

Updating the ICMA Buy-in Rules

Call: April 7, 2020

Meeting notes

Members discussed some of the key considerations and questions suggested for the projected market consultation on updating the ICMA Buy-in Rules in light of CSDR. The objective was to identify questions that may be superfluous, as well as any missing considerations.

PEP (pre-extension period) Buy-in

The PEP buy-in is intended to be used any time from ISD+1 (as now) up until the end of the relevant extension period. The PEP buy-in is intended to remedy the fail before going to a CSDR buy-in.

Minimum notice period

- Nobody objected to the suggestion that the notification period should be shortened, and the proposal to ask whether the minimum notice should be 3 or 4 days.
- ❖ *Ask whether 3 or 4 days are appropriate in the consultation.*

Final day to agree to negotiate alternative remedy

- Nobody disagreed with the proposal of ending the buy-in attempt a day early (potentially ISD+6 for bonds) to allow the parties to negotiate an alternative remedy (such as cash settlement) before going to the CSDR buy-in.
- ❖ *Suggest that the revised ICMA Rules allow a final day at the end of the extension period to negotiate an alternative remedy.*

Buy-in agent

- It was agreed that the current lack of requirement to appoint a buy-in agent was an advantage and should remain in the PEP. Participants stressed that anything that afforded flexibility to the process would add value.
- ❖ *Suggest that the revised ICMA Rules do not require the appointment of a buy-in agent.*

Defining guaranteed delivery

- There were mixed views on whether this would be helpful. The point was made that the front office and back office views on whether one 'owns' a security are different. A trader may think that they have a position to deliver into a buy-in (based on economic and legal ownership), but it may not be in the 'box', due to a settlement fail or reliance on contingent transactions.
- It was counterargued that guaranteed delivery was broadly understood, and that defining it could be too limiting, particularly where firms may have the resources to ensure delivery even if it is technically not in their box at that precise moment.
- It was further noted that in reality there can never truly be 'guaranteed delivery'. From a practical perspective this would require immediate (T+0) settlement, which will not work for most sellers into a buy-in. Once you move to more standard settlement cycles (such as T+2), even if you hold the securities in your box now, beyond moving them into a segregated account or holding all settlement instructions in the same security, it is impossible to guarantee that you will have them on the settlement date.
- It was suggested that guaranteed delivery not be defined in the ICMA Rules, but if helpful, an explanation provided elsewhere [possibly FAQs].

❖ *No definition of guaranteed delivery in the revised ICMA Rules.*

Settlement fail of the buy-in

- It was broadly agreed that the current basis of the buy-in being considered successful based on execution (rather than settlement) should apply under the PEP. This would also mean that the buy-in could be executed up until the end of the extension period.
- The question was raised as to what would happen in the event that the settlement of the buy-in failed, and the recourse of the receiving (purchasing) party. The ICMA secretariat pointed to Section 180 of the ICMA Rules ('Special Situations') which covers failure to deliver in the case of guaranteed delivery. Essentially, the purchasing party has the right to cancel the trade, or will have a claim to any reasonably foreseeable losses incurred due to such non-fulfilment of the special terms or conditions (i.e. guaranteed delivery).
- It was noted that it would seem reasonable in this circumstance that the purchasing party would have the option to cancel the trade (in the case that the market had moved in their favour), or to hold the selling party into the buy-in liable for any adverse market moves.
- In the event that canceling the buy-in would be disadvantageous to the purchasing party, it was suggested that an alternative remedy could be to keep the trade open, and if the selling party still fails to deliver, a buy-in could be initiated against them (either a PEP, or go to a CSDR buy-in). However, the downside of this could be that it is merely replacing one fail with another fail, rather than improving settlement efficiency.
- While there was general consensus that buy-in execution, rather than settlement, worked from the perspective of the PEP, it may be more challenging to adopt within the constraints of the CSDR provisions.

- ❖ *Suggest that the PEP retains the current mechanics of execution ending the buy-in, rather than settlement, with recourse to Section 180 in the event that the buy-in settlement fails.*

Pre-advice notice

- It was agreed that a pre-advice notice did not make sense in the case of the PEP, given the shortened timeframe. However, it was suggested that there could be value in the PEP notice also functioning as a pre-advice notice for the CSDR buy-in (in the event that the PEP is unsuccessful).
- ❖ *ICMA to explore additional wording for the PEP buy-in notice that could serve as a pre-advice notice for the CSDR buy-in.*

Information in the buy-in notice

- There was agreement to consult on the existing information required, including the possibility of the buy-in notice serving as a CSDR pre-advice.
- ❖ *Consult on the existing information required in the buy-in notice.*

Partial deliveries

- It was suggested that the ICMA Rules continue to provide for partial delivery by the selling party up until the day before the first buy-in date.
- ❖ *ICMA Rules to retain provisions for partialing.*

