

**European Commission targeted consultation document -
Review of regulation on improving securities settlement in the European
Union and on central securities depositories**

**Additional information regarding Question 36 -
suggestions for the improvement of the settlement
discipline framework in CSDR**

Measures to address settlement fails

In point 3 of our response to Question 36, we recommend that should a party be unable to deliver the instrument, the counterparty (the receiving party) should have a right to choose between executing a buy-in or closing out the trade at the prevailing market price, subject to providing an appropriate period of notice, during which the receiving party may still agree to accept delivery against the original trade.

We recommend certain key features of these options as indicated below.

Buy-in

- (a) We recommend that buy-in transactions be executed by the receiving party with any investment firm (or equivalent) that has the regulatory permission necessary to execute client orders.
- (b) In conducting the buy-in, the receiving party should be subject to an obligation to provide best execution to the failing party and to avoid any conflicts of interest.
- (c) As noted in our response to Question 34.1, we believe a successful buy-in should deliver the same economic outcome to the receiving party as the failing trade. To this end:
 - if the settlement amount (ie. total consideration) of the buy-in is higher than it would have been for the original trade, the failing party should be required to pay the difference to the receiving party, plus compensation for any entitlements (income, corporate actions etc.) that may have been missed;
 - if the settlement amount of the buy-in is lower than it would have been for the original trade, the receiving party should be required to pay the difference to the failing party, after deducting compensation for any entitlements (income, corporate actions etc.) that may have been missed;
 - in the event of a capital reconstruction occurring between the original transaction and the buy-in, it may be necessary to buy-in the different instruments resulting from that reconstruction.



- (d) Having received prior notice of the buy-in, the failing party should be able to deliver the instruments subsequently only with the express agreement of the receiving party.
- (e) In addition to the option from the outset of a fail, in the event that buy-in is not possible the receiving party should be able to close out the original failing transaction.
- (f) As noted in our response to Question 34.1, we believe the regime should provide specifically for a pass-on mechanism in order to minimise the number of buy-ins along a settlement chain. To this end the regime should include that the failing party is able to pass on a notice of buy-in and the associated economic consequences (price difference etc.) to the party(ies) from whom they sourced liquidity to fill the buyer's order and whose own inability to deliver has led to the buy-in.

Close out option

- (a) As an optional alternative to a buy-in, we recommend that the receiving party should have a right to sell the instruments back to the failing party at the prevailing market price.
- (b) We believe that where no market price exists for the instruments concerned, the regime should provide for the application of suitable market methodology to determine their fair value.
- (c) As noted in our response to Question 34.1, we believe this mechanism should deliver the same return to the receiving party as they would have received over the period since the original trade had it settled normally. To this end the value of any entitlements that may have been missed by the receiving party and are not reflected in the prevailing market price should be addressed through the payment of cash compensation paid to them by the failing party.
- (d) Having received prior notice of the close-out, the failing party should be able to deliver the instruments subsequently only with the express agreement of the receiving party.

Measures to prevent settlement fails

In point 4 of our response to Question 36, we recommend that the obligations concerning trade allocation and confirmation should recognise the dependencies that each party has on the other.

We recommend that the Level 2 provisions be revised to include the features:

- (a) The investment firm should be required to provide their settlement details to the professional client at the latest by close of business on the day of execution.
- (b) The investment firm should be required to provide a report of the execution, including the execution price, by close of business on the day of execution.
- (c) The professional client should be required to send allocation details and confirmation:
 - by close of business on the day of execution, where the execution report is received from the investment firm by 4pm CET and time difference is 2 hours or less;
 - otherwise by 10am on the next business day.
- (d) The investment firm should be required to provide confirmation of allocation-level settlement details:



- by 10am on T+1 where the allocation details are received from the professional client on the day of execution;
- otherwise by noon on the next business day.

The aim of the above would be to ensure that the professional client is informed of the terms of the trade with sufficient time to confirm its acceptance and for the final settlement details to be matched by noon on T+1, before the settlement instructions may be issued.

In addition, the current legislation provides only that the investment firm must allow its professional clients the option of sending them the allocation and confirmation electronically - it should also provide that the investment firm must be willing to send its own communications electronically.

We believe the above is already facilitated by central trade matching utilities that exist today, which allow each party to submit the relevant details when available and view the matching status versus the details entered by the other.