CSDR Settlement Discipline Rules
Implementation Blueprint
June 2020

Explore how the introduction of CSDR settlement discipline rules will alter the mechanics of European securities settlement, and get up to speed with what your firm should be doing to prepare for implementation.
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Introduction: Balancing an Idealistic Policy Agenda with the Need for Pragmatism

Over the next eight months, trading firms of every description, from asset managers to corporate treasury vehicles, will need to prepare for the implementation of settlement discipline rules set to be phased in under the Central Securities Depositories Regulation ("CSDR")\(^1\). From 1 February 2021, any entity that settles trades on an EU Central Securities Depository ("CSD") will fall within scope of these new rules, whether directly or indirectly (i.e., through contractual measures imposed by others in the settlement chain). In other words, therefore, a non-EU entity trading in a USD denominated bond could be brought within scope of the settlement discipline rules.

These settlement discipline rules will result in automatic daily penalties being imposed on firms that fail to settle the securities leg of their trades on time, and if settlement has not been achieved after a specified number of days has passed, a mandatory "buy-in" will need to be executed via a buy-in agent, with the aim of forcing settlement. Where the buy-in process fails, and settlement cannot be achieved, the failing counterparty will instead be required to pay "cash compensation".

The policy aim of these reforms is clear; having bolstered the prudential and operational standards applying to CSDs themselves, EU regulators have now turned their attention to limiting settlement failure occurring on trades settled through CSDs. As the Recitals to the CSDR perhaps ominously note, "one of the most efficient ways to address settlement fails is to require failing participants to be subject to a compulsory enforcement of the original agreement". In other words, where trading firms opt to settle their trades through an EU CSD such as Euroclear or Clearstream, they will effectively be opting in to a system that works to force settlement where possible, and to penalise settlement failure, regardless of the trading firm’s location.

Whilst the EU’s aim of increasing settlement efficiency and decreasing rates of failure is positive in theory, there are a number of practical issues that will arise as a result of transferring cash penalties throughout settlement chains and executing buy-in processes that could result in failed-to firms being "cash compensated" rather than actually taking delivery of securities. Firms that trade in higher volumes will also need to model the economic impact of the new standards, particularly in light of the increase in settlement fails that we saw at the peak of COVID-related market volatility.

In order to help firms navigate this new regime, we have set out in this briefing paper some background on the settlement rules themselves and the various timelines and triggers that apply to each aspect of the rules, followed by some tips on structuring a compliance plan. Finally, we end the briefing with a deeper dive into issues around buy-ins and the key ways in which the mandatory buy-in regime under the CSDR will diverge from traditional buy-ins. We believe that understanding this shift away from discretionary, market-fed buy-in solutions to mandatory CSDR buy-ins helps to contextualise how the "new world" of settlement will look in practice.

A Note on Timing and the Impact of Brexit

Having already been postponed once, the settlement discipline rules are currently expected to enter into force in the EU on 1 February 2021\(^2\), subject to objection from the European Parliament and/or the Council.

However, the UK Government has recently confirmed that the UK "will not be implementing the EU’s new settlement discipline regime" and that "UK firms should instead continue to apply the existing industry-led framework"\(^3\). The UK is able to take this approach as a result of the fact that Articles 6 to 8 of the CSDR (which contain the settlement discipline requirements) will not be in force prior to the date of Brexit; so in other words, they will not be classed as retained EU law.

The UK’s comments on implementation follow extensive lobbying by trade associations and others on the practical implications of the buy-in rules in particular. While EU regulators have to date taken the position (at least on a formal basis) that the rules should be implemented by EU firms and CSDs on time, the UK’s position, along with the operational challenges of preparing for compliance, may cause European regulators to reconsider pushing back the implementation date of the new requirements. However, unless and until this happens, firms will need to plan on a go-live date in EU27 Member States of February next year. UK firms should also bear in mind that the UK Government’s approach will not entirely insulate them from the scope of the new requirements, which are likely to be passed on contractually for any trades they enter into that settle through EU CSDs.

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\(^2\) Commission Delegated Regulation of 8 May 2020 amending the Delegated Regulation.

Background: What Are the Settlement Discipline Rules?

