only how extensive and disruptive a mandatory buy-in regime would be for European bond markets under normal conditions, but that the procyclical impacts during the March-April 2020 COVID-19 market turmoil could have been extremely disruptive.

If buy-ins are to remain part of CSDR, this will still require a number of essential revisions, including: (i) symmetrical payments for the buy-in and cash compensation differential; (ii) the introduction of a pass-on mechanism; (iii) greater flexibility in the requirement to appoint a buy-in agent; (iv) a clarification (and narrowing) of scope; (v) a more workable cash settlement ('cash compensation') mechanism for illiquid bonds; (vi) more tailored timelines for completing the buy-in; and (vii) guaranteed delivery for the buy-in process. It is difficult to see how the regime could be successfully implemented without these amendments.

ICMA and its members therefore argue that is essential that Settlement Discipline, in particular MBIs, is a key focus of this Review and subsequent Refit.

Timing

ICMA would also like to take this opportunity to highlight the industry concerns recently raised in the cross-industry letter co-signed by 15 different associations representing a wide range of stakeholders in the European and global financial markets.

The letter points out that the implementation of MBIs is a significant undertaking for the entire financial market, not only in Europe, but globally, involving not only extensive system developments, but also major client outreach across multiple markets and jurisdictions to undertake contractual papering and remediation. Implementing the mandatory buy-in requirements whilst the authorities concurrently review and revise the regulation will at best result in ongoing implementation efforts and investment being rendered redundant; while at worst it will mean repeating the exercise. The letter notes that creating such uncertainty around a regulatory implementation project of this profile and scale is damaging to the development and reputation of the EU's financial markets. The associations suggest that a far more robust approach would be to make the required revisions to the CSDR mandatory buy-in regime before attempting implementation.

Conclusion

ICMA would therefore emphasize not only the importance of reviewing and revising the MBI provisions before attempting implementation, but also the urgency for providing clarification to market participants and stakeholders, in Europe and globally, that sufficient time will be provided to facilitate implementation once the revisions to the regulation are passed into law.