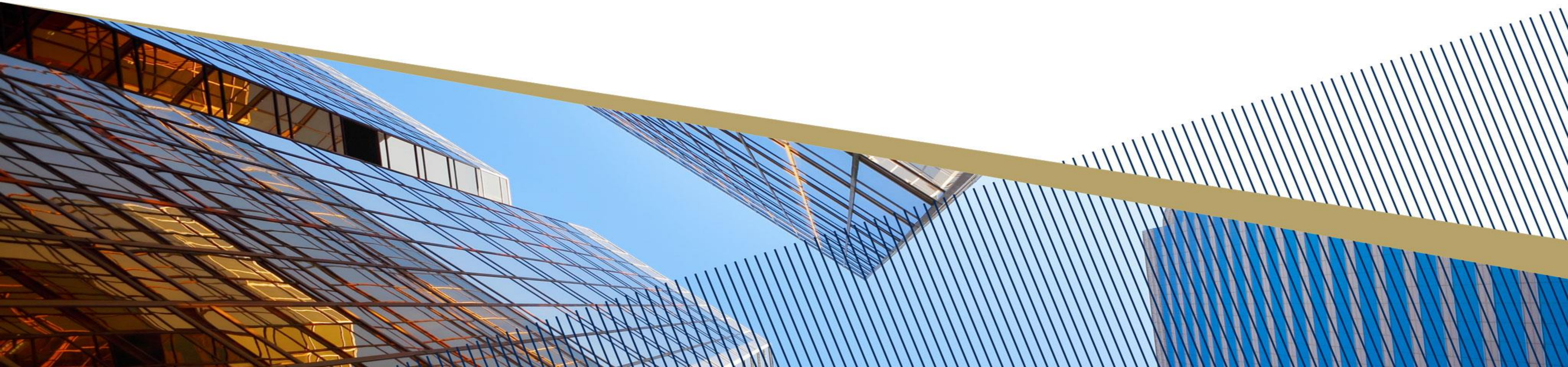
ICMA
International Capital Market Association

CSDR Mandatory Buy-ins:
Adapting the ICMA Buy-in Rules to align with implementation

August 2018



Key differences

ICMA Buy-in Rules	CSDR
Discretionary: can be initiated at any time from ISD+1	Mandatory: must be initiated on ISD+4 (liquid equities) or ISD+7
Non-defaulting party can elect time between notification and date of buy-in (4 to 10 days)	No defaulting party must start buy-in process following the extension period
Buy-in process can run indefinitely	Buy-in must be completed in 4 or 7 days, with option to attempt (‘defer’) for one more attempt
No requirement to appoint a buy-in agent	Requirement to appoint a buy-in agent
Buy-in differential (buy-in price vs original price) is paid in either direction between seller and buyer depending on which is higher/lower.	Buy-in differential payment is asymmetrical, and is only paid by the seller to the buyer where the buy-in price is higher. Where it is lower, the differential is “deemed paid”.
Cash compensation is possible, but not prescribed.	Cash compensation is prescribed.
Pass-on mechanism to provide for single buy-in to settle settlement chains	No pass-on mechanism
Applies to all firms trading under ICMA Rules (usually members) in ‘international securities’. The ICMA Rules form part of the contractual trading agreements between member firms.	Applies to all transactions intended to settle on an EU/EEA CSD in transferable securities, money-market instruments, units in collective investment undertakings, and emissions allowances, which are admitted to trading or traded on a trading venue or cleared by a CCP.

[1] Defined as a security intended t be traded on an international, cross-border basis (ie between parties in different countries), and capable of settlement through an international central securities depository or equivalent.

The CSDR asymmetry

Level 1: Article 7(6)

Without prejudice to the penalty mechanism referred to in paragraph 2, where the price of the shares agreed at the time of the trade is higher * than the price paid for the execution of the buy-in, the corresponding difference shall be paid to the receiving participant by the failing participant no later than on the second business day after the financial instruments have been delivered following the buy-in.

RTS: Article 35

Payment of the price difference

1. Where the price of financial instruments referred to in Article 5(1) of Regulation (EU) No 909/2014 agreed at the time of the trade is lower than the price effectively paid for those financial instruments pursuant to Articles 27(10), 29(10), and 31(10), the failing clearing members, failing trading venue members or failing trading parties shall pay the price difference to the CCP, receiving trading venue members or receiving trading parties, as applicable.
Where transactions are cleared by a CCP, the price difference referred to in the first subparagraph shall be collected from failing clearing members by the CCP and paid to the receiving clearing members.