The new settlement discipline rules are aimed at: (i) preventing settlement fails before they occur; and (ii) mitigating or managing the impact of settlement fails after the fact. The upcoming requirements will apply directly to transactions in transferable securities, money market instruments, fund units and emission allowances where those transactions are settled on an EU* CSD (and, in the case of the cash penalties and buy-in requirements, where the instrument is either cleared or "traded on a trading venue"). The rules will also bite on repo trades and certain derivative transactions as we explore in more detail in Section 3 ("Scoping the Impact") below.

As will become clear, a number of the rules have been informed by the idea of actively penalising settlement failure as well as simply managing its impact. We will look at each aspect in turn.

A. Preventing settlement failure

Article 6 of the CSDR sets out a number of requirements designed to prevent settlement failure. Certain of these requirements apply to market infrastructure providers; for example, trading venues will need to ensure the prompt confirmation of transaction details on the execution date, and CSDs will be required to facilitate and incentivise timely settlement. However, a number of requirements will apply directly to MiFID authorised investment firms.

In practice, these new standards will mean that buy-side clients (wherever they are established) will be required to sign up to a revised set of documentation with their EU dealers, and to implement new procedures relating to the allocation and confirmation of trades.

Allocations and confirmations: what is required?

Allocations: EU investment firms will require professional clients to send them "written allocations" of securities or cash which identify the accounts to be credited or debited in relation to in-scope trades. The key issue to bear in mind is that this allocation data will in future need to be delivered in a detailed format that is mandated by the terms of the CSDR, and which contains a series of identifiers relating to each transaction: see below.

* Note that the CSDR has been drafted with EEA relevance, so these requirements should in theory also extend to EEA states.

<table>
<thead>
<tr>
<th>Written Allocation Specifications</th>
</tr>
</thead>
<tbody>
<tr>
<td>One of the following types of transaction:</td>
</tr>
<tr>
<td>a) purchase or sale of securities;</td>
</tr>
<tr>
<td>b) collateral management operations;</td>
</tr>
<tr>
<td>c) securities lending/borrowing operations;</td>
</tr>
<tr>
<td>d) repurchase transactions;</td>
</tr>
<tr>
<td>e) other transactions.</td>
</tr>
<tr>
<td>The ISIN of the financial instrument.</td>
</tr>
<tr>
<td>The delivery or the receipt of financial instruments or cash.</td>
</tr>
<tr>
<td>The currency, except in the case of free of payment settlement instructions.</td>
</tr>
<tr>
<td>The nominal value for debt instruments, or the quantity for other financial instruments.</td>
</tr>
<tr>
<td>The trade date.</td>
</tr>
</tbody>
</table>
**Confirmations:** The CSDR will require EU investment firms to put in place new contractual arrangements governing the procedure for confirming trades (e.g., ensuring that their clients confirm their acceptance of the terms of transactions within the timeframe below).

**Timing:** Written allocations and confirmations will generally need to be provided by close of business on the business day on which the transaction has taken place, although this deadline will be extended to noon the following business day where there is a timezone difference or where the transaction was executed after 4pm CET. There is also a requirement for the investment firm to confirm receipt of the written allocation or confirmation within two hours.

**Implementation:** By February 2021, trading firms should expect to have agreed revised terms reflecting the new standards on written allocation and confirmation. Trading firms will also need to have updated their internal systems to deliver the required data and receipt confirmations by the required deadlines.

### B. Addressing settlement failure

The settlement discipline rules will implement three key measures to help address settlement failure:

a) **Cash penalties:** will automatically be applied to "participants that cause settlement fails" for each business day that a settlement instruction fails to settle;

b) **Buy-in:** a mandatory buy-in procedure will be implemented following a specified extension period; and

c) **Suspension / public censure:** in serious cases, CSDs, CCPs and trading venues may suspend and publicly censure firms that consistently and systematically fail to deliver financial instruments when required.

Each of these requirements will be applied following a "settlement fail", namely "the non-occurrence of settlement, or partial settlement of a securities transaction on the intended settlement date, due to a lack of securities or cash and regardless of the underlying cause". However, slightly different triggers and timelines will apply to each, as set out in the box below.

