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Consultation Paper on Draft Regulatory Technical standards on the CSD Regulation - The Operation of the Buy-In Process

August 2015

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on **ESMA's Regulatory Technical Standards on the CSD regulation – The Operation of the Buy-in Process**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Executive Summary

In an attempt to support an integrated market for securities settlement in Europe and provide a harmonised framework to address settlement fails, CSDR addresses the existing fragmentation in the process of handling settlement fails in the EU by imposing mandatory Buy-ins. AFME has worked closely with ESMA on previous occasions to establish a correct approach with regards to settlement fails and has strongly advocated in favour of harmonisation in the Post Trade area. We very much welcome and appreciate ESMA's efforts in this domain to achieve an adequate and balanced solution, and the openness to look at different options, as outlined in the Consultation Paper.

However, AFME believes that the proposed measures and options in ESMA's CP on Buy-ins still do not address some of the essential concerns raised in previous AFME submissions, by focusing on who carries the risks rather than addressing the following key concerns:

- Lack of definition in around what a buy-in is and which transactions are in scope.
- Additional costs to end investors and very significant impact on market liquidity, which does not seem to be in proportion with the intended objective to improve settlement efficiency.
- Significant costs in terms of the collateral that will need to be mobilized to mitigate risk for CSD participants under Options 2 and 3.
- Inability to address the extraterritoriality issue under all three Options (which also flows from the lack of clear definition of a buy-in).

In response to the specific questions raised in the consultation paper we wish to highlight the following points:

Option 1 is the most viable alternative.

Each of the three options proposed pose significant implementation challenges to the industry and have their own flaws this group considers this to be the better of the options proposed for the following reasons:

- Option 1 is the closest to the buy-in method currently utilised on a voluntary basis in the market today.
- Option 1 places the responsibility and liability for the buy-in at the appropriate level which is the Trading level.
- Both Options 2 & 3 will fundamentally change the role of intermediaries; both will result in additional risk which will need to be mitigated by imposing collateral requirements. The role of settlement agent is not to assume the principal risk for settlement; it is rightly the trading party's risk. Option 2 & 3 transfer risk from the trading parties to the settlement agents imposing responsibility for performance of transactions which essentially makes them a guarantor of settlement for its clients.
- Trading party has the necessary information to implement the buy-in. The relevant intermediary in the chain will provide information on reason for a fail which is passed to the trading party who can then take steps to resolve the fail. The CSD Participants/settlement agents do not have this information and are often several levels removed from the trading parties. This lack of visibility of the transaction itself or knowledge of the parties involved will lead to inefficiencies in the buy-in process.
- The implementation of a mandatory buy-in mechanism will be challenging and require the industry to have the operational and contractual framework in place to support it. We strongly believe that implements should be delayed until after Target2 Securities has been completely and successfully implemented.

AFME strongly considers that the introduction of a mandatory buy-in regime is likely to have damaging effects on liquidity in all European securities and therefore the level 1 text of CSDR should be amended.

AFME recognises that this is not within ESMA's power. Out of the three Options presented by ESMA in its CP, AFME considers that Option 1 the least worst method of implementing a mandatory buy-in regime from the perspective of maintaining (i) EU securities liquidity, (ii) EU securities markets efficiency and (iii) EU financial markets global competitiveness.

Introduction

We recognise that ESMA has carefully considered the responses to the consultation papers of December 2014 and have attempted to develop several suitable alternatives. The consultation period has been too short to compile all the cost analysis requested. However, we hope that the data we have provided will demonstrate our commitment to this process and concerns for its implementation as they stand.

Furthermore, AFME recognises the work undertaken by the Joint Work Group ETF and International Securities Lending Association (ISLA) in responding to this consultation paper. These groups are the subject matter experts in the respective fields and we refer to their expert views on specific lending/ETF points.

AFME would also like to acknowledge the input and support of the International Capital Markets Association (ICMA) and the Association of Global Custodians (AGC). AFME and ICMA not only share a

number of members, but also share concern over the market impacts of the mandatory buy-in provision as it is currently drafted. Accordingly, the two associations collaborated closely in preparing their respective responses.

Outstanding issues to be addressed

We have followed this consultation with interest and welcome this second consultation paper on the buy-in approach in CSDR. We recognise that ESMA are seeking to provide a number of options for implementing the buy-in requirements within the confines of the level 1 text. However, we are concerned that the following areas raised in the prior AFME response have not been addressed sufficiently within the latest consultation. We believe that it is crucial that these be addressed if any buy-in mechanism is to be effectively implemented:

- No clear definition of buy-in and its objectives.
- No clarity on the precise definition of transactions that are within the scope of the buy-in regime.
- Lack of consistency and clarity relating to definitions when used: e.g. meaning of the term "participant" is defined within CSDR level 1 as participant of a Securities Settlement System but is also used to mean participant of a trading venue (which should be a trading party) and in addition, a participant of a CCP. It should also be noted that CSDs themselves are participants in other CSDs, which means any CSD acting as an investor CSD would appear to be caught by this, meaning they will also be accountable for buy-in costs and cash compensation. We welcome ESMA's attempts to clarify some of the terminology in the draft RTS.
- Market risk taken by settlement agents acting on behalf of their clients' under Option 2 and 3, which increases systemic risk and cannot be fully mitigated contractually.
  In option 3, the receiving participant may also require collateral (or prefunding) from the prejudiced buyer in order to cover that risk. This will further increase the risk and collateral needs, but this time for the receiving participant.
- With regards to exemptions for short term financing transactions, a clear definition of liquid and illiquid securities with appropriate calibrations must be made consistent across the market, refined at regular intervals and agreed industry-wide. We are concerned that a failure to do this will result in significant disconnects in the market and confusion.

Level 1 Review

We acknowledge that the Technical Standards need to be aligned with the Level 1 text, and that some of these issues should be addressed at the level of CSDR, though we fully welcome ESMA's openness to look at alternatives. We are particularly concerned by the mandatory nature of Level 1. Fail rates are very low and the Post Trade infrastructure has proven to deal with shocks to the system remarkably well. Further, we believe that the consequences of introducing the mandatory buy-in regime as envisaged under the Level 1 text will be damaging and should be reviewed again with policymakers.

Adverse impact on liquidity

The additional potential costs of buy-ins will lead market participants and market makers to either substantially increase the bid offer spreads in securities (leading to increased costs for investors, and reduction in trading liquidity), or could lead to withdrawal of dealers from certain less liquid markets and instruments, achieving the opposite of what the settlement discipline regime was meant to achieve

(i.e. greater liquidity). In November 2014, ICMA published a report[1] which outlined the inability to continue market making as one significant concern resulting from the proposed measures.

Third Country Issues

The lack of clear territorial scope of the buy-in provisions, trading between EU and non EU parties is likely to be negatively impacted, reducing the attractiveness of investing in Europe for foreign investors, a key objective of Capital Markets Union (CMU).

Clarity of Definitions

As we have stated in previous responses, the lack of clear definitions at Level 1 makes the Level 2 process significantly more complex. We have supported calls for a precise definition of settlement transactions, i.e. the exact scope of transactions eligible to be bought in, since all obligations under CSDR use this terminology. Perhaps the biggest hurdle that ESMA face as a result of the Level 1 text is the lack of precision as to the territorial scope of the settlement discipline regime, including the mandatory buy-in regime, and in particular whether or not the buy-in regime applies to transactions governed by the law of a non-EU jurisdiction and/or traded outside the EU, but settled in an EU CSD. It is crucial to determine the precise territorial application of the penalty and buy-in regime instead of trying to solve this issue by holding settlement participants (who are not party to the trade being bought in) responsible.

Option 1 is the most viable alternative

The first option put forward by ESMA in the consultation paper is a recognised method of closing out a failing transaction in markets today, albeit on a voluntary basis for non-cleared transactions. A buy-in is the exercise of a right under a trading contract rather than a settlement instruction. **Therefore a buy-in should be effected at the level where the trade has been executed, and where a contractual buy and sell obligation has been created, rather than at the level of settlement participants.** In accordance with current market practice while Option 1 is far from ideal and many questions still remain as to how this will work in practice, as explained in our response to Question 1 below, AFME and its members believe Option 1 is the most viable alternative.

