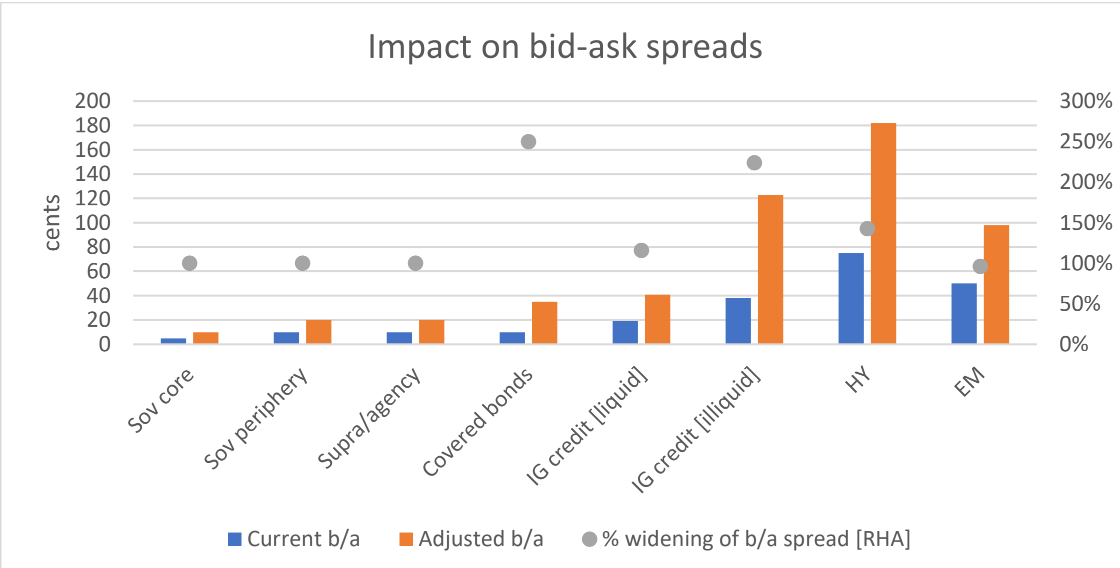
European Commission Targeted consultation on the review of the Regulation on improving securities settlement in the European Union and on central securities depositories

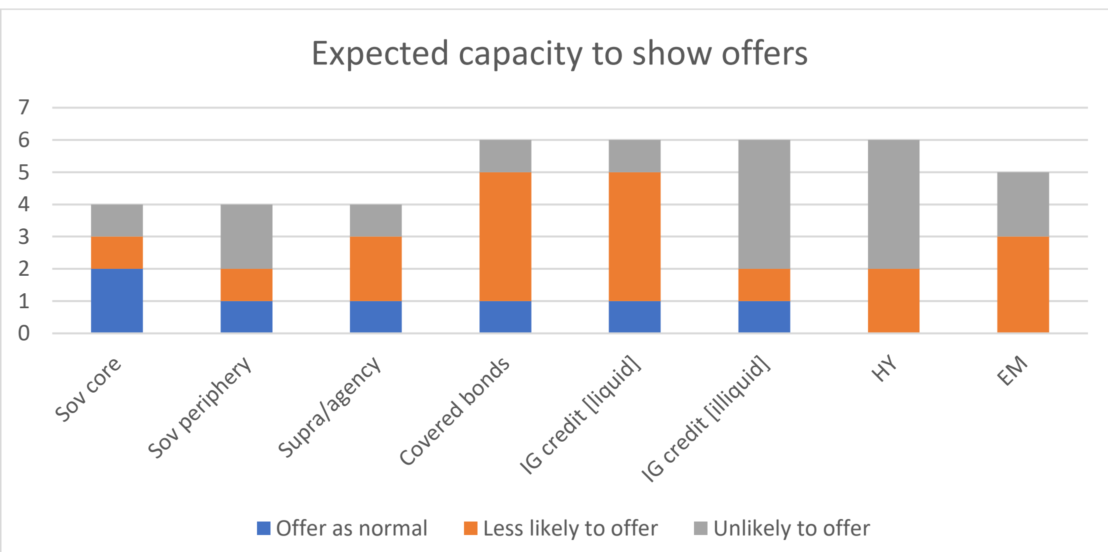
ICMA Response: supporting figures and tables (February 2021)

