

22 May 2014

Dear Sirs

**Responses to Draft Technical Standards for the Regulation on improving securities settlement in the European Union and on central securities depositories (Regulation)**

We offer comments on:

- (1) the confirmation, allocation and matching process; and
- (2) trading and settlement fails in relation to fixed income products.

As a general observation, we consider that the technical standards could helpfully confirm the interpretation that the Regulation applies only to trades settled at an (I)CSD established within the European Union.

To further support the work of ESMA on the Regulation, Trax has a considerable amount of historical information regarding fixed income liquidity and would be pleased to provide more detail.

Further information on MarketAxess and Trax is provided in Appendix 1.

**Q1: Which elements would you propose ESMA to take into account /to form the technical standards on confirmation and allocation between investment firms and their professional clients?**

We agree that the trade confirmation and allocation process is a fundamental enabler for market participants to successfully comply with T+2 settlement cycles.

There are a number of key elements which will work together to ensure the process is optimal:

- 1) *Promote electronic/confirmation systems.* Manual solutions such as fax and emails increase both the chance of errors occurring, as well as the operational cost of achieving a confirmation. Automated solutions can also significantly reduce the time taken for a

confirmation to be achieved. In this way electronic solutions serve to achieve the objectives set out in paragraph 10 of the Discussion Paper.

- 2) *Allocation and Confirmation should be as close to real time as possible.* The sooner a trade is confirmed the more likely it is to settle correctly, as there is a greater window to manage any exceptions that may occur. If confirmations are achieved on trade date (ideally within the first fifteen minutes following trade execution<sup>1</sup>) there will be adequate time to manage any exceptions.
- 3) *Inclusion of both fund level economics and settlement instructions in confirmations.* Incorrect settlement instructions are the most likely reason for trade failures. Confirmations should aim to capture the legal entity being traded with. If the confirmation is at fund level (rather than block level) and includes all the economic details of the trade<sup>1</sup> as well the settlement instructions, it will reduce the number of fails post T+2.
- 4) *Harmonisation of scope for confirmations.* The current practice of excluding certain asset classes from confirmations creates gaps and inefficiencies in processing. Further, while OTC trades will not be required to settle on T+2, the likelihood is that as the industry looks to harmonise the settlement process, these trades will also settle on T+2 and should therefore be subject to the same confirmation standards as trades executed on a regulated market or trading venue.

### **Q3: ESMA welcomes concrete proposals on how the relevant communication procedures and standards could be further defined to ensure STP.**

It is worth noting that confirmation providers already have existing solutions which can be leveraged solutions for use prior to CSD submission of the trade.

- 1) *Real time<sup>2</sup> automated confirmations prior to CSD submission.* This reduces the numbers of errors in the settlement process by providing exception management tools in real time.
- 2) *Confirmation of trades across different CSDs.* A confirmation provider can streamline the process by harmonizing the error capture and repair process within firms. These upstream checks centralise and streamline the trade validation process reducing the likelihood of exceptions arising within the CSD.
- 3) *Use of a unique transaction ID on a confirmation and the communication the CSD.* This will enable CSDs and firms track back through the life cycle of a trade and identify whether a

<sup>1</sup> Suggested fields are set out in Appendix 2

<sup>2</sup> Within 15 minutes or near to real-time

trade has been confirmed successfully. This will lead to greater efficiency in managing unmatched transactions in the CSD.

- 4) *Promotion of direct links between confirmation/allocation vendors and CSDs.* This will promote market efficiency and allow transactions to be sent immediately following a confirmation to the CSD.

**Q4: Do you share ESMA's view that matching should be compulsory and fields standardised as proposed? If not, please justify your answer and indicate any envisaged exception to this rule?**

We are supportive of the move towards matching and standardised fields, but we are of the view that it is not necessary for this function to be performed in the first instance by the CSDs because allocation & confirmation can (and is) better performed in advance of the submission to the CSDs.

Requiring CSD's to match in real time will necessitate widespread expenditure in the industry as CSDs upgrade their infrastructure.

Confirmation providers already have existing solutions to ensure that the matching occurs as soon as possible, all as set out in the response to Q3.

**Are there any additional fields that you would suggest ESMA to consider? How should clients' codes be considered?**

Additional fields to match in addition to those suggested should include:

- LEI (legal entity identifier) of the counterparty to highlight the settlement rates at a participant level.
- A UTI (unique trade identifier) to enable tracking of trades throughout their lifecycle. Participants would then be able to track exceptions in the CSD back to the trade confirmation and to front office systems.
- Settlement Currency
- Underlying client, due to their widespread industry adoption, LEIs should be used as the client identifier.