Option 3 would see agents banks become pseudo-Clearing Members, being asked to guarantee every trade in the absence of securities from their clients.

Option 2 could present similar problems especially if trading parties ignored the buy-in requirements and the fall back option becomes the default.

In both Option 2 and 3, CSD participants will be left with little option other than to collateralise these trades, clearly something ESMA is attempting to avoid. The CSD participant is not in a position to know if a buy-in has been executed between its client and the client's counterparty. On this basis the CSD participant is exposed to a risk it is unable to directly monitor and control.

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[1] The Current State and Future Evolution of European investment grade corporate bond secondary market : perspectives from the market
http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/survey-report-liquidity-in-the-european-secondary-bond-market-perspectives-from-the-market/

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The potential lack of a direct contractual relationship between a trading party and a CSD participant (there may be entities in between these parties) remains a grave concern.

Further, given that a buy-in is the exercise of a right under a trading contract, it is not appropriate to require a buy-in for a failed settlement where the settlement does not relate to the fulfilment of a trading contract. However, ESMA does not specify any exemptions for settlements which are not the result of a trading contract: There are numerous cases where a settlement instruction does not represent an underlying contractual agreement between a buyer and a seller to sell securities against an agreed price.

Examples of transfers between CSD accounts which do not represent an underlying trade are (non exhaustive):

- Portfolio transfers between accounts of the same client at different custodians.
- Realignment of assets between a broker's own account and client accounts.
- Allocation of assets across different funds, or in different tax pooling accounts.
- Collateral movements and margin deliveries/reimbursements.
- Settlement as a result of corporate actions etc.

These settlements are often free of payment, but could also be Delivery Versus Payment (DVP) for a variety of reasons, and it is not possible to determine purely by reviewing a settlement instruction whether or not it represents an underlying trade.

Implementation Timing

AFME continues to believe that any buy-in process should not be implemented until after the final T2S implementation wave at the earliest. Whichever Option is chosen, a more robust system will need to be implemented to ensure an appropriate level of information flow and control. This is predominantly a trading issue being driven by a settlement regulation. Therefore, the system will need to be automated for all parties, providing trading parties with buy-in notices and sufficient time to pass them on.

Conclusion

In **conclusion**, AFME considers that buy-ins should be directly applied at the trading level, at the election of the trading party who failed to receive securities. Whilst all of the options presented have disadvantages given the apparent constraints[2] of the Level 1 text, we are persuaded that Option 1 is the only model that can be realistically implemented throughout the EU. In general we have serious concerns including legal concerns about the mandatory nature of buy-ins in the Level 1 text as well as with regard to the Options 2 and 3 proposed by ESMA for implementing the buy-in process. We would be grateful if we could address our legal concerns which at present still require further assessment and elaboration in the follow-up meeting that we suggested earlier in this response. In addition, by effectively requiring participants in CSDs to guarantee settlement, Options 2 and 3 of the ESMA proposal would also lead to an across-the-board increase in settlement costs, thus undermining one of

[2] Although "participant" is defined in Article 2 by reference to a CSD participant, there are circumstances where the term is clearly being used in order to refer to a trading venue member (i.e. a trading participant, rather than CSD participant), for example in Article 7(1)(b). This may offer a way for ESMA to interpret the level 1 text as permitting the suggestion it sets out in Option 1.

the CSDR's original aims. It is furthermore imperative that the current issues and uncertainties in cross border settlements/extraterritoriality of buy-in rules outside the EU are resolved.

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.

The buy-in at trading level (Option 1) is a widely understood practice for resolving trade-related settlement fails past a certain date. It has been used for bonds and equities alike, both in Europe and in other jurisdictions. Crucially, in a chain transaction[3] the parties understand that their contractual relationship is with their trading counterparty. If a transaction is to be terminated by means of a buy-in, there is certainty about which entity should be bought in.

The obligation to deliver securities from the selling trading party to the buying trading party is established at trading level. By enhancing trading agreements and/or standard industry rules to refer to the mandatory obligations imposed by CSDR Level 1 text, trading parties can be contractually required to comply with the buy-in requirements under Article 7 CSDR.

For the most part, trading counterparties use one or more levels of intermediaries such as custodians and agent banks to settle securities and cash in the securities settlement system of any particular CSD. These custodian/banks act in the capacity of settlement agents, and do not assume responsibility for the performance of a client's (or an indirect client's) obligations under its trading contract towards the trading counterparty, of which they are often not aware. Further, settlement agents do not have any contractual relationship with other settlement agents (such as the settlement agent being used by a client or indirect client's trading counterparty). It should also be noted that a settlement agent legitimately relies on the customer to fund and/or hold relevant securities in its account in anticipation of settlement – because it is the customer's obligation under the trading contract to deliver funds and/or securities necessary to settle, not the settlement agent's.

We agree with ESMA that since the Level 1 text provides that CSDs 'shall include in their internal rules an obligation for their participants to be subject' to the buy-in measures, robust contractual arrangements will need to be in place between parties from Trading Party to CSD Participant and all entities in between to ensure compliance with the CSDR buy-in process. This includes the onerous and costly process for all parties to revise their legal agreements.

We also agree that a technical system and process will need to be devised that can keep all parties informed of the status of the buy-in in real time. However, we see no benefit in keeping CSDs constantly informed of the process. For the industry to develop and create market standards for such a system sufficient time will be required before buy-ins can be enforced. This requires a timeline of at least a 24 month phase-in period. This should provide the industry with sufficient time to agree and devise such a system if deemed to be required. CSDs will however need to be informed when a buy-in has been invoked and executed. A CSD will understand from its records if a failed settlement has met the relevant criteria for a buy-in to take place and the CSD will be able to report to the relevant National Competent Authority (NCA) accordingly. However, the CSD is not in a position to know if a trade is subject to buy-in

[3] Chain Transaction are transactions of which their settlement status depends on a linked transaction.

simply because it has reached the end of the extension period without settling, because the settlement may not actually represent a trading contract. Our preference would be to use the current intermediary chain to provide the notices between parties. This may require new messaging but not building a new process.

The use of the term participant is used inconsistently in Article 7(10) CSDR. Although 'participant' is defined at Article 2(1) (19) by reference to a CSD participant, there are circumstances where the term is clearly being used in order to refer to a trading venue member (i.e. a trading participant, rather than CSD participant), for example in Article 7(10) (b). This may offer a way for ESMA to interpret the level 1 text as permitting the suggestion it sets out in Option 1. ESMA states that one of the weaknesses of Option 1 is the lack of incentive for the buy-in to take place or the potential for documentation to be phrased differently leading to a failure of the trading parties to consistently initiate a buy-in. However, we do not think this should be a problem in practice, as a purchasing trading party buys securities for a specific purpose and expects to receive them. Industry standard wording could be created in order to mitigate the risk of different phrasing of the contractual buy-in requirements down the chain. It is therefore often in the purchasing trading party's interest to ensure that a buy-in occurs in the event of a settlement failure.

In relation to ESMA's concern that non-EU trading parties may not comply with terms in their contracts requiring them to execute buy-ins in accordance with CSDR, again, we think that this should not be a problem in practice. This is because many transactions will be linked, and therefore it is likely that a transaction chain will contain an EU trading party. The EU trading party will not be able to argue that it falls outside the territorial scope of the buy-in regime and will be required under the terms of its contract to invoke the buy-in, which will in turn drive global market practice in relation to EU securities.

Further, these concerns about extraterritoriality are generated by the Level 1 text and we do not think that Level 2 text should be required to solve this difficulty. We also believe that most 3rd country jurisdictions have the concept of “right to assets” under civil law, which means that there is a method for the buyer to enforce the delivery of their assets having purchased them.