CSDs will also be required to publish anonymised, aggregate data on settlement failure occurring across their system.
Triggers for application of the settlement discipline rules

Cash penalties

- Daily cash penalties will commence from the business day after a transaction's intended settlement date (including in situations where the settlement instruction has been put on hold).
- The "intended settlement date" refers here to the date that is entered into the securities settlement system as the settlement date (in other words, there would need to have been a settlement instruction entered into an EU CSD for the penalty to have been triggered).
- Note that the regime includes two categories of penalty:
  - late matching fail penalties: applied to any instruction matched after the relevant deadline on the intended settlement date; and
  - settlement fail penalties: applied to any matched instruction that fails on the intended settlement date onwards.
- Although the two categories of penalty follow a similar methodology, it is important to bear in mind that late matching fail penalties could apply to receiving parties that delay on entering instructions.
- Penalties will stop being applied once a buy-in process concludes or settlement occurs.

Mandatory buy-ins

- A mandatory buy-in process will automatically be initiated on the business day following a specific "extension period" of a fail beyond its intended settlement date. The extension period is as follows:
  - four business days for liquid shares;
  - fifteen days for securities traded on SME growth markets; and
  - seven business days for all other instruments.
- Importantly, there is no optionality involved in the timing of commencement of the buy-in procedure (this is a change from current practice, where buy-in would generally be optional in nature).
- Responsibility for the buy-in will vary depending on whether the trade is cleared, executed through trading venue, or executed OTC, as outlined in the section on buy-in procedures below.

Suspension / public censure

A participant will risk triggering suspension where it falls within the category of "consistently and systematically failing to deliver". This would be the case where its rate of settlement efficiency (determined by reference to either the number or the value of settlement instructions), is at least 15% lower than the rate of settlement efficiency of the securities settlement system in question, during at least 10% of days of activity over the course of a year.

How will cash penalty rates apply in practice?

- The penalty rate that is applied will be calculated according to a prescribed methodology, and will vary depending on the market value of the instrument, and also on its liquidity (in other words, penalties will be set at a higher rate for more liquid instruments that should in theory be more straightforward to settle, as set out below).
- CSDs will be required to deposit cash penalties into a dedicated account and distribute them to receiving participants affected by settlement fails. In other words, CSDs will not be entitled to retain the penalties for use within their own business.

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4 See Article 36 of the Delegated Regulation and definition in MiFID II.
Compliance Planning: What Will Firms Need to Consider?

Firms planning for implementation of the buy-in rules will first need to scope the impact of the rules in terms of affected trades and trading relationships, and will then need to consider what proactive steps they will need to take in negotiating documentary amendments and initiating operational build-out. To assist with this process, we have set out below a number of planning phases that will be broadly applicable to most trading firms.

A. Internal work streams

Firms will need to factor three general work streams into their planning matrix:

- **Documentation**: A key feature of planning for legal teams will be assessing when contractual amendments are likely to be required as a result of CSDR implementation. As part of this analysis, it will be worth giving thought to which relationships are likely to be governed by standard form revisions to documentation or amendments to market infrastructure rules, and, conversely, when proactive negotiation on bilateral contracts may be necessary.

- **Economics**: the economic impact of cash penalties and the buy-in process on trading strategies will need to be modelled in the run-up to implementation, particularly for higher-volume traders.

- **Operational build-out**: the operational aspects of compliance, which will require buy-in from the broader business, will need to be initiated and tested within a reasonable period prior to implementation.

B. Timing

Having already been postponed once, the settlement discipline rules are now set to enter into force in the EU on 1 February 2021.

Whilst firms should therefore plan on a go-live date of February next year for trades that settle through EU27 CSDs, compliance teams should monitor whether this is subject to any further delays. There is ongoing lobbying around deferrals to buy-in rules in particular, although to date, ESMA has taken the position that the rules should be implemented on time.

C. Scoping the impact

As a threshold matter, firms will need to scope out which transactions and which entities within their group are in-scope of the new requirements.