2. Where the price of the shares agreed at the time of the trade is higher than the price effectively paid for those shares pursuant to Article 27(10), Article 29(10) and Article 31(10), the corresponding difference referred to in Article 7(6) of Regulation (EU) No 909/2014 shall be deemed paid.

* Footnote added by ICMA. This would normally be expected to read “lower”, rather than “higher”, to be consistent with market practice. In the case that the price agreed at the time of the trade is *higher* than the price paid for the execution of the buy-in, the corresponding difference is normally paid **by** the receiving party **to** the failing party.

Addressing the CSDR asymmetry

- ICMA is exploring the possibility of updating its Buy-in Rules (or a version of its Buy-in Rules) to align with the regulatory provisions of CSDR.

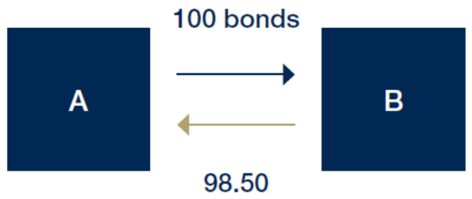
- For transactions subject to CSDR, the ICMA Buy-in Rules would allow for a contractual agreement between members or users of the Rules to settle the buy-in (or cash compensation) differential symmetrically.

- This would help to address a number of the more problematic risks arising as a result of the CSDR asymmetry, including:

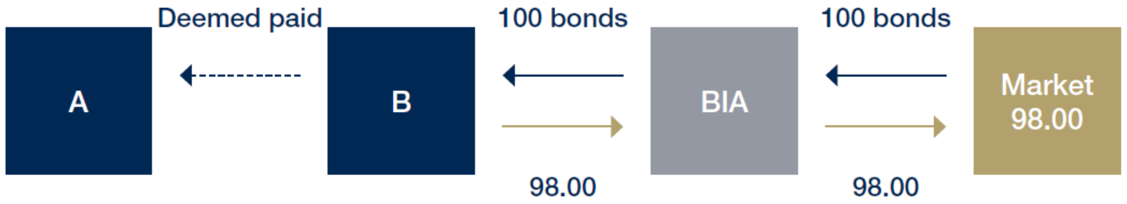
    - Additional risks to liquidity providers
    - The inability to use pass-ons to settle transaction chains
    - Additional risks to lenders of securities
    - The unlikelihood that non-EU firms will contractually agree to asymmetric buy-ins

Reducing risks for liquidity providers

Original transaction

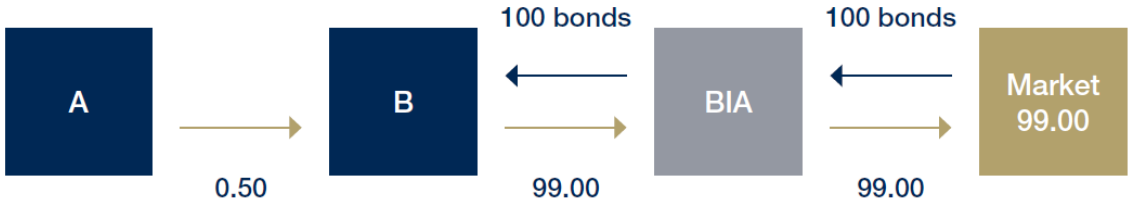


CSDR Buy-in



	A	B
P&L before buy-in	+0.50	(0.50)
P&L after buy-in	0	0
P&L impact of buy-in	(0.50)	+0.50

ICMA Buy-in

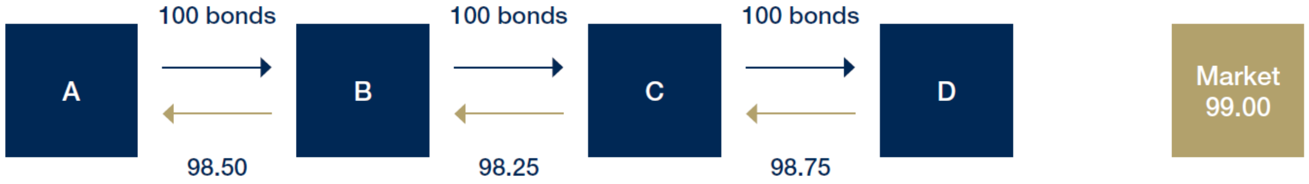


	A	B
P&L before buy-in	(0.50)	+0.50
P&L after buy-in	(0.50)	+0.50
P&L impact of buy-in	0	0