It could be argued that a similar problem exists with Options 2 and 3. If a participant uses a 3rd country CSD, it will be the 3rd country CSD as direct participant who is accountable for the buy-in. Until the 3rd country CSD can determine where to allocate the cost, they will need to account for it and manage the risk, like any other participant. This creates an unlevel playing field and will lessen the appetite for 3rd country CSDs as the risks in Europe increase.
Example (OTC transactions)

- Participant A in DTCC sells securities (e.g. US Treasuries) to Participant B in Euroclear Bank (‘EB’).
- Participant B sells these securities onwards to Participant C in Clearstream Bank Luxembourg (‘CBL’).
- Participant A does not deliver the securities to B, who as a result cannot deliver to C. A buy-in is initiated at the level of C.

This creates an unlevel playing field in Europe where B could be left with all costs as Participant A does not recognise the EU ruling.

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The level 1 text includes a mandatory buy-in regime which applies to securities transactions settling in an EU CSD. This has the potential to incentivise settlement of EU securities transactions away from the EU towards non-EU CSDs, which cannot be the intended consequence of the CSDR. This is a level 1 issue, which needs to be addressed by the EU legislature, rather than by ESMA.

In point 11, ESMA states that in the event of settlement fails, the status of the settlement instruction would have to be notified to the trading parties, through the chain of intermediaries. We note that the status of settlement instructions is already notified to trading parties today through the chain of intermediaries. Therefore the trading party already has all the required information to make a decision about invoking a buy-in. The CSD or intermediary does not need to provide a replicate of this information to the trading party. We would argue that a settlement agent will be once (or more) removed from the trading party and thus will have no direct contractual relationship with the other trading party or its settlement agent. A CSD is even further removed. We remain concerned that this process will lead to a number of buy-ins occurring which have no purpose.

Furthermore, in paragraph 14 (g) of the consultation paper, ESMA refers to Article 7(6) in order to justify that the failing participant is responsible for paying the price compensation.

As mentioned in the previous AFME submission, we believe that Article 7(6) is based on an erroneous assumption, and will lead to substantial issues, as it only applies to where the buy-in price is lower than the trade price, and not when it is higher. When the buy-in price is higher, there is no requirement for compensation (by the receiving participant to the delivering participant or its client). So in half of the cases there is no price compensation.

Finally, Article 7(6) refers to a situation where there has been a successful buy-in at a price which was lower than the agreed trade price, while the liability of the failing participants to pay compensation referred to in paragraph 14 (g) seems to refer to a situation where there has been no successful buy-in, in which case there is a need for cash compensation.

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.

If the buy-in is applied against a trade fail, then the trading party will always have the information required as to why the trade failed (its intermediary chain today will provide the information on this). In all scenarios throughout the lifecycle of the settlement instruction, the agent will notify their client of the reasons for the failure to settle which should enable this information to be passed to the trading party to assist with them with resolving the reasons for settlement failure.

Where the intermediary in question is the settlement agent, they act in an agency role on behalf of their clients and do not have the remit to prevent trades from settling without instruction from their contracting client. If the client has the position in their account with the agent then the trade will be sent to the market for matching and settlement with the counterparty.

If, however, the agent's client did not have the securities position required to complete the settlement, then although the agent may try and facilitate settlement of the delivery by arranging a loan, the contractual obligation to source the securities to allow for settlement, would lie with the agent's client.

For linked transactions, this may mean that the trading party will need to pursue its counterparty who will then need to pursue its counterparty and so on. We do not believe there would be an instance where the reason for the fail is due to the intermediary having a lack of own securities as the intermediary will be reliant on its customer having sufficient securities held with it to ensure delivery – the securities will be securities of its clients or its client's clients depending on the length of intermediary chain. In other words, we do not see an instance where the failure to deliver (resulting in a buy-in) would be due to a lack of securities held by an intermediary, and not a lack of securities held by the trading party.

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.

We welcome the consideration ESMA has given to the risk of buy-ins for intermediaries (custodians, agent banks, others) acting as delivering agents on behalf of their clients, and how this risk could be mitigated and reduced under Option 2. However, before answering the question on collateralisation, we would like to draw ESMA's attention to the following key concerns related to Option 2 (and Option 3).

Difference between Option 2 and Option 3, and why the risks (and the potential needs for collateral) are largely the same

Upon review of the ESMA CP and the draft RTS, the differences between Option 2 and Option 3 can largely be summarised as follows:

1. In Option 2, the buy-in is performed between trading parties, whereas in Option 3 it is between the settlement participants acting on behalf of the failing parties.
2. In Option 2, the failing participant is not held responsible, provided that a) it provides to the CSD the evidence that the buy-in process was performed or b) that the trading party is subject to an insolvency proceeding, within one business day following the notification process referred to in Article 13) failing to do so, the failing participant shall pay the cash compensation to the receiving participant.
3. In Option 3, the settlement participant must pay/deliver irrespective of whether there is a buy-in or cash compensation process.

From a risk management perspective, it is important for the failing participant to be able to control the risk to which it could be exposed, and whether it can control the factors influencing that risk.
If it cannot limit or control that risk, it will take a prudent view, and as a consequence protect itself against these risks in a worst case scenario.

Applying this to the differences between Option 2 and Option 3 listed above, the question then becomes whether the failing participant can control any of the differentiating factors between the two options. If the answer is yes, the logical outcome should be that the risk (and the ensuing collateral needs) should be less under Option 2 than under Option 3. If not, the conclusion is that the risk and thus the collateral needs are largely the same.

In Option 2, the failing participant must be able to provide the evidence that:
1. The buy-in process was performed or,
2. That the trading party is subject to an insolvency proceeding.

If not it must pay the cash compensation to the receiving participant.

Regarding a), it Is not clear how the failing participant – who will be passive in the buy-in process which is performed between the two trading parties (and initiated by the receiving participant) - can ensure that the buy-in process is actually performed. A successful buy-in depends on a variety of factors, none of which are under the control of the failing participant, such as:
1. The receiving party triggering the buy-in process: the failing participant (who is acting on behalf of the delivering party) does not know the counterparty of his client, and has no contractual relationship with him.
2. The buy-in could fail because of inability to find a buy-in agent, the lack of available securities in the market, etc, none of which is under control of the failing participant.
3. The receiving party can unilaterally decide to opt for cash compensation instead of a buy-in.

In other words, the failing participant cannot control whether or not a buy-in will be effected, or will lead to a cash compensation.

In relation to b), a failing participant cannot estimate or influence whether the trading party will be subject to insolvency proceeding:
1. It needs to make that assessment at the moment when it receives the delivery instruction from his client and sends it into the CSD (usually on T or T+1). After that and once the settlement is matched by the counterparty, it cannot be cancelled unilaterally anymore. It thus stakes the risk as from trade date till final settlement/buy-in.
2. In a multi-tier custody structure, the settlement participant at CSD level often does not have a direct relationship with the trading party, so cannot have a view on its credit quality, nor does it know whether it has gone insolvent in order to inform the CSD as per the draft RTS.

If the trading party does not enter into insolvency in the period leading up to the buy-in, but afterwards, or if it refuses to pay back the failing participant the costs of the buy-in, the latter will take the risk and costs of the buy-in.

Impact of buy-ins/cash compensation on the role and risks taken by settlement agents

Both Options 2 and 3 fundamentally change the role of the intermediaries: whereas today they provide an agency service to their clients (and not take principal risk for deliveries), under both Options 2 and 3 they take on some or all responsibility for the trades performed by their clients (or clients of clients): The delivering participant effectively guarantees the delivery of securities on behalf of the trading party in both Option 2 and 3 (see below).

The receiving participant would in Option 3 initiate the buy-in, and if the buy-in proceeds are delivered by the buy-in agent to the receiving agent, they also have to (pre)fund the buy-in on behalf of the receiving trading party. That is also highlighted in par 36 of the ESMA CP, and implies that even receiving participants will also assume risk for buy-ins and demand collateral.