**In-scope trades**

The settlement discipline requirements will apply directly to transactions in the following instruments where those transactions are settled on an EU CSD (e.g., Clearstream or Euroclear):

- transferable securities (e.g., shares and bonds);
- money-market instruments;
- units in funds and collective investment schemes; and
- emission allowances.
Note, however, that the application of the cash penalties and buy-in requirements will also depend on the instrument having been admitted to trading or traded on an EU trading venue, or the trade being cleared by a CCP. Although ESMA has not yet provided any guidance on the meaning of “traded on a trading venue” in this context, we would expect it to be defined by reference to the ESMA Financial Instrument Reference Database (“FIRDS”), which also sets the scope of transaction and trade reporting under MiFID II. Note, however, that dual-listed shares will be exempt from scope where their principal trading venue is located outside of the EU (in other words, if shares are listed on the ESMA register for exempted shares under the Short Selling Regulation, they will not fall within scope of the cash penalty or buy-in regime).

Therefore, firms should work on the basis that the cash penalties and buy-in regimes will apply to trades that are settled through an EU CSD and that also meet the following criteria:

- cleared by a CCP\(^5\);
- uncleared but executed on an EU trading venue; and
- uncleared and executed OTC in a class of instruments listed on FIRDS.

**Application to derivatives**

Although transactions in derivatives are not themselves within scope of the settlement discipline rules, derivatives may be impacted where they reference securities or other instruments that are within scope of the rules. Where such derivatives may be physically settled, unless there is guidance to the contrary, counterparties will need to consider the application of the settlement discipline rules (i.e., given that settlement of the underlying security could be required).

There is also a question as to whether margin transfers of in-scope instruments could be caught by the new settlement discipline rules; so, for example, transfers of sovereign debt used as collateral in connection with a derivative transaction may need to be considered as part of each firm’s CSDR roll-out. Although it is possible that future ESMA guidance will scope margin transfers out of the requirements, it is clear that the Delegated Regulation on settlement discipline\(^6\) takes a broad approach to defining a “transaction” (it refers to “collateral management operations”, for example).

**Application to SFTs and repo trades**

The definition of a “transaction” in the Delegated Regulation refers to securities financing transactions, and it is clear that repurchase agreements (aka “repos”) are, for example, intended to be within scope. Although there is an exemption from the buy-in regime for shorter-dated trades that settle within thirty business days, there are still open questions around how this exemption will operate in relation to “open” repo trades (i.e., rolling trades that can be settled at any time, and which could in theory extend beyond thirty days).

As we will explore below, the settlement discipline rules could also operate more generally to decrease available market liquidity in the repo markets.

**In-scope entities**

There will be some work for larger corporate groups to do in assessing exactly which corporate entities could be brought within scope of the new rules, whether directly or contractually, given that any entity will be affected in some way where its trades settle through an EU CSD (whether directly as CSD members, or indirectly through a settlement or clearing agent).

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5 Note that the term “CCP” has not been limited to EU CCPs.

D. Initiating documentary amendments

The Delegated Regulation makes clear that “parties in the settlement chain” must establish contractual arrangements that incorporate and formalise the settlement discipline requirements. In addition, parties must ensure that these contractual arrangements are “enforceable in all the jurisdictions to which parties in the settlement chain belong”. The Delegated Regulation is not prescriptive on exactly which steps parties will need to undertake to demonstrate enforceability, but this may in practice need to be achieved through an opinion to the effect that the relevant documentation is legal, valid and binding.

In practice, much of this new contractual framework will slot into place as a result of revisions to the rulebooks of CSDs, CCPs and trading venues, and amendments to the standard terms on which brokers, clearing members and other intermediaries provide their services. There will be limited room for negotiation in many of these situations, but buy-side firms should ensure that they have a system in place for monitoring amendments, and that, where appropriate, they seek to ensure that revisions to terms of business are reciprocal in nature. Trading firms may also consider approaching others in the market over the next few months to understand their approach to documentary amendments, in order to give them more time to negotiate if required.

Importantly, all trading firms should make themselves aware of situations where:

a) they may need to take the initiative in amending documentation; and

b) bilateral trading agreements need to be amended (making it more likely that there will be room for negotiation between the counterparties).