Enabling the use of pass-ons to settle transaction chains

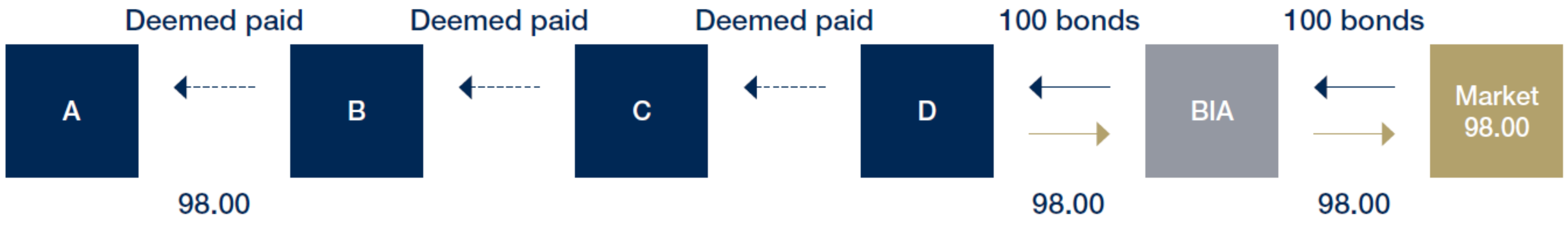
NB: another challenge to using pass-ons is the mandatory nature of the extension period. Often in transaction chains, trades have different settlement dates. Thus chains are resolvable though discretionary buy-ins, but under mandatory buy-ins transaction chains will require separate buy-ins for each settlement date in the chain.

Original transactions



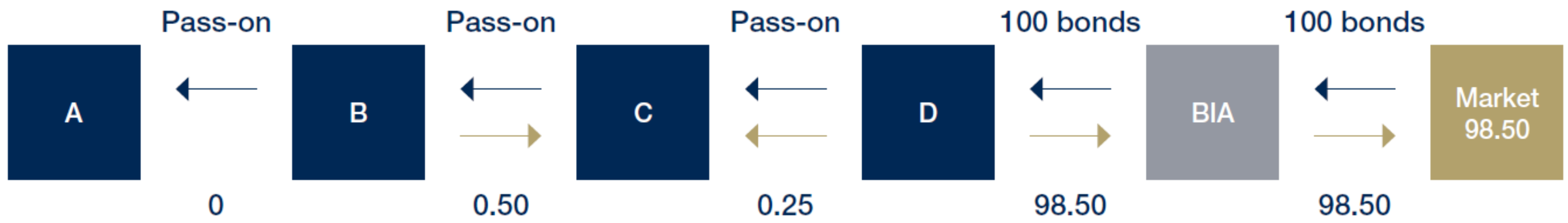
	A	B	C	D
P&L	(0.50)	(0.25)	+0.50	+0.25

CSDR Buy-in



	A	B	C	D
P&L before buy-in	+0.50	(0.25)	+0.50	(0.75)
P&L after buy-in	0	0	0	0
P&L impact of buy-in	(0.50)	+0.25	(0.50)	+0.75

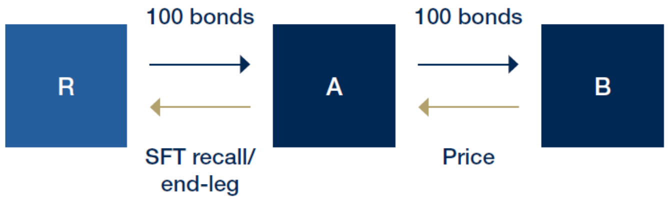
ICMA Buy-in



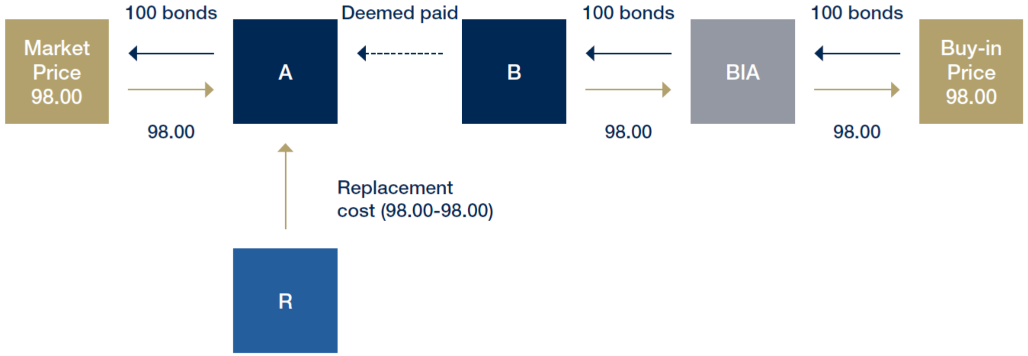
	A	B	C	D
P&L before buy-in	0	(0.25)	+0.50	(0.25)
P&L after buy-in	0	(0.25)	+0.50	(0.25)
P&L impact of buy-in	0	0	0	0