Figure 1: impact of mandatory buy-ins on bond market pricing



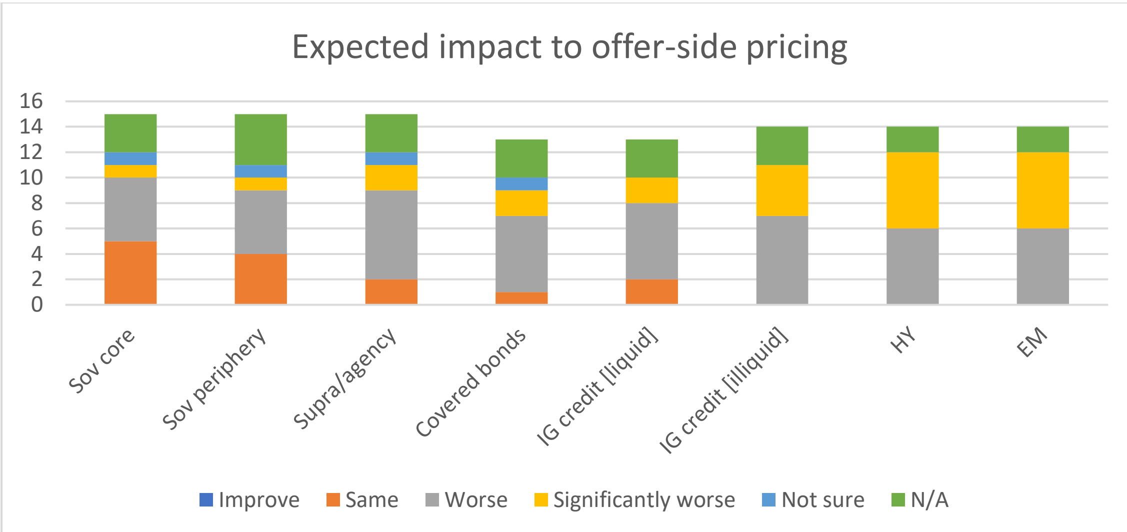
Source: ICMA member survey data

Figure 2: impact of mandatory buy-ins on capacity to show offers



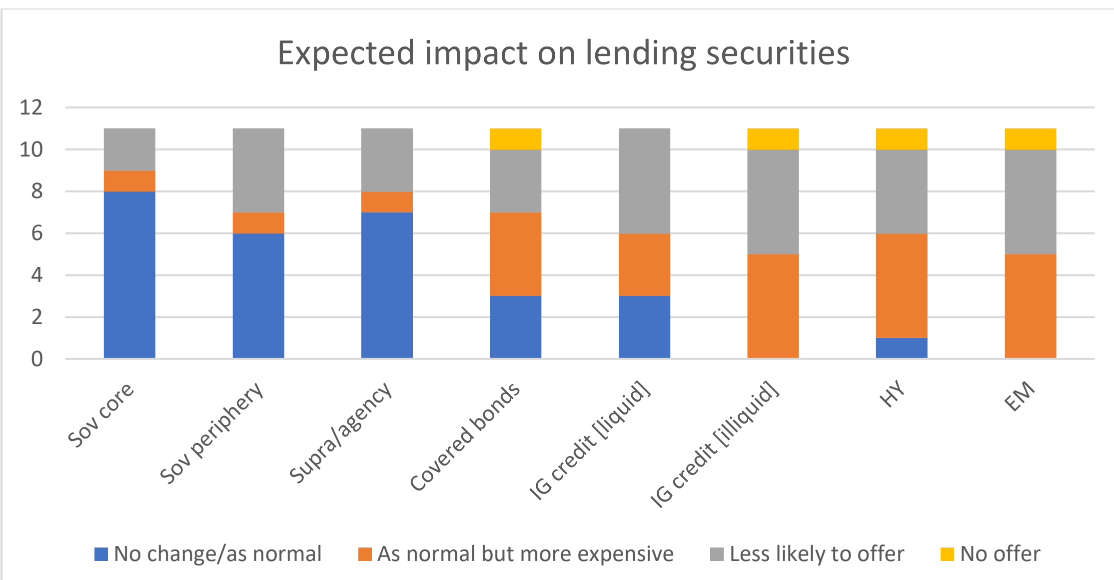
Source: ICMA member survey data

Figure 3: buy-side expected impact on bond market liquidity



Source: ICMA member survey data

Figure 4: impact on repo and securities lending market for bonds



Source: ICMA member survey data

Table 1: Estimated cost to investors through dealer price adjustment (NFCs & Government bonds, Euroclear)

