WMBA Response Draft Technical Standards for the Regulation on Improving Securities Settlement in the European Union in Central Securities Depositories (CSD)

1. Introduction

The Wholesale Markets Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) (jointly referred to in this document as the 'WMBA') are the European industry associations for the wholesale intermediation of organised venue and Over-the-Counter (OTC) markets in financial, energy, commodity and emissions markets and their traded derivatives. Our members act solely as intermediaries in wholesale financial markets and do not undertake any proprietary trading. As a result they are classified as Limited Activity and Limited Licence under BIPRU[1] in the UK where they carry out the vast majority of their activities regardless of home domicile of the individual holding companies. This functionality places them under either Article 95 (1) of CRR or Article 96 (1) of CRR) firms in respect of the current FCA classifications[2,3].

WMBA is fully supportive of ESMA's objectives of introducing standards that contribute to the settlement of transactions on settlement date and the reduction of the number of instructions that fail on the intended settlement date. Quicker and surer settlement with lowered opportunity for operational and settlement risk is singular to our members' business models. This is especially the case

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1. *BIPRU limited licence firm* [3] has the meaning in BIPRU 1.1.17 R (Types of BIPRU investment firm), which is in summary a *limited licence firm* that meets the following conditions:
   a) it is a *firm*; and
   b) its head office is in the *United Kingdom* and it is not otherwise excluded from the definition of *BIPRU firm* under BIPRU 1.1.7 R (Exclusion of certain types of *firm* from the definition of *BIPRU firm*).

   BIPRU limited activity firm[1]
   a) in the PRA Handbook: has the meaning set out BIPRU 1.1.11 R (Types of investment firm: Limited activity firms).
   b) In the FCA Handbook: has the meaning in article 96(1) of the *EU CRR*.

2. **Article 95 Own funds requirements for investment firms with limited authorisation to provide investment services**

   For the purposes of Article 92(3), investment firms that are not authorised to provide the investment services and activities listed in points (3) and (6) of Section A of Annex I to Directive 2004/39/EC shall use the calculation of the total risk exposure amount specified in paragraph 2.

3. **Article 96 Own funds requirements for investment firms which hold initial capital as laid down in Article 28(2) of Directive 2013/36/EU**

   For the purposes of Article 92(3), the following categories of investment firm which hold initial capital in accordance with Article 28(2) of Directive 2013/36/EU shall use the calculation of the total risk exposure amount specified in paragraph 2 of this Article:
   (a) investment firms that deal on own account only for the purpose of fulfilling or executing a client order or for the purpose of gaining entrance to a clearing and settlement system or a recognised exchange when acting in an agency capacity or executing a client order;
   (b) investment firms that meet all the following conditions:
      (i) that do not hold client money or securities;
      (ii) that undertake only dealing on own account;
      (iii) that have no external customers;
      (iv) for which the execution and settlement whose trans-actions takes place under the responsibility of a clearing institution and are guaranteed by that clearing institution.

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across those fixed income markets where we act as market arrangers in the 'Matched Principal' (which is just about all of them) model and IDBs are subject to a Basel Pillar2 charge for such risks.

The WMBA remains very concerned about the scope of the buy-in procedures and their potential impact on liquidity and costs in the post MiFID ll environment of formalised venue trading in which IDBs will fulfil most of the OTF participations. In parts this seems to readdress issues which we thought had been dealt with in the faulty Short Selling Regulation (SSR) level 2 and implementations. That is, that venues do not have the capital nor capacity to intervene in the markets as agent to a market participant who forms a client to the IDB. Details of these concerns are provided below.

The WMBA notes that it fully endorses the consultation replies by both the International Capital Markets Association (ICMA) and the European Banking Federation (EBF) in their entireties, and therefore does not intend to repeat those fulsome replies herewith.

Operation of the Appropriate Buy-In Mechanisms (Article 7(14) c

The CDS Regulation states:

a. *Article 7 3 – "…. Where a failing participant does not deliver the financial instrument referred to in Article 5(1) to the receiving participant within 4 business days or after the intended settlement date("extension period") a buy in process shall be initiated whereby those instruments shall be available for settlement and delivered to the receiving participant within an appropriate timeframe*
b. *Article 7 10 b - " For transaction **not cleared by a CCP** but executed on a **trading venue,** the trading venue shall include in its internal rules an obligation for its members and its participants to be subject to the buy-in procedures as laid out in Article 3 of the regulation"*

The Current Consultation Paper states

a. *Para 52-".....As a consequence, buy-in procedures can be managed by a CSD, a Trading Venue or a CCP*

Under the definitions currently contained in MiFID ll when operating a Multi-Lateral Trading Facility or an Organised Trading Facility (previously classified as "Hybrid Trading) WMBA member firms will be classified as "Organised Trading Venues" and hence will be subject to the buy-in procedures of the CSD Regulations.

WMBA is concerned by the proposed buy-in mechanism in paragraph 52 of the discussion paper that states that "buy-in procedures can be managed by a CSD,CRR or a **Trading Venue**" for the following reasons:

a. It is unclear to WMBA the definition of "managed" and whether the trading venue would be required to sourcing and execute the trades in the market. It is also unclear whether managing by these category of firms is mandatory or what other firms can "manage" the buy-in process.

b. As stated above WMBA members act as pure arrangers in the wholesale markets, matching buyers and sellers of securities and do not have the authorisation under MiFID to undertake

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proprietary trading. Consequently any buy-in executed by WMBA members trading venues could only be executed by them as agent for their client. This will lead to confusion in the market in respect of the capacity in which the broker is acting in respect of an individual trade and the correct counterparty credit exposure. An 'arranger' cannot and should not be an 'agent' since the arranger needs to remain neutral. That is highlighted in the case of OTFs operating the 'Matched Principal' function whereby the OTF operator may not take proprietary risk under MiFIR. Moreover, this would only detriment the relationship between IDB and client, which would be a disservice to market liquidity.

c. As a consequence of the European harmonisation initiatives there are now multiple CDSs, Trading Venues and CCPs and hence it is impossible for any of these three identified vehicles to have any certainty of the position of each participant. Only the two parties involved in the trade will have a clear understanding of their own positions.

d. Participants in illiquid bond markets such as emerging market issues which settle in USD onto EU CSDs or high grade markets are closely aware of the possibility and probability of settlement fails. The deal with them frequently and have developed a business model to cope with this. WMBA members deal with this each and every minute of the day in these markets, although such events are almost unknown in the more liquid EU Sovereigns. Proportionality and suitability are therefore key here and should take the place of fixed and inflexible regulation.

As a result of these concerns WMBA is of the opinion that:

a. After the implementation of MiFIDII, the definition of trading venue should either specifically exclude trades executed on an OTF or treat them with a proportionality which is more akin to OTC trading.

b. Buy-in procedures should be initiated by the receiving party to the trade and conducted and executed on its behalf by banks or securities dealers designated by the CCP, CSD or trading venue and who are not connected to the participants.

c. CDS to identify "chains" of settlement fails and:
   i. The same buy-in agent to transact all buy-ins for all settlements in the chain
   ii. One buy-in instruction to trigger multiple buy-ins within the chain

d. Cooperation between trading venues, CCP, CSD and buy-in agent to ensure that the buy-in agent has sufficient information regarding the feasibility of a buy-in instruction and enough settlement details to conclude the trade.

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Should you require any further information or clarification please do not hesitate to contact the persons named below. The WMBA are happy for these comments to be disclosed.

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