Reducing risks for lenders of securities

Recall of an SFT to settle an outright sale

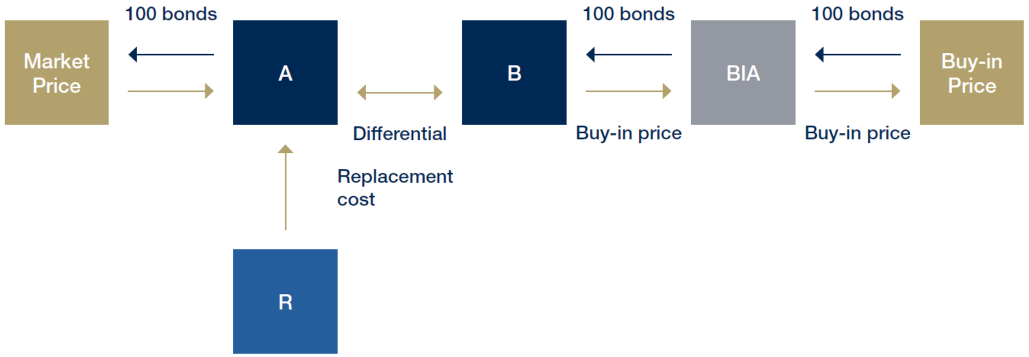


CSDR Buy-in vs mini close-out



	A	B
P&L before buy-in	+0.50	(0.50)
P&L after buy-in	0	0
P&L impact of buy-in	(0.50)	+0.50

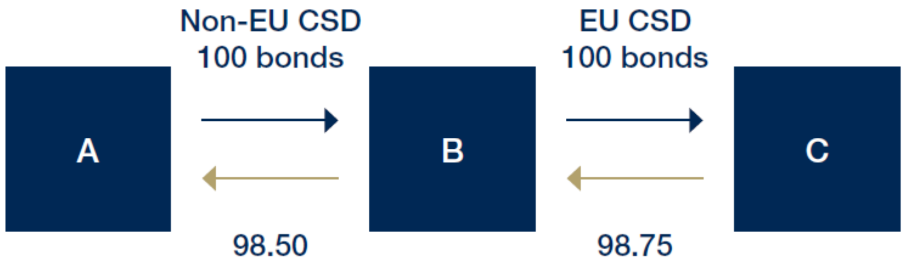
ICMA Buy-in vs mini close-out



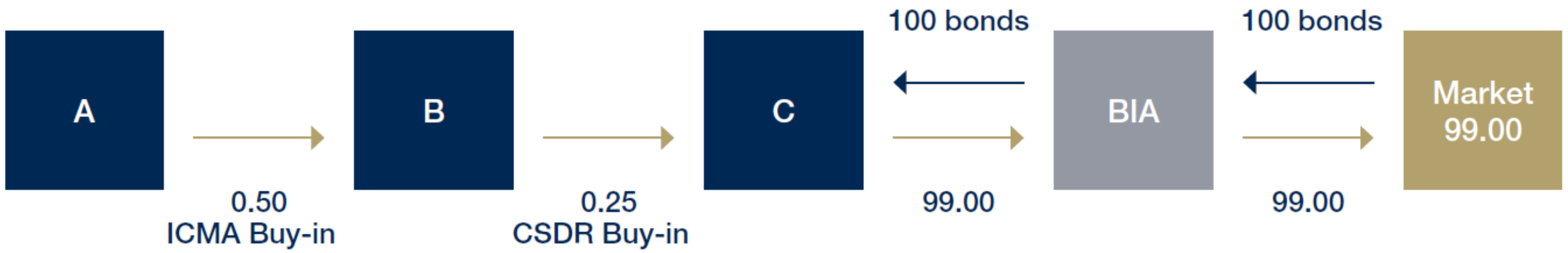
There remains a risk that the buy-in price will not be acceptable as the replacement cost, but the lender will not incur losses due to the buy-in asymmetry in the buy-in price differential.

Reducing risks of adverse extraterritorial impacts

Original transactions



Effect of asymmetric buy-ins (the worst of all worlds)



Challenges of adapting the ICMA Buy-in Rules to address the CSDR asymmetry

- Will require ESMA, NCA, and EC support.
- In a falling market, it could still be preferable for the end purchaser to elect for an asymmetric buy-in (as per the regulation), since this generates windfall profits.
- ICMA Buy-in Rules largely apply to the international bond markets and not all in-scope securities and transactions.