Some thought will, in particular, need to be given to how buy-in rules should be factored into OTC trades that are not executed on-venue. Any intra-group settlement arrangements may also need to be revised with a view to compliance with settlement discipline rules.
Points to Consider: Revisions to Standard Terms

- In general, contractual amendments will need to be reviewed against the terms of the CSDR and Delegated Regulation, and basic issues such as whether the appropriate universe of trades has been identified, or whether the drafting is instead overbroad, will need to be considered and addressed.

- For example, amendments to broker and custodian terms and conditions should reflect their clients’ need to receive the necessary information on settlement failures and the various steps involved in the buy-in process.

- Trading firms should also be aware that CSD participants, clearing members and other intermediaries may aim to pass on cash penalties via contract where they perceive their client as being in some way responsible for the settlement fail, and any such terms should be scrutinised closely.

Points to Consider: Revisions to Bilateral Terms

- Although trade bodies such as the FIA are giving thought to how standard documentary amendments should look, some judgment will still need to be exercised in incorporating any standard form revisions into existing agreements.

- Particular questions will arise, for example, in relation to how the settlement discipline rules will interact with default provisions in documentation, and how the rules on delivery of cash compensation in an insolvency situation should be reflected contractually.

- Counterparties to physically settled derivative transactions requiring the delivery of in-scope securities may also consider whether and when cash settlement may be a viable option to avoid the application of the buy-in process.

- Finally, particular thought will need to be given to repo and SFT documentation; for example, the question of whether and how buy-in costs are passed on through GMRAs or GMSLAs will need to be negotiated.

- Given that a number of aspects of the regime’s application to repos generally are still unclear, the market will need to take a view on these issues and reflect that view in the documentation if no regulatory guidance is forthcoming. For example, parties will need to determine whether, if they buy-in against the start-leg of their repo, the end-leg remains valid. In other words, parties will need to consider questions such as: should only the start leg be cancelled, or should the entire trade be cancelled? What occurs in the event that a buy-in relating to the start leg results in cash compensation?
E. Modelling the impact on the pricing/economics of trades

For firms that trade securities in higher volumes, some work may need to be done around assessing the monetary impact of the new rules on trading activities, e.g., by reference to the firm’s current rate of settlement failure. For example, the impact of cash penalties and buy-in costs will need to be assessed, along with the economic impact of the asymmetrical manner in which buy-in cash flows are settled (see below). However, what will be considerably more difficult to model is the impact that the introduction of settlement discipline rules will have on market liquidity, and ultimately on the pricing of securities.

Why could pricing be affected? There is evidence that the introduction of buy-in rules will directly increase pricing in liquid equities (see ICMA’s Impact Study for CSDR Mandatory Buy-ins, for example)\(^7\). Markets in less liquid instruments, on the other hand, could see liquidity providers being incentivised to provide offers solely in relation to securities they actually hold. This is partly the result of increased risks that market makers face in connection with securities lending arrangements; simply put, if a liquidity provider agrees to sell securities it has lent out and those securities are not returned in time, the liquidity provider will run the risk of being bought-in, which is particularly problematic in a falling market. These dynamics could in turn lead to a reduction in the capacity of market makers to provide liquidity, with an associated impact on pricing.

Quantifying the impact of cash penalties

The rate of cash penalties applied will change depending on the type of security involved, as set out in the table below:

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Cash penalty rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquid shares</td>
<td>1.0 basis points</td>
</tr>
<tr>
<td>Illiquid shares</td>
<td>0.50 basis points</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>0.20 basis points</td>
</tr>
<tr>
<td>Government and similar bonds</td>
<td>0.10 basis points</td>
</tr>
<tr>
<td>SME growth instruments (excluding debt)</td>
<td>0.25 basis points</td>
</tr>
<tr>
<td>SME debt instruments</td>
<td>0.15 basis points</td>
</tr>
</tbody>
</table>

F. Operational build-out

In addition to operational adjustments that may be required to ensure prompt delivery of data in accordance with the CSDR rules on allocation, confirmation and matching instructions, firms with higher trading volumes may choose to consider what would be required to raise their existing settlement standards, with a view to limiting the economic impact of the settlement discipline regime. A first step will be to assess current rates of settlement efficiency, understanding the primary reasons behind situations where trades fail to settle on the intended settlement date, and then assessing whether there is any scope to reduce settlement fails. Some operational points that may need to be considered with a view to raising settlement standards are:

- Ensuring that data relevant to the settlement process is delivered in a timely and accurate manner. This may involve looking at where data failures occur and ensuring that static data is accurate, the correct messaging formats are used, and ensuring that the necessary procedures are put in place to ensure that settlement instructions are not released with inaccuracies.
- Ensuring that the necessary steps are taken to ensure more effective management of the firm’s inventory, where relevant.
- Ensuring that the necessary data on open trades and positions is being delivered within the necessary timeframe by the firm’s CSD or settlement agent.
- Reviewing the settlement fail rates of brokers and custodian banks.
- Ensuring that there is an effective process in place for complying with and responding to updates in the procedures of the firm’s CSD and other relevant bodies such as SWIFT and TARGET2.
Buy-In Deep Dive

A. Conventional Buy-ins vs. Mandatory CSDR Buy-ins

What is a buy-in?

In basic terms, buy-in mechanisms are intended to provide a buyer of securities with the right to source those securities elsewhere in the event that settlement fails, generally for guaranteed delivery. The original trade will be cancelled as a result, and the two original counterparties will need to settle any difference in price between the cost of original transaction and the buy-in transaction.

It is important to note that contractual buy-in mechanisms already exist in the market. However, there are a number of differences between those buy-in mechanisms that are currently adopted in the market (e.g., under the ICMA Buy-In Rules) and the new regulatory framework that will effectively require parties to rely on buy-ins in the event of a settlement fail. In addition, although there is already a regulatory buy-in framework in place under the EU Short Selling regime, it is far more limited than will be the case under the CSDR and applies solely to shares cleared by a CCP.

This departure from the status quo goes some way to explaining why the adoption of CSDR settlement discipline rules met with controversy, and why they will be a significant change for parties throughout the settlement chain.

Differences between typical contractual buy-ins and CSDR mandatory buy-ins

Optional buy-ins vs. mandatory buy-ins: Across much of the market, buy-ins would generally be structured as optional contractual remedies (in other words, commencing a buy-in procedure is a right rather than an obligation). This differs from CSDR mandatory buy-ins, where the buy-in process is required to be commenced following the expiry of the relevant extension period.

This is a key difference, given that: (i) receiving parties are currently able to give themselves more time to negotiate with the failing party before executing a buy-in; (ii) the receiving party can currently choose to execute the buy-in at a time when liquidity is at a comparatively advantageous level; and (iii) the discretionary nature of timing currently allows for one single buy-in to address multiple fails, which may not be the case with mandatory buy-ins under CSDR (see below).

Buy-ins as a penalty mechanism: Conventional buy-ins are also not intended to function as a penalty mechanism designed to discourage settlement failure; instead, they are generally underpinned by the principle that the economics of the original trade should be preserved to the greatest extent possible, with the parties to the original transaction being restored to their original position. For example, the differential between the new buy-in price and the original transaction may be settled in either direction (depending on whether the buy-in price is higher or lower). Under the CSDR, on the other hand, the process is asymmetrical in the sense that the payment of any differential can only be made in one direction: from the failing party to the receiving party.

Mandatory buy-in agent: Under the CSDR regime, the parties will be required to appoint a buy-in agent to source the securities for the receiving party at the best available price. Although buy-in agents are traditionally a feature of the buy-in process, they are not always used, given that trading firms at times encounter difficulties in sourcing market makers and other liquidity providers to act as agents (bearing in mind that this role would generally involve agreeing to guaranteed delivery).
There are therefore questions around how brokers and liquidity providers will be incentivised to take on this role under the mandatory CSDR regime, and how their appointment will affect the economics of transactions.

Requirement for cash compensation:
Under the CSDR process, if the initial buy-in fails, the receiving party may initiate one further attempt at a buy-in. Otherwise, however, the process will result in "cash compensation", where the trade is cancelled and the failing party makes a payment to the receiving party set by reference to the market value of the instruments and based on a methodology set out in the Delegated Regulation. While cash compensation is a possible outcome of conventional buy-ins, it is not currently mandatory, and trading firms will need to consider how this shift will affect their trading activities in practice. For example, where the receiving firm has entered into hedging or other positions contingent upon taking delivery of the securities in question (e.g., FX derivatives, IRS or CDS trades), these positions may need to be unwound where it has simply received cash compensation. There will effectively also be a degree of economic risk involved, depending on the reference price used to calculate the cash compensation.

