RESPONSE APT EC CONSULTATION CSDR - JANUARY 2021

Section 7 – Settlement Discipline

33. *Do you consider that a revision of the settlement discipline regime of CSDR is necessary?*
Yes

33.1. *If you answered yes to Question 33, please indicate which elements of the settlement discipline regime should be reviewed: (you may choose more than one options)*
Rules relating to the buy-in;
Rules on penalties.

33.2 *If you answered "Other" to Question 33.1, please specify to which elements you are referring.*
N/A

34. *The Commission has received input from various stakeholders concerning the settlement discipline framework. Please indicate whether you agree (rating from 1 to 5) with the statements below:*

Buy-ins should be mandatory 2 (rather disagree)
Buy-ins should be voluntary 4 (rather agree)
Rules on buy-ins should be differentiated, taking into account different markets, instruments and transaction types 4 (rather agree)
A pass on mechanism should be introduced 5 (fully agree)
The rules on the use of buy-in agents should be amended 4 (rather agree)
The scope of the buy-in regime and the exemptions applicable should be clarified 4 (rather agree)
The asymmetry in the reimbursement for changes in market prices should be eliminated No opinion
The CSDR penalties framework can have procyclical effects 3 (neutral)
The penalty rates should be revised 3 (neutral)
The penalty regime should not apply to certain types of transactions (e.g. market claims in cash) 3 (neutral)

34.1. *Please explain your answers to question 34, providing where possible quantitative evidence and concrete examples.*

- We believe the CSDR settlement discipline framework should primarily focus on measures that *prevent* settlement failure and that industry participants should continue to be responsible for addressing settlement fails through enforceable agreements. Therefore, buy-ins should only be voluntary, i.e. should be agreed upon contractually, and only applied if this is in line with the original agreement between the parties. Where mandatory buy-in rules will confront the industry with different platforms, fees, business models, causing fragmentation and increase in costs, voluntary buy-ins will leave the challenges around buy-in agents and agreements to the industry participants, which we believe is where these belong.

- We do believe (voluntary) buy-in rules should distinguish between different instruments, such as cash instruments and ETFs, as these may have different primary markets (and/or liquid securities lending/borrowing market). CCPs already apply such distinction, and consistent application throughout the settlement chain would be welcomed.

- To prevent settlement fails, the rules around transaction confirmations should be addressed. As is recognized under CSDR, the current lack of consistency contributes to settlement fails.

The current rules designed to address settlement fails come with significant system, legal, staffing, and operational costs, which will lead to wider spreads and thus reduce liquidity. This is contrary to the importance of liquidity provision to orderly and efficient markets.

- A clear pass-on mechanism, which is lacking at the moment, would widely benefit the industry, albeit on the premise of clear and direct communication between parties that are included in the chain of transactions. Certain EU markets already have a practice of pass-on mechanisms in applicable buy-in procedures, which may be a useful reference point for clarifying rules around chains of transactions.

- In line with the approach under CSDR that the number of buy-ins should be kept at a minimum (cf. recital (19) CSDR), settlement failures in respect of transactions that are part of a chain of transactions should not lead to multiple, individual buy-ins, due to the inefficient, distortive and time-consuming nature of buy-ins. Furthermore, the chain of transactions could be problematic if the middle of the chain contains entities that delivered on time. When delivered on time, the respective entity should be relieved from expending operational resources as well as running potential liability to their counterparty for claims.

- When buy-ins would be made mandatory, there should be an exemption (f.e. +5 days) for continuously trading/liquidity providing/market making proprietary trading firms. This is similar to rules in other jurisdictions, such as the US.

35. *Would the application of the settlement discipline regime during the market turmoil provoked by COVID-19 in March and April 2020 have had a significant impact on the market?*
Yes

35.1. *Please explain your answer to Question 35, describing all the potential impacts (e.g. liquidity, financial stability, etc.) and providing quantitative evidence and/ or examples where possible.*
In March and April 2020, the settlement discipline regime was not yet clear enough for market participants to have a significant contribution to the purpose of the CSDR settlement discipline regime. On the contrary, the application of the settlement discipline regime in the then prevailing form could have been detrimental.

36. *Which suggestions do you have for the improvement of the settlement discipline framework in CSDR? Where possible, for each suggestion indicate which costs and benefits you and other market participants would incur.*

- See the suggestions in answer to 34.1 above.

- The current rules lack the clarity for an effective implementation of the settlement discipline and should be clarified. F.e., CSDR does not address the role of buy-in agents, and the Settlement Discipline RTS only describes that a buy-in agent should avoid conflicts of interest and act in accordance with MiFID II 'best execution' principles. These unclear rules may discourage industry participants to act as buy-in agent. A comparable lack of clarity can be found in article 25 Settlement Discipline RTS, which describes that parties in the settlement chain must establish arrangements with 'their relevant counterparties' to incorporate the buy-in process requirements, which are enforceable in 'all relevant jurisdictions', which leaves room for interpretation, legal uncertainty and fragmentation.