

Regulatory Technical Standards on the CSD Regulation The Operation of the Buy-in Process

Prague, 3 August 2015

This paper constitutes CSD Prague's response to the ESMA Consultation Paper of 30 June 2015 on "Regulatory Technical Standards on the CSD Regulation: The Operation of the Buy-in Process" (ESMA/2015/1065).

Summary

If we compare all three options put forward in the Consultation Paper we believe that that option 1 is the most suitable. Buy-ins would be managed by the trading counterparties without the requirement that CSDs and their participants would have to play an active role. Certainly the option 1 has practical difficulties, but on the other hand it would limit the amount of risk to which we and our participants would be exposed.

Other two options would be problematic for us mainly in case of CSD links and could force us to collect margins from participants. We do not think that CSDR should increase risk profile of CSDs and move them to positions of CCPs. Also participants would have to manage their risk and all CSD's participants would start playing a role of General Clearing Member for their clients. We are sure that this situation would increase costs and decrease efficiency of settlement and the highest impact would be on cross-border settlement.

Q1: Please provide evidence of how placing the responsibility for the buy-in on the trading party will ensure the buy-in requirements are effectively applied.

Please provide quantitative cost-benefit elements to sustain your arguments.

We believe that also in case of the first option CSD's participants and their intermediaries will have strong incentive to ensure an appropriate contractual framework, because all penalty fees or cash compensations will be debited from an account of a participant despite a lack of final liability. Their clients will also have an incentive to protect themselves via appropriate contractual arrangements if they do not wish to be liable towards the CSD participants for fails caused by their own underlying clients. Having an appropriate contractual framework will also be a legal requirement going forward, so we expect all parties in the chain will have to set out such a framework for their own internal compliance reasons.

Q2: Please indicate whether the assumption that the trading party has all the information required to apply the buy in would be correct, in particular in cases where the fail does not originate from the trading party, but would rather be due to a lack of securities held by one of the intermediaries within the chain.

Our participants are informed about failed settlement instructions, and are therefore able to communicate this information to their own clients. When a buy-in is triggered by the trading counterparty suffering from the fail, the CSD participant (and its own clients) will have an incentive to identify the responsible party in the chain in order to pass on the costs of the buy-in. If the client of a CSD participant is not itself liable for the failed delivery, it will seek to charge the cost of the buy-in or cash compensation to its own client, and so on until the intermediary responsible for the fail is identified.

Q3: Should you believe that the collateralisation costs attached to this option are significant, please provide detailed quantitative data to estimate the exact costs and please explain why a participant would need to collateralise its settlement instructions under this option.

We are not able to estimate the valid costs of such a requirement, but we believe that it can be significant amount. Our participants should answer this question accurately.

Q4: If you believe that option 1 (trading party executes the buy-in) can ensure the applicability of the buy-in provisions are effectively applied, please explain why and what are the disadvantages of the proposed option 2 (trading party executes the buy-in with participant as fall back) compared to option 1, or please evidence the higher costs that option 2 would incur. Please provide details of these costs.

The option 2 would require our participants to take collateral from clients to protect themselves against the associated settlement risk. Such collateral requirements would have an adverse impact on market efficiency and liquidity, thus increasing the cost of settlement without providing the guarantee that this would effectively help to foster buy-in execution. This option would mean also for us new risks and liabilities due to our link with other CSDs, because we would be under the same terms and conditions as all other participants. We would have to create and enforce a pre-positioning functionality (requiring that securities be prefunded by requesting participants before the settlement instruction is sent to the receiving CSD) and to collect margins from participants in order to protect ourselves. The need for such collateralisation would certainly dis-incentivise cross-CSD links and would mean for us additional implementation costs.

Q5: Please provide detailed quantitative evidence of the costs associated with the participant being fully responsible for the buy in process and on the methodology used to estimate these costs.

We are not able to estimate these costs incurred by our participants, but for us it would mean implementation and operation costs in circa hundreds of thousands EUR.

The main advantage of this option is that it would reflect the CSD's contractual framework, i.e. the fact that the delivery arising from the buy-in must be made by the CSD participants. Therefore it makes participants accountable for promptly acting in the interest of their clients, e.g. by seeking a bilateral cancellation or by executing the buy-in. On the other hand we do not agree that our national competent authority (NCA) will have the ability to ensure the buy-in rules are appropriately applied. The NCA itself will often not be the competent authority for many of our participants, and will only be able to penalise us and not our participants in case of a breach. If our participant does not abide by the buy-in requirement contained in the CSD internal rules, the CSD itself cannot force the participant to pay the cash compensation or the costs of the buy-in.