Agents acting on behalf of buyers, not only have to do the work on the execution of buy-ins, but they also have to pay the buy-in agent and take in the securities against payment, without assurance that the

buyer/trading party will reimburse them. As argued below, this risk cannot be fully mitigated contractually, and the receiving participant may also require collateral (or prefunding) from the prejudiced buyer in order to cover that risk, which will further increase the risk and collateral needs, but this time for the receiving participant. Collateral impacts are thoroughly analysed in question 5.

The role and risks taken by settlement agents will change fundamentally as a result of the buy-in proposed rules, leading to a substantial increase in structural and systemic risk related to settlement of trades in EU CSDs. That cannot have been the objective of the regulators when they established the Level 1 CSDR buy-in rules, and hence needs to be reviewed fundamentally (see also our introduction). It is also unclear whether a CSD participant within a ring-fenced bank (post-implementation of the EU BSR) would be permitted to comply with either Options 2 or 3, given the principal nature of the risk undertaken.

Settlement participants are not well placed to execute buy-ins or assess whether cash compensation is payable

A further consideration that should be acknowledged under Options 2 and 3 is the fact that settlement participants are not involved in the trading process, and the consequences thereof on both the validity and effectiveness of buy-ins initiated by settlement participants instead of trading parties are:

Settlement participants are not involved in, nor aware of the transaction between trading parties. They are not involved when the trade is concluded, are not counterparty to the trade (nor should they), and in many cases do not even know who the trading counterparty of their client is. In cases where there are several intermediaries (e.g. Global Custodians) between CSD participants and the trading party, the CSD participant will often not know the identity of the trading party on its side (and certainly will not have a contractual relationship with them).

The settlement participant will only see settlement instructions and not the details of the trade itself. The CSD participant does not know what the origin of these transactions is, nor if they even represent valid trades for which a buy-in would serve as a remedy for. As highlighted in the AFME response to the previous ESMA Consultation, not all settlements represent trades for which a buy-in would be relevant: portfolio transfers, delivery proceeds on the back of corporate actions, margin deliveries or reimbursement all translate into settlement instructions, but a buy-in would be meaningless: there is often no trade/transaction nor two trading parties.

We have not seen any carve-out in the draft RTS for these type of settlements, which would be needed in Option 2 and 3 (in Option 1 trading parties would presumably know the origin of the settlement instruction and whether a buy-in would be relevant). Also, in these Options both the delivering and receiving participants would need to acquire all this information in order to initiate/execute a buy-in or pay cash compensation, leading to a large and ineffective increase in workload and system builds. Under both Option 2 and Option 3, the intermediary (participant) would effectively guarantee the delivery of securities on behalf of its client (the trading party). Whilst we appreciate ESMA's efforts to reduce this risk in Option 2 through a more practicable alternative, we believe Option 2 will in essence give rise to similar risks as Option 3, and also open up other issues. As a result, we refer to the analysis under question 5 regarding the potential need for collateral.

Based on the above, we would argue that there is essentially no difference in terms of the risk assumption between Option 2 and Option 3 for the settlement participant, as the failing participant is not able to control, influence or have visibility to the key factors determining its risk.

Thus the open risk and potential collateral needs under Option 2 are similar to the ones under Option 3. We therefore refer to our answer under Question 5 to also cover the requirements for question 3. In addition, it is unclear whether the additional risk undertaken by CSD participants would require allocation of additional operational capital under Pillar 2 of the capital requirements, thereby further increasing the costs of the buy-in approach.

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.

Option 1 ensures a consistency of approach in respect of the type of entity responsible to perform the buy-in and for all types of buy-in scenario, be that for CCP cleared, trading venue or bilateral transactions subject to a buy-in. The process is already in place and it is proven that there is no confusion about who should invoke the buy-in.

The provision of a robust contractual framework between parties should ensure that the buy-in provisions in Option 1 are applied. The fallback process described in Option 2 is far less certain. Given the choice between invoking a buy-in and allowing the fall back process to start, the trading party who may have no direct relationship with the CSD participant (as explained above), may decide that it has no interest in setting the buy-in process in motion for commercial or practical purposes. In short, we would be concerned that this Option could become a disincentive for trading parties to invoke the buy-in process.

This Option continues to blur the distinctions between the various actors in a transaction. We understand that under Option 2, cash compensation is due to be paid by one CSD participant to another following the failure of a buy-in. The receiving CSD participant then has to pass the compensation over to t the relevant trading party, who may or may not be a direct client party of the CSD participant.

In paragraph 21 of the consultation paper, ESMA states that “All parties within the chain are potentially subject to be asked to pay the cash compensation if the buy-in is not executed, so all the parties have an interest in making sure that the buy-in is executed or the instruction is cancelled”. However, the only way that all parties are subject to paying the cash compensation is if they are legally bound by this. Option 2 holds the CSD participant liable to pay cash compensation if the buy-in does not happen. The end failing party may not be the CSD participant’s client but its client’s client, and therefore there is no method of ensuring that the failing party is subject except by means of contractual clauses all the way up the chain.

ESMA states that this option is better aligned to Level 1 and the CSD participant could recover all costs from its relevant client. Theoretically, in a simple failure to deliver, it may be correct that a CSD participant could recover its costs. However, the markets are rarely determined by one to one relationships and markets where prices rarely fluctuate. The costs involved could prove significant and the client may be one or more steps away from the CSD participant. Until the CSD participant can pass on the costs/risk, they will need to account for and manage this risk. Use of collateral would be one approach against their direct customer for all trades instructions (they won’t always know who the

underlying customer is). This will cause additional complexity, cost, and reduce liquidity in the market as each party along an intermediary chain is required to collateralize their settlement instructions. The process becomes more problematic in an insolvency situation if the end failing party is not the client of the CSD participant, and if the failing party is outside of EU. The CSD participant is unlikely to recover its costs in this case so collateralization is clearly required.

The alignment of Option 2 with the Level 1 text is also highly doubtful. The Level 1 text suggesting that a delivering participant should pay, namely Article 7, paragraphs 6 and 8, refers specifically to costs and differences in the event that a buy-in has been executed. Option 2 relates specifically to the case of non-execution of a buy-in. Paragraph 7, which covers the case of cash compensation in the event of non-execution of a buy-in, does not specify who should pay. As in the first part of Paragraph 7 the term “receiving participant” clearly refers to the underlying purchaser (and cannot refer to anybody else), we believe that it is appropriate to interpret the term “participant” in paragraphs 6, 7 and 8 as referring to the underlying trading parties. In short, we believe that Option 1 and Option 2 are equally aligned to the Level 1 text.

The lack of a requirement to post collateral appears to be one of the central pillars of Option 2. We cannot agree with ESMA on this point. There is risk and in order to manage and mitigate it, counterparties will be required to post collateral to cover their risk on outstanding transactions starting on trade date until settlement, buy-in or cash compensation. This may lead to an unlevel playing field between transactions settled in an EU CSD (subject to mandatory buy-ins) vs. transactions settled outside the EU, and may drive trading and settlement outside the EU, which seems contrary to the objectives of CMU.

Assuming that one of ESMA’s three options needs to be chosen, Option 1 is the industry’s preference and we do not share ESMA’s concern that Option 1 would lead to a significant enforcement issues or gap. We do not think it is very common for there to be OTC transactions between two non-EU trading counterparties where there is no link with an EU trading counterparty. To the extent that EU trading counterparties are obliged to effect the buy-in regime as per Option 1, it is likely that such EU trading counterparties would include back-to-back provisions/obligations in their contractual arrangements with non-EU counterparties/clients (and would have an incentive for enforcing such contractual arrangements). In this way, we expect market practice would shift globally, even under Option 1.

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.

As stated in our response under Question 3, in our view there is no real difference in the risks and thus the associated potential collateral costs between Option 2 and Option 3 for the delivering CSD participant.

