## KDPW response to the ESMA Consultation on Draft Regulatory Technical Standards on the CSD Regulation - The Operation of the Buy-in Process

With this paper KDPW would like to present its comments to the ESMA proposal of regulatory technical standards on buy-ins presented in 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), including responses to the questions raised in the Consultation Paper, as well as specific comments related to the wording of the proposed standards.

# Response to the consultation questions

***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.***

KDPW agrees with the strenghts of option 1 presented in paragraph 13 of the Consultation Paper. In our opinion this option is less risky for CSDs than options 2 and 3, as it doesn’t involve their active role in the buy-in process.

In our opinion, the key to the successful application of this option is setting up an effective information and notification flow through the chain of intermediaries. From the CSD perspective, the greatest challenge is to ensure the effectiveness of such a flow, reaching beyond the level of CSD participants up until the trading counterparties, which would require harmonised and efficient communication channels among all parties involved, taking into account that:

* CSDs communicate with their participants, who in turn communicate with their clients, up until the trading counterparties. CSDs cannot be expected to communicate with trading counterparties directly as they might not have information on who they are, and as they have no contractual relationships with them;
* as a consequence of the above, CSDs cannot be held liable for the accuracy of the information provided to regulators or others as a result of article 17(3), as they will not be in a position to cross-check the information and should only be obliged to transmit the information provided.

As regards reporting to regulators, KDPW is of the opinion that CSDs should only have to report on those instructions for which a buy-in has been initiated, and not on the execution of buy-ins, which will be handled at trading level. Further reporting could however be provided by CSDs to regulators on instructions subject to a buy-in which are still pending in the settlement system after the defined buy-in execution period.

***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.***

KDPW participants are always informed about failed settlement instructions, and are therefore able to communicate this information to their own clients (although KDPW is not able to monitor this process, and the participant's client will not necessarily be the trading counterparty). In the case where the fail is not caused by the lack of securities on the side of the trading counterparty and the buy-in is triggered by the suffering party, KDPW expects it to be solved through the contractual arrangements among intermediaries, who will have an incentive to identify the responsible party in the chain in order to pass on the costs of the buy-in.

***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.***

Option 2 would require CSD participants to pay for the cost of a buy-in or for the cash compensation in case the failing trading counterparty does not fulfil its buy-in obligation. Thus, they will take collateral from their clients to protect themselves against the associated settlement risk.

KDPW cannot estimate the costs of such a requirement and believes that CSD participants are best placed to answer this question.

***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.***

Like option 3, option 2 would require CSD participants to take collateral from clients. 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.

Moreover, from a CSD perspective, options 2 and 3 have an additional disadvantage compared to option 1 as they could impose new risks and liabilities on CSDs acting as participants in other CSDs because of the operational links they have. A CSD establishing a link with another CSD becomes a participant in that CSD, subject to the same terms and conditions as all other participants. If options 2 or 3 are implemented, there is a risk that a CSD could be required, in its capacity as participant in another EU CSD, either to pay cash compensation or to execute buy-ins on behalf of its participants if they do not deliver securities on time. The risk that a CSD might be liable to pay for the cost of buy-ins on participants' securities would increase its risk profile and dis-incentivise cross-CSD links.

***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.***

KDPW agrees with ESMA that this option might be the most costly because it would require CSD participants to fully collateralise settlement instructions, but we cannot estimate the costs incurred by CSD participants in such a case and we believe that they are best placed to answer this question.

# Comments on the draft technical standards (Annex 2)

* **Art.12 (1)**

In our opinion the buy-in process should be initiated at the beginning of the business day following the elapse of the extension period, rather than at the end of that day. Initiation of the buy-in at the end of the day would cause undue delay of the process, as its execution would, in practice, take place no sooner than on the day following the buy-in initiation.

* **Art. 14 (5)**

KDPW would like to point out, that the proposal presented by ESMA does not specify how to ensure the applicability of this requirement in practice. In our opinion the initiation of the buy-in procedure should trigger blocking/holding of the failed settlement instruction in the CSD system. This would prevent the risk of double delivery, when settlement of the failed instruction would be effected in parallel with the delivery of securities resulting from the buy-in process.

* **Art.16**

KDPW suggests deleting article 16, as well as recital 8.

For legal and technical reasons, a CSD may not have the authority to force a partial, where a participant has not consented, nor have the operational ability to amend the failing instruction to activate a partial. For example the KDPW system currently does not make it possible for the CSD to amend the partial settlement indicator in an instruction. If a CSD participant does not opt for partial settlement, mandatory partial settlement in the case of buy-ins would force the CSD to create an amendment message to change the partial settlement indicator, thereby intervening in participants' transactions flows. Besides, the participant’s decision to opt-out from partial settlement might be taken in order to avoid the settlement of the failed transaction of a client using securities of other clients, deposited on the same collective clients’ account of the CSD participant (taking securities from the pool).

Taking into account the above arguments, KDPW is against imposing partial settlement irrespective of any contractual choice made by CSD participants, and we believe that participants will have an incentive to opt for partial settlement if they wish to minimise the need for buy-ins.