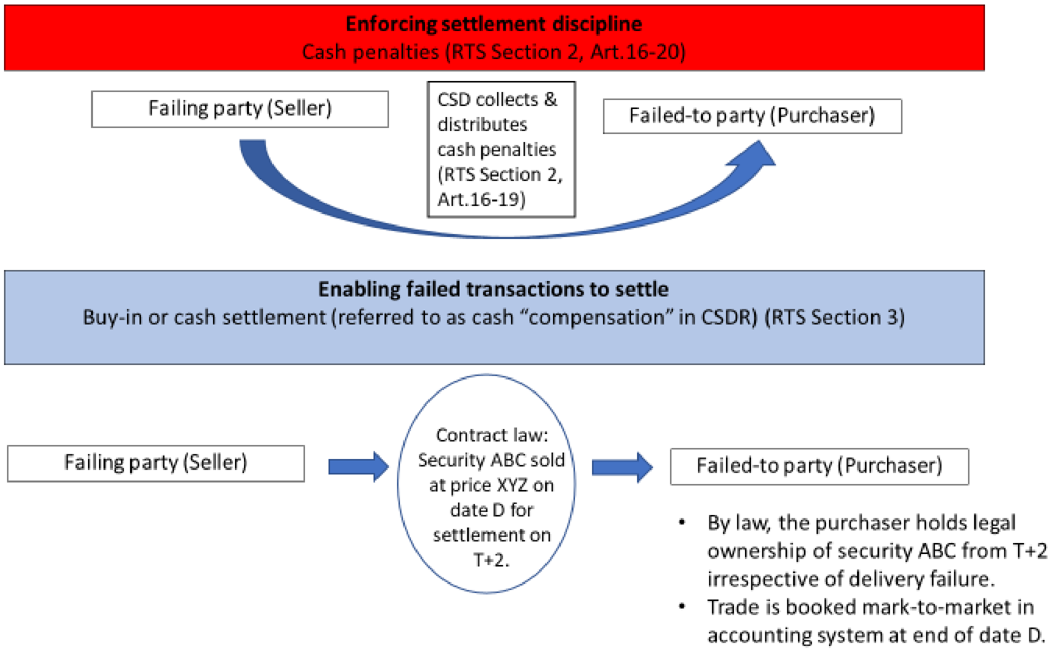
NFCs	Fails @ISD+7	Expected fails (trades)	Expected fails (vol)	Avg price adjustment (103c)
Total (Jan-Aug)	1.41%	49,892	€60,763,879,051	€625,867,954
Annualized total:	1.41%	74,838	€91,145,818,577	**€938,801,931**
Government bonds				Avg price adjustment (14c)
Total (Jan-Aug)	0.19%	12,181	€159,706,745,067	€223,589,443
Annualized total:	0.19%	18,272	€239,560,117,601	**€335,384,165**

Table 2: Estimated annual cost of buy-in agents (fails on Euroclear only)

	Expected fails (vol)	Buy-in agent costs (based on 25c)	Buy-in agent costs (based on 50c)
NFCs	€91,145,818,577	€227,864,546	€455,729,093
Government bonds	€239,560,117,601	€598,900,294	€1,197,800,588

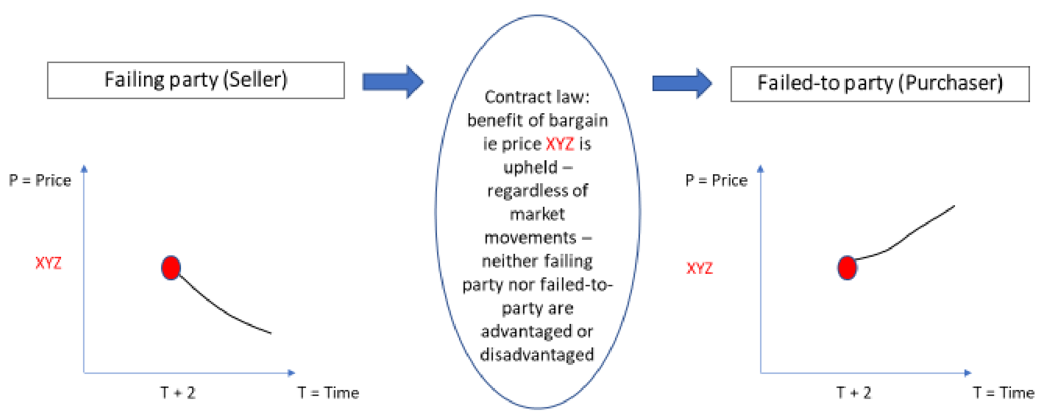
Source: ICMA analysis using Euroclear Bank data and ICMA member survey data