A. Similarities between the risk taken by the delivering CSD participant for buy-ins in OTC transactions, and the risk taken by clearing members for CCP cleared transactions

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Role of Delivering CSD participant under CSDR buy-in rules (Option 2 and 3)	**Role of General Clearing member for CCP cleared trades**
The delivering CSD participant acting on behalf of the trading party (seller) is held responsible for the delivery by his client (or the client of his client) of securities, on the back of a trade to which he is not a party	The General Clearing Member ('GCM') of a CCP, acting on behalf of the trading party (Non Clearing Member or NCM), is held responsible for the delivery by his client of securities, on the back of a trade to which he is not a party (we ignore purchases from CCP's in this context)
As from the moment the settlement instruction has been sent to the CSD and matched (after which it becomes irrevocable unless both parties agree to cancel), the delivering participant effectively guarantees delivery of the securities to the receiving CSD participant on behalf of his client, the trading party	As from the moment the trade has been novated by the CCP (after which it becomes irrevocable), the GCM effectively guarantees delivery of the securities to the CCP on behalf of its client, the trading party (NCM
If the delivery does not happen, the receiving participant (or the trading party in Option 2) will buy in the delivering participant, or if that is unsuccessful, go for cash compensation. The delivering CSD participant can then try to recuperate that cost from his client, but is exposed to the risk of his client not doing so	If the delivery does not happen, the receiving participant (or the trading party in option 2) must buy in the delivering participant or, if that is unsuccessful, go for cash compensation. The GCM can then try to recuperate that cost from his client the NCM, but is exposed to the risk of his client not doing so. That risk could be substantial but is dependent on how buy-ins are executed and difficult to quantify.

Further support can also be found in the CSDR buy-in rules itself, where for CCP cleared transactions, it is the failing clearing member who is held responsible by the CCP for the buy-in and the cash compensation (see proposed draft RTS Article 15 (2)), where for OTC settlements it is the failing participant that must be subject to these measures, I.e. there is a one to one transposition of clearing members (for CCP cleared transactions) and delivering participants (for OTC transactions) for similar settlement fails.

B. Differences between the risks borne by delivering CSD participants and CCP cleared transactions

There are also a number of differences between the two scenarios, which could impact the calculation of the risks borne in the two scenarios and the potential collateral needs:

1. The CCP margin is intended to cover the risk of the default of the NCM, while for buy-ins the delivering CSD participant is only responsible for the costs of the Buy-in/compensation
   While at first sight the two scenarios are different, in reality they are very similar:

a. **Both are driven by the variation in the market price of the securities vs., the original trade price.**
CCP margins are calculated on a trade by trade basis, considering for each trade the open market risk (price difference) between the original trade price and the current /predicted market price upon close-out of the position. The margins to cover this risk are initial margin[4] and variation margin.

The risk taken by the delivering CSD participant on behalf of the trading party is similar: the cost of the buy-in/cash compensation is (roughly) equal to the difference between the agreed trading price, and the price at which the buy-in has been executed.

In fact, under CSDR the delivering party/participants has a one way skewed price risk: if the buy-in price is lower than the trade price, he still needs to compensate the buyer (who as a result makes a windfall profit), whereas if the buy-in price is higher than the original trade price, the buyer does not need to pay the seller (Article 7(6) CSDR). **CCP margins are intended to cover a scenario of default of the clearing member/NCM, which are (under Option 3) exempted.**

While this may seem a major difference, in reality there is not a real distinction to be made on this point either:

- As highlighted under Question 3, the delivering participant is committed as of the moment that the settlement instruction has been sent and matched at the CSD. As from that moment, it is exposed to the price variation risk on all open settlements. As and when they settle, that risk rolls off (most of which on the intended settlement date, 'S'), but at the same time the risk of a new settlements roll-on. That is very similar to the risks taken by CCP's on a rolling portfolio of open trades until settlement.
- In this respect, it is important to note that CCP's also margin on all open trades, and that most CCP settlements also settle on S (at which time they are taken out of the risk/margining calculations).
- CCP's and settlement participants have the same risk on all open trades, and CCP margins are levied and can be used to cover that risk on all the open trades, not just in a default scenario of the GCM, but in all circumstances where the GCM does not fulfil his obligations to deliver (receive).
- The suggestion made by ESMA to exclude in Option 2 the scenario of a default of a trading party is appreciated, but as demonstrated under Q3, the delivering participant cannot control or have visibility of this event, so is entitled to take a worst case assumption for risk/collateralisation purposes.

b. **CCP margins are calculated on the total portfolio of novated trades, while for buy-ins the risk is on the failing settlement.**
As stated above, the delivering CSD participant also takes a risk on all open settlements as of the

[4] Defined by the BIS: 'initial margin means a clearing member's or clients collateral posted to a CCP to mitigate the CCP's potential future exposure to the clearing members arising from the possible future change in the value of their transactions". Variation margin is the daily mark to market of the transactions

moment they are instructed until final settlement, much like CCP's. However, a major difference is that delivering CSD participants are not able to:

- Net and offset different deliveries and receipts, even in the same security: e.g. say A and B trade frequently the same security between each other (typical for most dealers, esp. in bonds). if A fails to deliver to B 100 securities on day 1, and B fails to deliver 60 securities on day 3, their market risk is on 40 (open position). Under the proposed buy-in process, A will be bought on for 100 without consideration of the other transaction for 40. That actually makes the risk for delivering participants higher than in a CCP scenario (where such close out netting can often be applied, and where netting of offsetting trades, especially with the same trade/settlement date, is applied).
- Amend the risk calculation/margin for trades in securities whose trade price evolution is correlated. As stated above, each settlement is considered separately for buy-in purposes.

Based on the above, AFME and its members are of the view that the risk borne by delivering CSD participants for OTC settlements is comparable to the risk assumed by General Clearing Members in a CCP clearing environment, though we acknowledge there are also differences. Drawing upon this analogy has the following benefits:

a. The below methodologies to calculate the risk in buy-in scenarios are based on a comparison (with adjustments where needed) with a CCP cleared environment. This has the benefit that calculations are based on a comparison with current/actual numbers (instead of a hypothetical future scenario).
b. It also has the advantage of applying a generic-proven risk model to a new category of risk. Indeed, the risk views and methodologies of different market participants vary widely, and coming up with a commonly agreed methodology is very difficult in the timeframe provided by the Consultation Paper.

C. Calculation: margining of outstanding OTC settlements per type of security, based on CCP margin % for similar transactions

Description

This method looks at the total value of outstanding OTC deliveries over a typical settlement period of 2 days for different types of securities, and applies a margin % based on typical margin requirements from CCP's.

Formula and key elements

Formula

(Total open OTC delivery position – exclusions) x margin percentage (based on typical CCP margining) +add-ons= total amount of open risk for intermediaries, which could/should be covered by collateral)

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Key elements

- **Total open delivery position**:
  Total of all pending/matched/unsettled delivery instructions across key impacted EU CSD, using the most recent ECB Blue Book data[5] available (2014 numbers).
  Time period taken is a rolling 2 days open risk, assuming a standard 2 day settlement cycle. This covers the period between the start of the risk for the delivering participant (moment when the settlement is sent to the CSD level, which is T (early T+1), and the moment of settlement (across S (T+2) for most instructions.

- **Exclusions:**
  - All deliveries by CCP's (which are margined separately by the CCP).
  - Short-term financing transactions exempt under art 7.4 (b) of CSDR. No accurate settlement data exists on this, but the amounts used below have been reduced based on an extrapolation of the relative size of repos with a maturity under one week vs. the total repo market[6]
    Deliveries for which the client/delivering participant already has the securities at the moment when the settlement needs to be sent into the CSD[7]. Provided that the securities are not allowed to be used for other settlements, there should be no risk that the delivery does not settle (unless the receiving participant/the buyer does not have the cash in which case there should be no buy-in (see above under Q3) , so there should be no need for collateral.
    It is extremely difficult to estimate what average percentage reduction to apply, as this is dependent on the type of activity, the type of client and the instrument. We have taken a very cautious (low) stance and assumed that the risk only exists in 20% of all deliveries. This is likely to be an underestimation of the real risk assumed by settlement participants.