**Q5: Do you agree with the above proposals? What kind of disincentives (other than monetary incentives such as discounts on matching fees) might be envisaged and under which product scope?**

If the confirmation process is utilized on a near to real-time basis prior to matching within the CSD, settlement fails are likely to reduce. Therefore, focusing on the *accuracy* of trade submission to the CSD rather than just the timeliness, is a key driver towards settlement efficiency.

More accurate submissions to the CSD would reduce the amount of effort required to resolve issues and have the net effect of ensuring more trades are able to match sooner. Based on data available to Trax, the industry should be able to adopt a code of practice that strives to achieve allocation and confirmation within 15 minutes of the transaction time.<sup>3</sup>

**Q.6 In your opinion, should CSDs be obliged to offer at least 3 daily settlements/batches per day? Of which duration? Please elaborate providing relevant data to estimate the cost and benefit associated with the different options.**

Three batches per day would require allocation and confirmation in real-time before it gets to the batched processes. Allocation and confirmation before submission to the CSD reduces any immediate need to increase this frequency.

**Q9: Do you agree with the above monitoring system description? What further elements would you suggest? Please present the appropriate details, notably having in mind the current CSD datasets and possible impact on reporting costs.**

These reports referred to in Article 7(1) are very high level. If the reports are the trade level and include the UTI of the trade it would provide the ability to easily tie a trade back through various systems and identify the root cause of fails.

**Q13. CSDR provides that the extension period shall be based on asset type and liquidity. How would you propose that these be considered? Notably what asset types should be taken into consideration?**

We agree that the ability to successfully manage buy-ins is to a large extent determined by liquidity in the market. It is important that the rules on buy-ins reflect this. Through data available to Trax we have meaningful insight on bond activity across Europe<sup>4</sup>.

<sup>3</sup> Based on data available to Trax, we estimate that 65% of fixed income trades are submitted to it within 15 mins of stated execution times

<sup>4</sup> Trax data is estimated to cover around two thirds of activity in the European fixed income market – the information cited in this response information is based on a sample of Trax data in appendix 3

*Government Bonds:* As you note, a longer buy-in period is the practice today in the Government bond market. Based on our sample data, less than half of government bonds trade less than five times a day<sup>5</sup>.

*Corporate Bonds:* The corporate bond market is even less liquid than government bonds. 86% of corporate bonds trade less than five times a day. We are concerned that mandatory buy-ins in the corporate bond market four days after Intended Settlement Date may well result in further fails.

As a consequence, we believe that at a minimum, the same extension period should apply to both government and corporate bond markets.

**Q14. Do you see the need to specify other minimum requirements for the buy-in mechanism? With regard to the length of the buy-in mechanism, do you have specific suggestions as to the different timelines and in particular would you find a buy-in execution period of 4 business days acceptable for liquid products?**

Please see answer to Q.13 -regarding Corporate Bonds, which should have a buy-in period of at least 7 days.

**Q15. Under what circumstances can a buy-in be considered not possible? Would you consider beneficial if the technical standard envisaged a coordination of multiple buy-ins on the same financial instruments? How should this take place?**

Para 53 notes that buy-ins are often executed at the 'CCP or trading venue level'. However, this is currently not the practice in the bond markets.

It is difficult to envisage how trading venues could provide effective buy-in facilities with the current market structure for bonds, due to:

- 1) the multiplicity of trading venues; and
- 2) bilateral trading (where the venue has no visibility and no involvement at all in the settlement activity of the trades occurring over the system)

These characteristics mean that a particular trading venue does not have the necessary information on failures or related trades. As a consequence, in the bond markets currently, a trading venue operating the above model is not able to effect a buy-in. Following MiFID II it will not be possible for a trading venue to be a counterparty to a trade in any event.

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<sup>5</sup> See appendix 3

Furthermore, there is no material CCP involvement in the bond markets currently. Consequently, the only entity with the information relevant to effect a buy-in in the bond market would be the CSD and the counterparties to the trade.

**Q17. Do you agree with the proposed approach? How would you calculate the reference price?**

We agree fully with the approach laid out in relation to cash compensation should a buy-in not be possible.

In the corporate bond market, some further flexibility in how the reference price is calculated may be necessary. For many issues, a composite price will need to be calculated based on recent traded activity and available quotations in similar securities.

**Q18. Would you agree with ESMA's approach? Would you indicate further or different conditions to be considered for the suspension of the failing participant?**

We agree with the approach suggested in relation to basing suspension on the thresholds proposed (percentage fails of value and volume) over a period of time.

These are the key issues to consider further.

