International
Capital
Market
Association

Mr. Patrick Pearson
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European Commission
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Mr. Fabrizio Planta
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Dear Messrs. Pearson and Planta,

Industry concerns relating to the implementation of the CSDR mandatory buy-in regime

On behalf of ICMA's global membership, which includes banks, intermediaries, asset managers, pension funds, and investment funds, among others active in the international debt markets, I am writing to you to update you on our increasing concerns related to the upcoming implementation of the CSDR mandatory buy-in provisions. The first concern is with respect to the market's ability to comply by the projected go-live (now expected to be 1 February 2021). The second is a widely held conviction that this regulatory initiative will likely inflict severe damage on the functioning and stability of the European bond markets. Both of these concerns have been amplified by the ongoing secondary market dislocations resulting from the COVID-19 pandemic.

While continuing to question the rationale and design of the CSDR buy-in framework, ICMA, working closely with its members, has remained committed to ensuring that its implementation is as successful as possible. To this end, ICMA has had extensive discussions with ESMA and the European Commission over several years to find ways to address the most challenging aspects of the regulation. These include overcoming acknowledged anomalies in the regulation, in particular the asymmetric provision for the payment of the price component of the buy-in and cash compensation differential, the absence of a pass-on mechanism (which has fundamental implications for market stability), and an ongoing lack of clarification of the transaction scope of the regulation. As much as these industry initiatives and proposals are targeted at mitigating many of the unintended consequences and additional market risks created by the regulation, which will be largely unique to the EU, they are also intended to make the buy-in regime workable in practice.

Meanwhile, the industry continues to identify further risks to implementation, such as the lack of buy-in agents (noting that the only solution currently putting itself forward as a buy-in agent to date is not necessarily compatible with many buy-side operational models, nor may it be able to interface with non-EU trading parties), as well as an insufficient means of determining cash compensation in the case of illiquid securities.

The proposed enhancements and additional clarifications to the regulation are required by our members and the broader industry to facilitate their implementation plans. In the absence of guidance from the authorities on these basic threshold matters, such as scope, the market's efforts to prepare remain severely compromised. The regulatory requirement that parties establish contractual arrangements incorporating the buy-in process requirements in all relevant jurisdictions provides an obvious example. This involves extensive repapering of legal contracts (including through the ICMA Buy-in Rules and the Global Master Repurchase Agreement), not only within the EU, but globally, as well as updating internal operational and risk management processes with related technology and infrastructure builds. All of this takes significant lead time, conditional on a clear understanding of the scope and application of the regulation. Unfortunately, the lack of clarification on the critical issues mentioned above continues to hamper this cross-industry implementation effort.

We know that you are well aware of these issues - we have discussed them with you and your colleagues a number of times over the past years - but as the clock ticks down we wanted to reiterate the importance of resolving these uncertainties as soon as possible.

Aside from the ongoing need for clarification required for successful, and timely, implementation of the CSDR mandatory buy-in regime, ICMA and its members wanted to use this opportunity, again, to alert the authorities to the potential dire consequences of this regulatory regime for European bond market functioning, liquidity, and stability. The industry remains deeply concerned that the design of the initiative will introduce market disruption and create difficult to hedge, non-linear exposures for market participants, undermining the very objectives of the Regulation related to efficient and orderly market operations. The risks of this are starkly illustrated by the recent secondary market dislocations caused by the COVID-19 pandemic. The recent and ongoing secondary market challenges and disruptions provide an important data set which we believe EU authorities should consider as part of a detailed and extensive impact assessment prior to implementation.

In the last weeks of February and through most of March, European credit secondary markets came under significant pressure as the market repriced risk and as fund managers responded to sizeable outflows. At the same time, operational infrastructure was stress-tested to its limits, as firms adjusted to working remotely against a backdrop of significantly increased volumes needing to be processed. Two main factors allowed the market to continue to function through this disruption: firstly, the ability and willingness of broker-dealers to continue to make markets for their clients, and secondly a market-wide tolerance of settlement fails (which increased significantly in absolute terms). Given that a mandatory buy-in regime is designed to make settlement fails economically unviable, and will restrict market-making capacity, it is worth considering how this regime would have impacted the market's ability to function during this crisis, and the extent to which it would have added to systemic market risks and instability, thereby further amplifying the already extreme dislocations.

While we continue to ask for urgent clarification on industry proposals to help mitigate some of the more problematic elements of the CSDR mandatory buy-in framework and to improve its chances of successful implementation, we also urge you to consider the potential impacts of the regime on the health and soundness of the European bond markets, and most importantly its underlying customers - Europe's investors, savers, and future pensioners - particularly in times of market stress.

ICMA and its members remain fully committed to the implementation and objectives of the CSDR Settlement Discipline measures, and will continue to support initiatives, both regulatory and market based, to improve settlement efficiency in the EU securities markets. The concerns, and request for review, relate specifically to the application of the proposed mandatory buy-in provisions in the non-cleared bond markets. Furthermore, while modifying the mandatory nature of the buy-in to be discretionary rather than obligatory would be optimal, there remain other potential solutions, such as a more workable extension period (say 30 business days), or a phased approach to implementation along the lines of the MiFIR liquidity calibrations. ICMA and its members remain ready to discuss the practicalities and impacts of such modifications.

We look forward to your response to these industry concerns and suggestions.

Yours sincerely,

Martin Scheck
Chief Executive

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