- **Margin percentage**:
  The margin percentage is translating the above open position into a risk-weighted amount, which is intended to cover the risk to the delivering participant of having to pay for the buy-in costs (Option 3) or pay for the cash compensation (Option 2).
  - The risk is on the costs of the buy-in, which may have to be carried by the intermediary.
  - That risk exists from trade date (or more precisely the date when the settlement instruction is sent into the CSD, which is T or T+1 latest under CSDR: same timing as when CCP's run their risk calculation process) and ends either upon final settlement (S till S+7/14) or upon the moment of the buy-in (S+…). This is similar to the IM and VM asked for by CCP's.
  - During all that time, the delivering participant is exposed to the price variation on the open settlement. Of course, once a trade is settled, the risk no longer exists, which is why the bulk of the margin requirements relate to the first two days after trade date, until the risk is very similar to the one taken by CCP's (though they can offset and net positions), for which they ask initial and variation margining. As such, we have taken an average of margin % for the different types of instruments listed in the ECB Blue Book (based on a poll of different major clearing members), and applied these percentages to the total open position. Based on a poll

[5] The ECB data does not distinguish between OTC and on-exchange therefore in the figures used for our calculations OTC on-exchange transactions are included.
[6] We refer to the ICMA submission for more details
[7] In principle, the risk should also be much less in case of chain transactions, as the buy-in can be passed on. In reality, it is difficult to assess this at the moment the settlement is instructed into the CSD

of key AFME members/GCM's of what typical/average CCP margin calls are for different CCP's, we established some average risk percentages per type of instrument/open position. These are averages providing a generic view: the real actual numbers vary substantially depending on the CCP, type of activity; and instrument.

- **Add-ons**
  As stated above, Option 3 requires receiving participants to execute a buy-in on behalf of their prejudiced clients/buyers. That requires them to appoint a buy-in agent, manage the process, and take in the securities from the buy-in agent; while the proposed RTS is not very clear on what this exactly means, it will likely expose the receiving settlement participant to assume an additional degree of risk towards the buyer, which would need to be collateralized. This was also highlighted in the Consultation Paper (par 36). This risk may be substantial, as it would be on the full amount of the buy-in rather than on the price variance.
  - It is very hard to quantify this risk with a reasonable degree of confidence, and the resulting numbers seem very large, which is why we have not referenced them here, It may lead to the consequence that in order to settle a purchase, the buyer may be required to put up an almost equal amount of collateral. A buy-in process which was intended to protect the interests of the buyer, actually leads to the buyer and its settlement agent assuming a large additional degree of risk, which may need to be collateralized by the buyer. That seems the opposite of what the CSDR buy-in rules were intended to achieve.

Resulting calculations

Category	TOTAL (million €) delivery settlements for 2014	TOTAL (million €) excl SFT's	20% at risk of fall	Average Outastanding Value (2 days rolling)	Average margin %	Average Margin Requirement (Option 2 & Option 3)
Bonds	985,685,752					
Bonds (CCP)	53,056,873					
Total B	**€ 932,628,879**	**€ 932,241,525**	**€ 186,448,305**	**€ 1,473,900**	**4.50%**	**€ 66,325**
Short-term paper	€ 97,030,445					
SP (CCP)	€ 5,430,929					
Total S	**€ 91,599,516**	**€ 91,561,471**	**€ 18,312,294**	**€ 144,761**	**4.50%**	**€ 6,514**
Equities	€ 58,085,807					
Equities (CCP)	€ 5,140,098					
Total E	**€ 52,945,709**	**€ 52,923,719**	**€ 10,584,744**	**€ 83,674**	**9.00%**	**€ 7,531**
Other	€ 20,066,002					
Other (CCP)	€ 20,366					
Total O	**€ 20,045,636**	**€ 20,037,311**	**€ 4,007,462**	**€ 31,680**	**32.50%**	**€ 10,296**
Total (excl CCP)	**€ 1,097,219,740**	**€ 1,096,764,026**	**€ 219,352,805**	**€ 1,734,014**	**Total (rolling)**	**€ 90,666**

Table 1: Calculation results of collateral requirements under Option 2 and 3

Based on the above, we estimate that the additional collateral requirements flowing from option 2 and option 3 would be in the range of 90 Billion Euro, while under Option 1 no additional collateral would be required. This is an average extra collateral requirement at all times, and actual impacts may vary substantially.

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Additional considerations

We note that according to current market practice (such as under the ICMA buy-in rules), where a buy-in is initiated in relation to a failing cash trade (i.e. where the Seller of securities does not deliver and Buyer appoints a buy-in agent to buy the securities in the market and pass on the cost of purchase to the Seller), the buy-in agent gives two prices. One price is for guaranteed delivery and the other is for non-guaranteed delivery.

The guaranteed delivery price can be significantly higher than the price for non-guaranteed delivery. As we understand the CSDR buy-in regime to be based on the guaranteed delivery model, the buy in price based on guaranteed delivery has the potential to be significantly greater than the original transaction price (market value of the securities at the time of trade). Again, this is likely to increase the amount of collateral a settlement agent may require to cover its risks, particularly under Option 3.

Similarly, under Option 2, if the guaranteed delivery price is used as the basis for calculating cash compensation, then these costs are likely to be much higher than otherwise anticipated. Again, participants are likely to require more collateral to cover this increased risk associated with cash compensation under Option 2. One potential solution would be to provide that cash compensation should be calculated based on the non-guaranteed delivery price. Indeed, this would seem to be an appropriate method for calculating the value of cash compensation, to reflect the fact there is no delivery of securities.

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ANNEX

Proposed Amendments to draft Regulatory Technical Standards

Article/ Paragraph	**Draft Technical Standards on the operation of the buy-in under the different options**	**AFME's Suggested Re-Drafting (From previous Technical Standards and new)**
(1)	In order to support an integrated market for securities settlement, the buy-in process should be harmonised and should include some common requirements. Given the importance of incentivising timely actions to address settlement fails, it is important to keep all relevant involved parties informed during the process.	Agreed
(2)	Regulation (EU) No 909/2014 refers to participants in different infrastructures, CSDs, CCPs and trading venues. It is essential for the correct identification the entity responsible for executing a buy-in that parties and participants are distinguished, where parties are the trading parties in an OTC transaction or in a trading venue or the clearing members in a CCP, and participants are participants to a securities settlement system of a CSD.	Agreed (We agree that a definition of the various actors is required. This weakness in the Level 1 text leads to increasing problems when defining Level 2)
(3)	The buy-in process should provide for a way to address settlement fails without jeopardizing the risk profile of CSDs, CCPs or trading venues. Buy-in should not imply any unnecessary risk taking by a CSD, a CCP or a trading venue. A CSD or a trading venue should therefore not perform the buy-in as counterparty on its own account.	**"The buy-in process should provide for a way to address trade related settlement fails...."**
(4)	The settlement of an instruction aims at ensuring the final settlement of a transaction concluded between trading parties. For transactions executed on a trading venue and for transactions cleared by a CCP, the trading venue members and the clearing members respectively are the parties to the transaction and therefore the parties that should perform the buy-in. They have the relevant information to execute it. For transactions not executed on a trading venue nor cleared by a CCP,	The settlement of an instruction aims at ensuring the final settlement of a transaction concluded between trading parties. For transactions executed on a trading venue, the trading venue members are the parties to the transaction and therefore the parties that should ~~perform~~ **appoint** the buy-in agent and are