Figure 5: CSDR settlement discipline – cash penalties and buy-ins/cash compensation



Source: ICMA

Figure 6: the economic function of buy-ins / cash settlement



- The buy-in process enables the purchaser to source the security from a third party. If P > XYZ on the date of buy-in execution, the failing party makes a payment (P-XYZ) to the failed-to party. In case P < XYZ , the failed-to party makes a payment (XYZ-P) to the failing party. In both cases, price XYZ is upheld as per contractual agreement.
- In case the security cannot be sourced eg there is no buy-in agent or seller for the specific security, the failing party and failed-to party agree to settle cash. Price XYZ is upheld and payments are made either from the failing party to the failed-to-party or vice versa, depending on the mark-to-market value of the security (even though there is no physical delivery).
- ***Note:*** The failing party continues to incur cash penalties which are passed on by the CSD to the failed-to party as long as the transaction has not settled.

Source: ICMA

Figure 7: CSDR settlement discipline – payments between parties

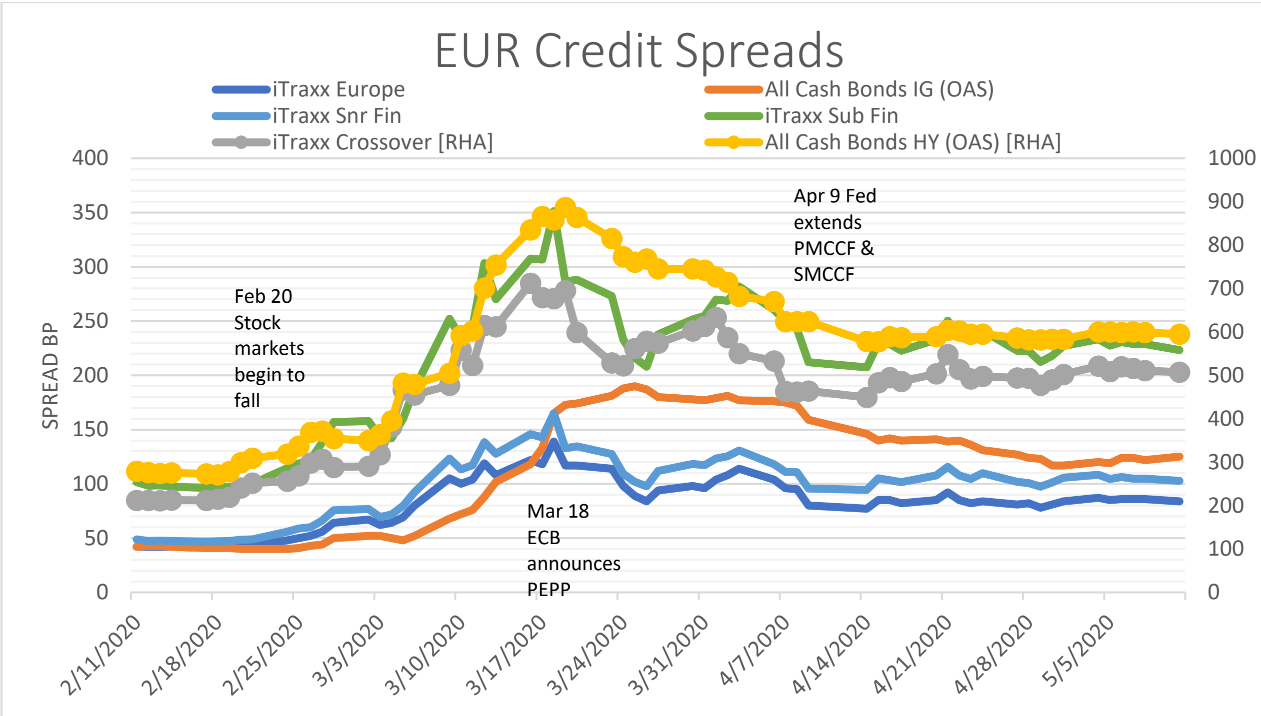
One-way payment from failing party (seller) to non-failing party (buyer)

Payment possible in either direction depending on market value vs contract price

Penalty for failure	Reflecting the economic exposure	Other trade components
Paid by the failing party (seller) to compensate the non-failing party (buyer)	**Paid in either direction, to restore original economics of the trade**	**Paid by the failing party (seller) to the non-failing party (buyer)**
Irrespective of whether settlement failure results in a buy-in or cash settlement, the CSD collects & distributes cash penalties **from the seller to the buyer**.	Irrespective of whether settlement failure results in a buy-in or cash settlement, the resulting account/settlement **should reflect the fact that the buyer has an economic exposure to the market value of the securities from the intended settlement date**. If the market value is higher than the contract price, the differential should be paid from the seller to the buyer. If the market value is lower than the contract price, the differential should be paid from the buyer to the seller.	Irrespective of whether settlement failure results in a buy-in or cash settlement, the resulting account/settlement reflects the **buyer's right to accrued interest or coupon payments**.