Definition of 'immediate'

- Currently the ICMA Rules require that on execution of the buy-in, this is communicated immediately to the selling party, and similarly along the chain in the case of a pass-on situation. This raised a question of whether there was a need to be more definitive in the timing of such communications in a world with far more frequent buy-ins, and the market risks this would create.
- It was asked, for instance, what would be the recourse for a seller who was not informed that they had been bought-in until the following day?
- It was suggested that perhaps language could be added to specify that the buy-in had to be communicated no later than the end of the business day. However, it was discussed that if notice is given at the very end of the day, it could be too late for the bought-in party to take the

necessary action. Similarly, if the time is too constrained, it may not be possible to communicate the buy-in through a pass-on chain.

- The question was raised as to what would be consequence of a party not communicating the buy-in within the required timeline.
- ❖ *ICMA to discuss internally possible language and consequences around communication timelines*

Sell-out Rules

- It was discussed whether the Sell-out Rules should mirror the Buy-in Rules, as has always been the case. The view, however, was that since there was no regulatory sell-out requirement under CSDR, there seemed little sense in creating Rules that mirrored the CSDR Buy-in Rules, which would effectively be a downgrade of the existing Sell-out Rules.
- This suggested that the existing Sell-out Rules may be better left as they are. However, it was also asked whether there could be situations where the Buy-in and Sell-out Rules interacted and where some form of coordination could be helpful.
- ❖ *ICMA to explore whether there could be implications of having different Buy-in and Sell-out provisions, before putting a recommendation for consultation.*

Continuation of existing features

- It was agreed that the PEP should retain the current features of symmetric differential payments as well as the possibility of multi-ISD pass-ons (within the limitations of the extension period).

CSDR Buy-in

Still part of the ICMA Rules, these are the buy-in provisions that would apply post-extension period and are designed to align with the CSDR requirements.

Pre-advice

- Participants felt that in the case of the CSDR buy-in, there was value in parties confirming that a potential buy-in situation existed before the end of the extension period.
- In the case that a PEP buy-in had not been initiated – and some felt that in most cases parties would wait for the CSDR buy-in – this would require some form of notification between the parties.
- Timing and content of such a notice would need to be explored, perhaps with reference to work being undertaken by the AFME WG to ensure alignment.
- It was also suggested that such pre-advice notice would most likely be a best practice Recommendation, rather than a Rule.

- ❖ *ICMA to liaise with AFME on their considerations for a pre-advice notice.*

Information in the buy-in notice

- ❖ *Same as PEP – to be consulted on.*

Guaranteed delivery / Settlement failure of the buy-in

- While participants saw value in guaranteed delivery being a requirement of the PEP buy-in, the general view was that it may be difficult to apply in the CSDR context. It was further noted that there is no regulatory requirement for guaranteed delivery.
 - This led to the issue of what should happen if the buy-in settlement fails. The general view was that the buy-in should be canceled and the original fail remain unremedied, with the option of deferral and/or cash compensation as per the regulation.
 - The risks arising from the success of the buy-in relying on successful settlement, rather than successful execution were discussed. It was agreed that this was perhaps an oversight on the part of the drafters who had not considered the market risk implications of the provisions, but without a change to the Level 2 it would be difficult to 'contract around this'. Also, the way the regulation is drafted, a number of requirements in the buy-in process rely on successful settlement.
 - It was also suggested that highlighting to the regulators the additional market risk the provisions created for the failing party would probably not garner much sympathy.
 - The general view was that it would be difficult to find a way to replicate the provisions of the PEP for ending the buy-in process (i.e. execution of the buy-in) under the CSDR buy-in, and potentially flawed as they were, the ICMA Rules would most likely need to accommodate the CSDR provisions (i.e. the success of the buy-in contingent on settlement).
 - In light of this, it was agreed that canceling the buy-in in the event of it failing is the most appropriate action.
 - It was noted that this would mean different operational processes for the PEP and the CSDR buy-in with respect to when the settlement instructions for the original trade are canceled.
- ❖ *The (non-PEP) Rules to align with the CSDR provisions: (i) no guaranteed delivery requirement; (ii) settlement instructions for the original trade canceled only on successful settlement of the buy-in; (iii) buy-in to be canceled in the event it fails to settle.*

Solving for the asymmetry

- It was agreed that the ICMA Rules should explicitly continue to provide for symmetrical payment of the buy-in and cash settlement ('compensation') price differential, subject to clarification from ESMA.

Pass-on mechanism

- It was agreed that the ICMA Rules should provide for a pass-on mechanism, subject to guidance from ESMA.

It was agreed that a follow-up call would be scheduled for the following week (confirmed as April 16) to finish discussing the considerations for the consultation. In the meantime, ICMA would share a note of this call, along with an updated outline of the potential consultation questions and considerations.

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