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	Either Option 1 and 2 (trading party) the buy-in should be performed by the trading parties that concluded that transaction. The original parties are the ones with the relevant information on why the settlement failed and who the relevant counterparty responsible for it is.	subject to buy-in rules**. For transactions cleared by a CCP, the CCP should appoint the buy-in agent to buy-in their Clearing Member the buy-in should be performed by the trading parties that concluded that transaction.** The original trading parties are the ones with the relevant information on why the settlement failed and who the relevant, responsible counterparty is.
(5)	Given the different parties involved in a settlement chain, they need to be informed of the status of the buy-in process at key points in time. This information should be formalised by way of notification in order for the counterparty to be alerted on the status of the actions to settle the transaction and take action as need be.	Given the different parties involved in a settlement chain, they need to be informed of the status of the buy-in process at key points in time. This information should be formalised by way of notification **by the buy-in party** in order for the counterparty & other intermediaries to be alerted on the status of the actions to settle the transaction and take action as need be.
(6)	Either Option 1 and 2 (trading party) The buy-in agent will act upon request from the receiving party, but the cost will be borne by the failing party. It is appropriate to set a framework so that the buy-in agent will act in the interest of the failing party	**The receiving party shall appoint a buy-in agent to execute the buy-in under best execution rules.** The buy-in agent shall not have any conflict of interest in the execution of the buy-in. All costs are to be borne by the failing trading party.
(7)	In order to limit the number of buy-ins and preserve liquidity of the market for the relevant instrument, the failing party should be allowed to deliver the financial instruments to the receiving party up to the moment when it is informed that the buy-in agent is appointed. As from that point in time, in order to prevent a situation where the receiving party would receive twice the financial instruments from the buy-in agent and from the	In order to limit the number of buy-ins and preserve liquidity of the market for the relevant instrument, the failing party should be allowed to deliver the financial instruments to the receiving party **no** later than the execution and notification of the buy-in by the buy-in agent. As

	failing party, the failing party should be able to deliver the financial instruments to the buy-in agent or to the entity performing the auction with the approval of that agent or entity.	from that point in time, in order to prevent a situation where the receiving party would receive twice the financial instruments from the buy-in agent and from the failing party, the failing party **will not have the ability to complete the transfer of securities and each party should cancel their instructions accordingly**. ~~should be able to deliver the financial instruments to the buy-in agent or to the entity performing the auction with the approval of that agent or entity.~~
(8)	A settlement instruction that is not eligible for partial settlement may fail for the entire amount of financial instruments of that instruction, even if part of the financial instruments is available for delivery to the account of the delivering participant. As the purpose of the buy-in is to address settlement fails, the receiving participant should accept partial settlement from the last business day of the extension period, so that a buy-in will only be performed for the non-delivered financial instruments. Partial settlement should not apply to settlement instructions that have been put on hold by a participant, since this may indicate that the financial instruments in the account do not belong to the client for which the instruction has been entered into the system. For the same reason, the financial instruments received as part of the buy-in process should be delivered to the receiving participant, even if the amount of such instruments allow only settlement of part of the settlement instruction.	A settlement instruction that is not eligible for partial settlement may fail for the entire amount of financial instruments of that instruction, even if part of the financial instruments is available for delivery to the account of the delivering participant. As the purpose of the buy-in is to address **trade related** settlement fails, the receiving participant should accept partial settlement from the last business day of the extension period, so that a buy-in will only be performed for the non-delivered financial instruments. Partial settlement should not apply to settlement instructions that have been put on hold by a participant, since this may indicate that the financial instruments in the account do not belong to the client for which the instruction has been entered into the system. For the same reason, the financial instruments received as part of the buy-in process should be

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		delivered to the receiving participant, even if the amount of such instruments allow only settlement of part of the settlement instruction.
(9)	With the aim to balance the uncertainty resulting from the buy-in process and the interest of the parties to close the transaction, in case the buy-in fails, in the absence of express communication of the receiving party choice, the buy-in process should be terminated and the cash compensation should be paid.	With the aim to balance the uncertainty resulting from the buy-in process and the interest of the parties to close the transaction, in case the buy-in fails, **in the absence of express communication of the receiving party choice, the default option of the buy-in process should be "Deferred"**. ~~terminated and the cash compensation should be paid.~~
(10)	Contractual arrangements between parties of a settlement chain can only produce their effects if the parties have an economic interest in making sure that the terms of a contract are complied with. Therefore, for the buy-in process to be effectively applied, CSDs participants should be responsible for the cash compensation in case the buy-in process is not applied through the appropriate contractual arrangements. In some circumstances, a financial instrument may no longer be available on the market, for instance when a financial instrument has been redeemed or converted, in which case a buy-in is no longer possible. The buy-in process should in that case be accelerated, so that cash compensation could be paid before the end of the buy-in process, thus limiting the period of uncertainty.	Contractual arrangements between parties of a settlement chain can only produce their effects if the parties have an economic interest in making sure that the terms of a contract are complied with. . In some circumstances, a financial instrument may no longer be available on the market, for instance when a financial instrument has been redeemed or converted, in which case a buy-in is no longer possible. The receiving Party shall inform the delivering Party of the desired outcome of any corporate action. The delivering Party should act in accordance with these instructions. ~~The buy-in process should in that case be accelerated, so that cash compensation could be paid before the end of the buy-in process, thus limiting the period of uncertainty.~~

(11)	Either Option1 and 2 (trading party) A transaction may in some cases be part of a chain of transactions and instructions. In order to avoid that a buy-in has to be performed for each settlement fail in a chain of transactions a CSD should allow the parties to pass on the buy-in notification, which could be further passed on to other parties involved in the cause of the settlement fail. The CSD should remain informed of the pass-on and of the identity of the party receiving that notification	A transaction may in some cases be part of a chain of transactions and instructions. In order to avoid that a buy-in has to be performed for each settlement fail in a chain of transactions a CSD**, and/or Trading Venue, and/or CCP** should allow the parties to pass on the buy-in notification, which could be further passed on to other parties involved in the cause of the settlement fail. **All relevant parties** ~~The CSD~~ should remain informed of the pass-on and of the identity of the party receiving that notification **[Recommend that a cut-off time for passing on the last passing-on notice should be established. After this time the entity in receipt of the buy-in notice will be bought in]**

SECTION 3

Details of operation of the appropriate buy-in process

(Point (c) of Article 7(15) of Regulation (EU) No 909/2014)

Article 12

General

Article/ Paragraph	**Draft Technical Standards on the operation of the buy-in under the different options**	**AFME's Suggested Re-Drafting (From previous Technical Standards and new)**
(1)	The buy-in process shall be initiated at the end of the business day following the elapse of the extension period.	The buy-in process shall be initiated **by the trading party (buyer)** at the end of the business day following the elapse of the extension period and both parties shall cancel their settlement instructions up on receipt of the buy-in notice.
(2)	The buy-in process shall comprise the following elements: (a) the notifications, as specified in Article 13; (b) the appointment without undue delay of a buy-in agent, where relevant;	

	(c) the execution of the buy-in process through the acquisition of the securities by the buy-in agent or through an auction; Either Option 1 and 2 (trading party) (d) the completion of the buy-in process through the delivery to the receiving party by the buy-in agent or the entity executing the auction, of all or some of the bought-in securities and the payment of the cash compensation for the non-delivered securities to the receiving party by the failing party.	Agreed

Article 13
Notifications

Article/ Paragraph	**Draft Technical Standards on the operation of the buy-in under the different options**	**AFME's Suggested Re-Drafting (From previous Technical Standards and new)**
(1)	The notifications referred to in point (a) of Article 12(2) shall be served upon the following steps and contain the following information: (a) without delay upon the initiation of the buy-in process, a notification specifying the settlement fail it relates to; (b) without delay upon the appointment of the buy-in agent, a notification specifying the date of the appointment and the name of the buy-in agent; (c) on the last business day of the buy-in process, a notification specifying the results of the buy-in process; (d) as the case may be, without delay, upon election of a choice made pursuant to Articles 15(1)(b) or (c), 15(2)(b) or (c) and 15(3)(b), a notification of such choice; (e) as the case may be, at the latest upon the last business day of the deferral period, a notification	Agreed **(c) Notice of the buy-in result should be immediately after the buy-in execution, or at a time that the buy-in is deemed not to have 'failed'**

	specifying the results of the deferred buy-in process.	
(2)	For transactions executed on a trading venue and not cleared by a CCP, the receiving party shall provide the relevant notifications referred to in paragraph 1 to the failing party and to the trading venue which shall transmit it to the CSD.	Agreed
(3)	For transactions cleared by a CCP, the CCP shall provide the notifications referred to in paragraph 1 to the failing clearing member and to the CSD.	Agreed
(4)	For transactions not executed on a trading venue nor cleared by a CCP, the receiving party shall provide the notifications referred to in paragraph 1 to the failing party and ensure that the CSD is informed of the initiation, execution and results of the buy-in.	Agreed