- 1) *Disconnect between trading and settlement counterparties.* Participants on the trading venue are not necessarily the same as the participants in the securities settlement system. I.e. in term of 'participants', settlement is disconnected from execution on the venue. Many of the participants on our MTF outsource their settlement activity and will not themselves be the participants in the securities settlement system. As discussed further below in response to Q.20, linking settlements back to trading activity cannot therefore occur, without major change to the post-trade infrastructure. We question whether or not suspension of participants on trading venues will achieve the desired result and suspension of participants on MTFs could instead achieve the unintended consequence of transfer of business to be executed off venue (fully OTC).
- 2) *Lack of Involvement of the MTF in settlement.* We refer to our response to Q15. Given the lack of involvement of the trading venue with settlement (a prohibition which will become mandatory for MTFs post MiFID II) an MTF will be completely reliant on information provided to it by (I)CSDs or the Competent Authority in order to suspend one of its participants for repeated failure to settle. It should be incumbent upon the CSDs to police and/enforce the settlement fails. The discipline for failure should also be a matter for the

Competent Authority. For a trading venue such as an MTF to take any action, the information to be provided to the MTFs should be clear and unequivocal (a direction to suspend participant X) based on the information available to the (I)CSD.

- 3) Suspension of participants on MTFs would likely lead to transfer of business to be executed on a bilateral, OTC basis.

**Q20. What is in your view the settlement information that CSDs need to provide to CCPs and trading venues for the execution of buy -ins? Do you agree with the approach outline above? If not please explain what alternative solutions might be used to achieve the same results.**

We refer to our answer to Q.18

In common with other electronic execution venues for corporate bonds, we are not a participant in any securities settlement system.. We welcome the drive towards greater settlement discipline and believe it will be a helpful driver in promoting straight through processing. However, as explained above in our response to Q 18; (i) the ability of an MTF to suspend its participants for poor settlement performance will be entirely dependent on the relevant information being provided from (I)CSDs or the Competent Authority; and (ii) given that the MTF is not involved in settlement and, post MiFID II, cannot be itself a counterparty to a transaction, it is not clear how an MTF will be able to enforce, manage or monitor a buying in regime.

As you note, this information will also need to map participants at the trading venue to the settlement agents who are participants at the relevant (I)CSD/securities settlement system. The proposed solution, whereby participants segregate (I)CSD accounts by trading venue and trading participant could only work if the (I)CSDS were obliged to provide the trading venues with the relevant information linking the fail back to the *actual participant* on the trading venue.

We are concerned that the effect of this approach may actually be contrary to the overall policy objective. In particular, when trading participants buy and sell on different venues, we are concerned that settlement may be disrupted by an additional step as securities are repositioned between accounts. Furthermore, as noted above, such an approach will likely drive business increasingly towards OTC execution off regulated trading venues.

We believe that a solution needs to be further investigated in which settlement instructions and confirmations carry a reference to the trading platform on which the underlying trade was executed.



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## **Appendix 1**

### **Background**

**Trax** is a leading provider of capital market data, trade matching and regulatory reporting services to the global securities market. In 2013 Trax processed 1.12 billion transactions on behalf of its user community and has over 25 years' experience in providing innovative, secure and reliable systems for the financial services sector.

**MarketAxess Europe Limited** operates a leading fully electronic platform that enables fixed-income market participants to efficiently trade corporate bonds and other types of fixed-income instruments, and is authorised and regulated as an MTF Operator.

## Appendix 2

### Confirmation Fields

- Originating firm
- Counterparty
- Fund Identifier (where applicable)
- Security Identifier (ISIN code)
- Quantity
- Price
- Currency
- Trade Date
- Buy/sell indicator
- Settlement Date
- Settlement Amount (Net Cash)
- Settlement Currency
- Place of Settlement
- Delivery vs. payment/free of payment
- Delivering agent BIC
- Delivering agent account
- Receiving agent BIC
- Receiving agent account
- Delivering custodian BIC
- Delivering custodian account
- Receiving custodian BIC
- Receiving custodian account

**Appendix 3**  
**Sample Data from Trax**<sup>®</sup>

<u>Reporting Period</u>	<u>MARKET</u>	<u>ISSUER CATEGORY</u>	<u>Number of Bonds which traded less than 5 times per business day</u>	<u>Number of Bonds which traded greater than or equal to 5 times per business day</u>	<u>% of Bonds which traded less than 5 times per business day</u>	<u>% of Bonds which traded greater than or equal to 5 times per business day</u>
2013	secondary	Corporations (Financials and Non-financials)	707,495	130,202	84%	16%
2013	secondary	General Government	105,904	114,491	48%	52%