No pass-on mechanism:
Conventional buy-ins (e.g., under the ICMA rules) generally allow for one single buy-in to settle a chain of settlement fails across various intermediaries as well as the ultimate buyer and seller of the securities in question. However, the new CSDR buy-in rules will make this far more difficult, given that each settlement date within a transaction chain will trigger its own independent buy-in, with no discretion around timing. Thus, there is a question as to whether parties will choose to trigger a contractual buy-in process ahead of the mandated timeline, in order to avoid each settlement date in the transaction chain producing its own separate buy-in.

B. How will responsibility for buy-in procedures be allocated?

Cleared trades
For cleared trades, the buy-in process will be operated by the CCP.

- On the business day following the expiry of the extension period, it will be the CCP’s responsibility to verify whether a buy-in is possible.
- Where a buy-in is not possible, the CCP will notify the failing clearing member of the necessary cash compensation amount.
- Where a buy-in is possible, the CCP will either launch an auction or appoint a buy-in agent and will notify both the failing and receiving clearing members of this.
- The CCP will then have responsibility of: (i) notifying the results of the buy-in to the failing and receiving clearing members and the relevant CSD; (ii) ensuring that any bought-in financial instruments are delivered to the receiving clearing members; and (iii) overseeing that settlement instructions are updated in line with the buy-in procedure.

Documentation impact
May include amendments to CCP rulebooks and agreements with clearing members.
Uncleared trades executed on a trading venue

Although the buy-in process will need to operate consistently with the rules of the trading venue, it will be the members of the trading venue themselves that are responsible for ensuring that the buy-in process is implemented, with the receiving member taking responsibility for commencing the process and appointing a buy-in agent.

- Receiving CSD participants (through their clients) will be required to inform receiving trading venue members of any settlement fails without undue delay.

- On the business day following the expiry of the extension period, the receiving trading venue member will need to verify whether a buy-in is possible.

- Where a buy-in is not possible, the receiving trading venue member will need to notify the failing trading venue member of this, along with the cash compensation amount.

- Where a buy-in is possible, the receiving trading venue member will need to appoint a buy-in agent on the business day following the expiry of the extension period and notify the failing trading venue member that this has been done.

- The failing trading venue member will then need to ensure that any relevant settlement instructions are put on hold. Following this point, it may only deliver the financial instruments with the consent of the buy-in agent.

- The receiving trading venue member will be required to notify the results of the buy-in to the failing trading venue member and to the relevant CSD, and the amount of cash compensation in the event that the buy-in has not been successful.

- Both the receiving and the failing trading venue members will be responsible for ensuring that the settlement instructions relating to the trade are revised accordingly.

Documentation impact

May include amendments to direct market access documentation and trading venue rulebooks.

Uncleared OTC trades

The receiving trading party will be required to commence the buy-in process and appoint the buy-in agent.

- Receiving CSD participants (through their clients) will be required to inform receiving trading parties of any settlement fails without undue delay.

- On the business day following the expiry of the extension period, the receiving trading party will need to verify whether a buy-in is possible.

- Where a buy-in is not possible, the receiving party will need to notify the failing party of this, along with the cash compensation amount.

- Where the buy-in is possible, the receiving trading party will need appoint a buy-in agent on the business day following the expiry of the extension period and notify the failing trading party that this has occurred. The failing trading party will then need to ensure that any relevant settlement instruction relating to the settlement fail is put on hold.

- The receiving trading party will then need to notify the results of the buy-in to the failing trading party, including either the quantity and price of the bought-in financial instruments if the buy-in was successful, or the cash compensation amount if not.

- Both the receiving and failing trading parties will then be responsible for ensuring that settlement instructions are updated.

Documentation impact

As above, revisions to trading documentation will be necessary.

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Note that this process may also need to be adapted to trades that are executed through a non-EU trading venue.
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