Article 14

Appointment of the buy-in agent and execution

Article/ Paragraph	**Draft Technical Standards on the operation of the buy-in under the different options**	**AFME's Suggested Re-Drafting (From previous Technical Standards and new)**
(1)	For transactions executed on a trading venue and not cleared by a CCP, the rules of a trading venue shall provide that the receiving party shall appoint a buy-in agent. The trading venue shall appoint a buy-in agent where the receiving party does not do so within two business days following the elapse of the extension period.	**CSDs, CCPs, and trading venues shall include in their rules that the receiving party shall appoint a buy-in agent and will be subject to buy-in rules under CSD Regulation. Their rules should also state who is responsible for appointing a buy-in agent or executing a buy-in auction**
(2)	For transactions cleared by a CCP, the rules of a CCP shall provide that the CCP shall appoint a buy-in agent or shall execute a buy-in through an auction.	Agreed
(3)	For transactions not executed on a trading venue	Agreed

	nor cleared by a CCP, the receiving party shall be responsible for appointing a buy-in agent and a CSD shall include in its rules that: (a) the participant shall ensure that the receiving party informs it of its choices pursuant to Article 15(3)(b) or (c); (b) the participant shall inform the CSD with respect to the choices it was informed of pursuant to point (a).	
(4)	The buy-in agent shall not have any conflict of interests in the execution of the buy-in process and shall execute the buy-in process on the terms most favourable to the failing party, in accordance with Article 27 of Directive 2014/65/EU	Agreed
(5)	Failing parties shall be allowed to deliver the securities until the receipt of the notification referred to in Article 13(1)(b). The failing parties shall thereafter be allowed to deliver the securities to the buy-in agent or to the entity that executes the buy-in auction upon agreement of that entity.	Failing parties shall be allowed to deliver the securities until the receipt of the notification referred to in Article 13(1)(b). ~~The failing parties shall thereafter be allowed to deliver the securities to the buy-in agent or to the entity that executes the buy-in auction upon agreement of that entity.~~

Article 15

Completion of the buy-in process

Article/ Paragraph	**Draft Technical Standards on the operation of the buy-in under the different options**	**AFME's Suggested Re-Drafting (From previous Technical Standards and new)**
(1)	For transactions executed on a trading venue but not cleared by a CCP: (a) when the buy-in has been successful, the securities shall be delivered to the receiving party and the failing and receiving parties shall ensure that the settlement instruction is cancelled; (b) where the buy-in failed, the receiving party shall notify without delay to the trading venue and to the failing party whether it prefers to defer the buy-in, or whether it prefers to receive the cash	(a) when the buy-in has been successful, the securities shall be delivered to the receiving party ~~and the failing and receiving parties shall ensure that the settlement instruction is cancelled~~

	compensation. In the absence of such notification, the failing party shall pay to the receiving party the cash compensation; (c) where the buy-in results in a partial delivery of securities, the receiving party shall accept the bought-in securities. For the non-delivered securities, the receiving party shall notify without delay to the trading venue and to the failing party whether it prefers to defer the execution of the buy-in or to receive cash compensation. In the absence of such notification, the failing party shall pay the cash compensation to the receiving party.	
(2)	For transactions cleared by a CCP: (a) where the buy-in has been successful, the securities shall be delivered to the receiving clearing member, and upon completion of the buy-in process, the CCP shall ensure that the settlement instruction is cancelled; (b) where the buy-in failed, the CCP shall notify without delay to the failing clearing member whether it prefers to defer the buy-in, or whether it prefers to receive the cash compensation. In the absence of such notification, the failing clearing member shall pay to the CCP the cash compensation, which the CCP shall pass to the receiving clearing member; (c) where the buy-in results in partial delivery of securities, the receiving clearing member shall accept the bought-in securities. For the non-delivered securities, the receiving clearing member shall notify without delay to the CCP whether it prefers to defer the buy-in process or to receive the cash compensation. In the absence of such notification, the failing clearing member shall pay to the CCP the cash compensation, which the CCP shall pass to the receiving clearing member.	Agreed
(3)	For transactions not executed on a trading venue nor cleared by a CCP: (a) where the buy-in has been successful, the securities shall be delivered to the receiving party and the failing and receiving parties shall ensure that the settlement instruction is cancelled; (b) where the buy-in failed, the receiving party	(a) where the buy-in has been successful, the securities shall be delivered to the receiving party ~~and the failing and receiving parties shall ensure that the settlement instruction is cancelled;~~

	shall notify to the failing party without delay whether it prefers to defer the buy-in, or whether it prefers to receive the cash compensation. In the absence of such notification, the failing party shall pay to the receiving party the cash compensation; (c) where the buy-in results in a partial delivery of securities, the receiving party shall accept the bought-in securities. For the non-delivered securities, the receiving party shall notify to the failing party without delay whether it prefers to defer the buy-in or to receive the cash compensation. In the absence of such notification, the failing party shall pay to the receiving party the cash compensation.	
(4)	The buy-in is deemed to be impossible only when the relevant securities do not exist any longer as a result of the actions taken by the issuer of such securities. In such case, the receiving party or participant shall receive the cash compensation. For transactions cleared by a CCP, the CCP shall transfer the received cash compensation to the receiving clearing member.	In such case, the receiving party ~~or participant~~ shall receive the cash compensation.
(5)	Cash Compensation Calculation	**ESMA should establish the methodology by which cash compensation is calculated. AFME is not in favor of the current practice that CCPs use of adding a penal element to the buy-in cost.**

Article 16
Partials

Article/ Paragraph	**Draft Technical Standards on the operation of the buy-in under the different options**	**AFME's Suggested Re-Drafting (From previous Technical Standards and new)**
(1)	When the relevant securities are available in the account of the delivering participant, partial settlement offered by CSDs in accordance with Article 3(9) shall be applied from the last business day of the extension period, irrespective of any	**The partialling functionality offered by the CSD, referred to under Article 3(7) shall be applied no later than the day prior to the final day of the**

	contractual choice made by the participants.	**extension period when the financial instruments are available in the account of the delivering party irrespective of any opt out elected by the receiving party. The partialling functionality shall not be mandatory for omnibus account structures when clients' ownership of assets cannot be guaranteed.**

Article 17
Minimising the number of buy-in processes

Article/ Paragraph	**Draft Technical Standards on the operation of the buy-in under the different options**	**AFME's Suggested Re-Drafting (From previous Technical Standards and new)**
(1)	For transactions referred to in Article 15 (3), the failing party that is failing because of a failed receipt of securities can pass-on to the party causing the fail the notification referred to in point (a) of Article 12(2). The latter party in turn can pass on the notification to the party that originally caused the settlement fail. The party who has caused the settlement fail and who receives that notification shall pay to the receiving party identified in the notification the amounts referred to in Article 7(6) and (8) Regulation (EU) No 909/2014 or the cash compensation.	**ESMA should determine a timeframe for the cut-off of the last pass-on notification which should be on the same day as the notification was issued.**
(2)	A receiving party who is also a failing party can pass on the notification referred to in point (a) of Article 12(2) to the party that originally caused the settlement fail. In such case, the former party shall not perform the buy-in as a receiving party	Agreed
(3)	A party who has passed on the notification referred to in point (a) of Article 12(2) shall ensure that the CSD is informed that it has passed-on that notification and of the identity of the party receiving that notification.	Agreed

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(4)	A party passing-on a notification referred to in point (a) of Article 12(2) shall notify the party in receipt of that notification and both shall ensure that the CSD is informed of the initiation, execution and results of the buy-in process.	Agreed