ISDA Safe, Efficient Markets

FIA

ISDA and FIA response to the European Commission's consultation on the CSDR inception impact assessment

(submitted via European Commission's online portal)

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ISDA and FIA (the 'Associations') welcome the opportunity to provide feedback to the European Commission's (EC) consultation on the CSDR inception impact assessment (Roadmap). The Associations welcome the opportunity to provide their views to the EC on revising the CSDR framework, especially regarding the scope of the mandatory buy-in requirements as part of the Settlement Discipline Regime (SDR). In line with our response[1] to the EC's targeted consultation on the review of CSDR, we would like to reiterate the Associations members' primary concern with the SDR, which is the application of the mandatory buy-in requirements to derivatives transactions.[2] In this context, we appreciate the EC's reference to stakeholders' concerns that *'the scope of that framework cast doubts on the clarity of the current rules as well as their potential impact outside the sphere of securities trading and settlement.'*. However, the Associations' members believe that reforming the SDR regime, in particular the buy-in rules, should be the main priority in the upcoming review process. Furthermore, we remain concerned about the application date of the SDR in February 2022 given that the legislative proposal is expected to be published in Q4 2021, hence revised CSDR will not be in place prior to the current implementation date.[3] In this respect, the Associations' members request that the EC indicates its intention with respect to amendments and clarifications to the SDR buy-in rules as soon as possible and well in advance of unveiling the legislative proposal, giving market participants the opportunity to plan for SDR implementation. It is critical that the SDR mandatory buy-in regime is amended, clarified, and improved before any further implementation efforts are made by market participants on the basis of the current regime.

Although the Associations support the EC's objective *"to ensure that the objectives of CSDR - to promote safe, efficient and smooth settlement by laying down uniform requirements for the settlement of financial instruments in the Union and rules on the organisation and conduct of CSDs – are met in a more proportionate, effective and efficient manner",* we are of the view that the SDR mandatory buy-in regime, as it applies to margin transfers and physically settled derivatives, does not contribute to the objective above and that market participants have already put in place other measures that prevent and remedy settlement fails. A summary of our position is set out below.

Margin Transfers

We do not consider that margin transfers are intended to be captured by the mandatory buy-in regime, but a lack of clarity on the meaning of "transaction" under CSDR and the absence of

[1] ISDA, FIA, FIA-EPTA response to the EC's targeted consultation: https://www.isda.org/a/4jCTE/ISDA-FIA-and-FIA-EPTA-joint-response-to-Commission-Consultation-on-CSDR-Review.pdf

[2] By derivatives transactions in the context of CSDR, we refer to margin transfers in the context of cleared and uncleared derivatives transactions and physically settled derivatives (both cleared and uncleared).

[3] Joint Trade Associations letter on the application of SDR: https://www.isda.org/a/dfZTE/Joint-Trade-Association-Letter-regarding-Implementation-of-the-CSDR-Settlement-Discipline-Regime.pdf

an express carve-out creates uncertainty around the scope of the buy-in regime, as explained below. Therefore, we request that the CSDR settlement discipline regime is amended to clarify that margin transfers are not subject to mandatory buy-in requirements. Currently, the term "transaction" seems to refer to commercial transactions only (for example, in the context of the mandatory buy-in rules under Articles 7(3) to (8) CSDR), whereas in other cases it appears to have a broader meaning (for example, in the context of CSD settlement fails monitoring and reporting under Article 7(1) CSDR).

In practice, if there is a settlement fail for margin transfers, the parties simply agree that different collateral is delivered from a range of pre-agreed eligible collateral. Further, as noted in more detail below, there are existing contractual remedies available to counterparties to deal with settlement fails arising out of margin transfers (the ultimate disincentive to failing to deliver margin being the right of the recipient to terminate all derivatives transactions between the parties). Such practicalities and rights render the mandatory buy-in requirement unnecessary in the context of margin transfers.

Mandating a buy-in in this situation would be counterproductive as it would increase the receiving party's exposure to the posting / failing counterparty (and the receiving party would remain uncollateralised until the buy-in is completed). This would therefore undermine the risk-mitigating purpose of regulatory margin requirements under EMIR, contrary to Article 1(3) CSDR, which states that the requirements of CSDR shall be "without prejudice to provisions o*f Union law concerning specific financial instruments"*.

Physically settled derivatives

The term "transaction" is not clear, and this leads to legal uncertainty with respect to the settlement of physically settled derivatives. We do not consider it appropriate to impose mandatory buy-ins in the context of physical settlement of derivatives transactions and the scale of implementation required would be wholly disproportionate to any benefit. Industry standard derivatives trading and clearing documentation (such as ISDA and FIA documentation) already includes extensive provisions setting out the parties' rights and remedies in case of a failure to deliver financial instruments in physical settlement of the derivatives transaction. In many cases, these rights and remedies may provide for cash settlement (instead of physical settlement) and/or allow for termination and close-out of relevant transactions, potentially after an agreed grace period. We believe that the imposition of a regulatory buy-in would likely disrupt existing contractual default provisions (including grace periods) in ways that the parties did not contemplate when they entered into the agreement. In fact, grace periods under ISDA and FIA documentation are significantly shorter (1-3 business days) than the CSDR buy-in extension periods. Hence, the mandatory buy-in requirements would not add any value in the context of settlement fails, however they would impose large-scale repapering exercises on market participants, requiring costly and unnecessary client outreach and resulting in excessive administrative costs. As noted in the margin transfer section of our response above, industry standard contractual provisions, which start to apply before the mandatory buy-in rules are triggered, extend also to settlement fails in the context of margin transfers, and they effectively remedy settlement fails without the need for any mandatory buy-in requirements.

The Associations have provided the EC with practical examples for cleared and non-cleared derivatives transaction which we hope are useful for the re-calibration of the CSDR SDR. We remain at your disposal if you would like to discuss further.