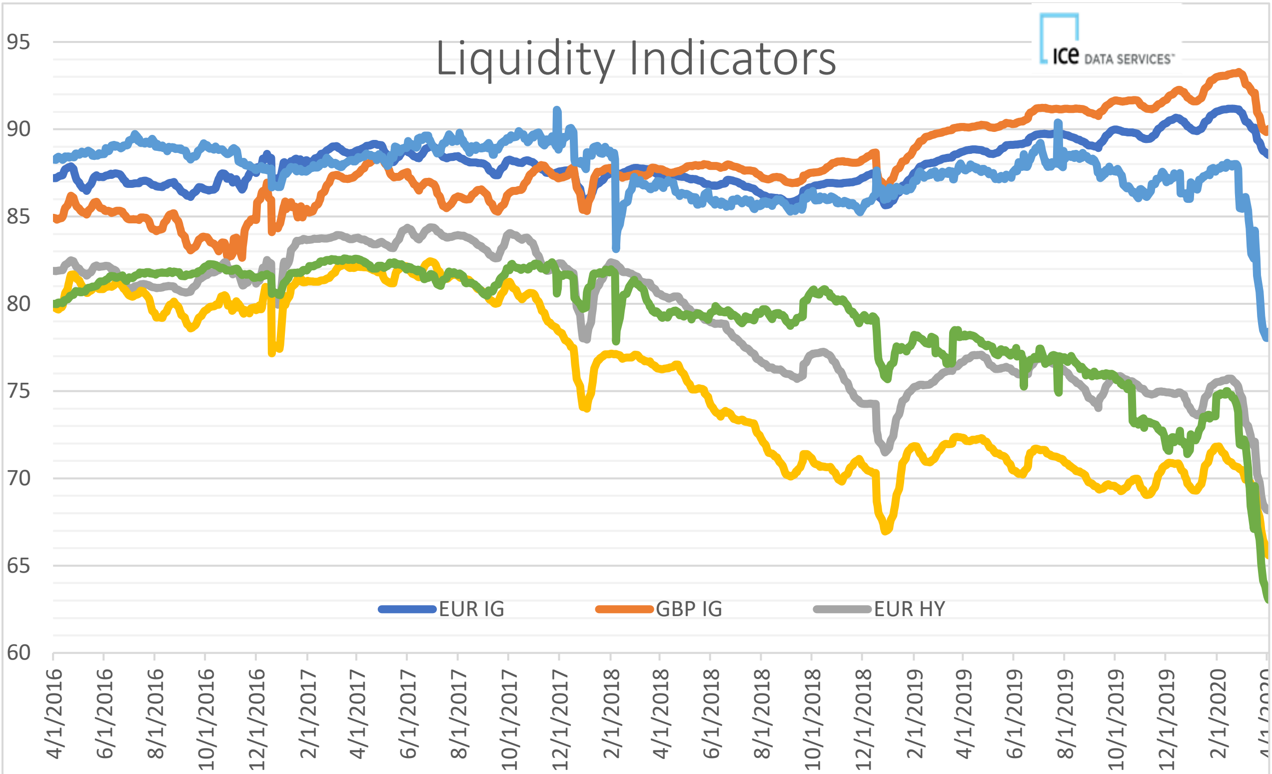
Source: ICMA

Figure 8: EUR corporate credit spreads and the COVID-19 crisis



Source: ICMA analysis using Bloomberg data

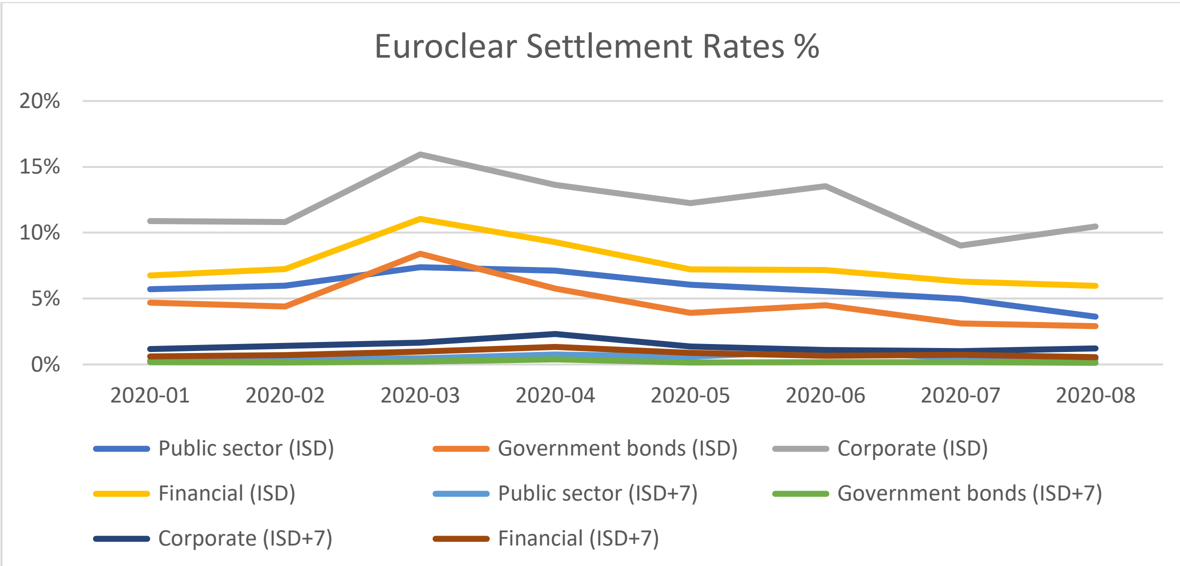
Figure 9: ICE Data Services Liquidity Indicators ™



Source: ICE Data Services

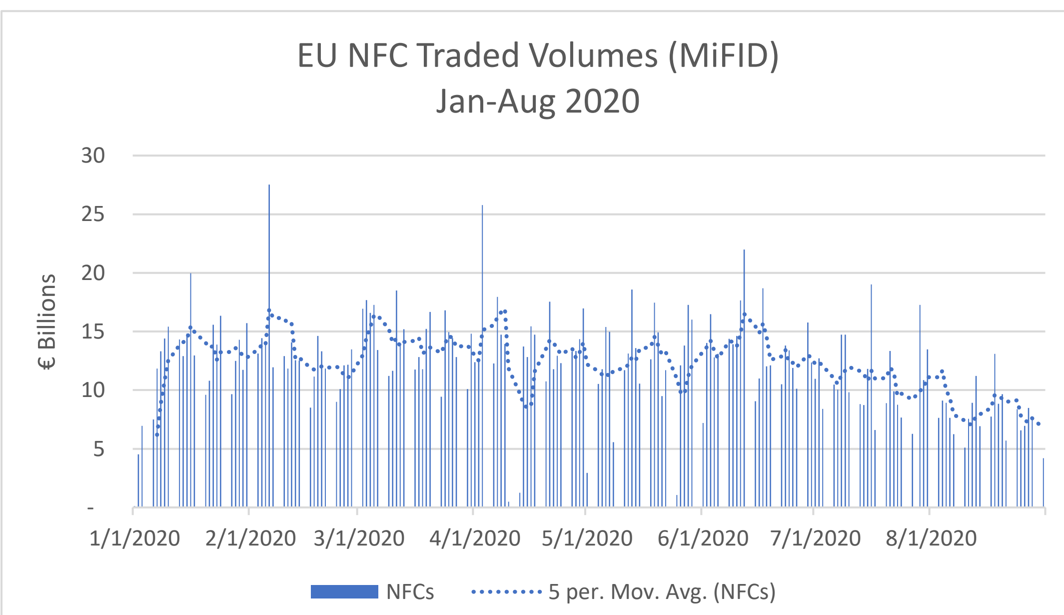
ICE Data Services' Liquidity Indicators are designed to reflect the average liquidity across the three major currencies by tracking the changes in weighted-average liquidity costs over time for both portfolios of Investment Grade and High-Yield securities. The cost calculation used in these indicators is based on an estimate of market price impact. This price impact metric incorporates security-level features, including projected trading volume capacity, transaction costs, price volatility, etc. to estimate the liquidity cost measured as a percentage of the bid price.

Figure 10: Euroclear settlement fails for bonds (Jan-Aug 2020)



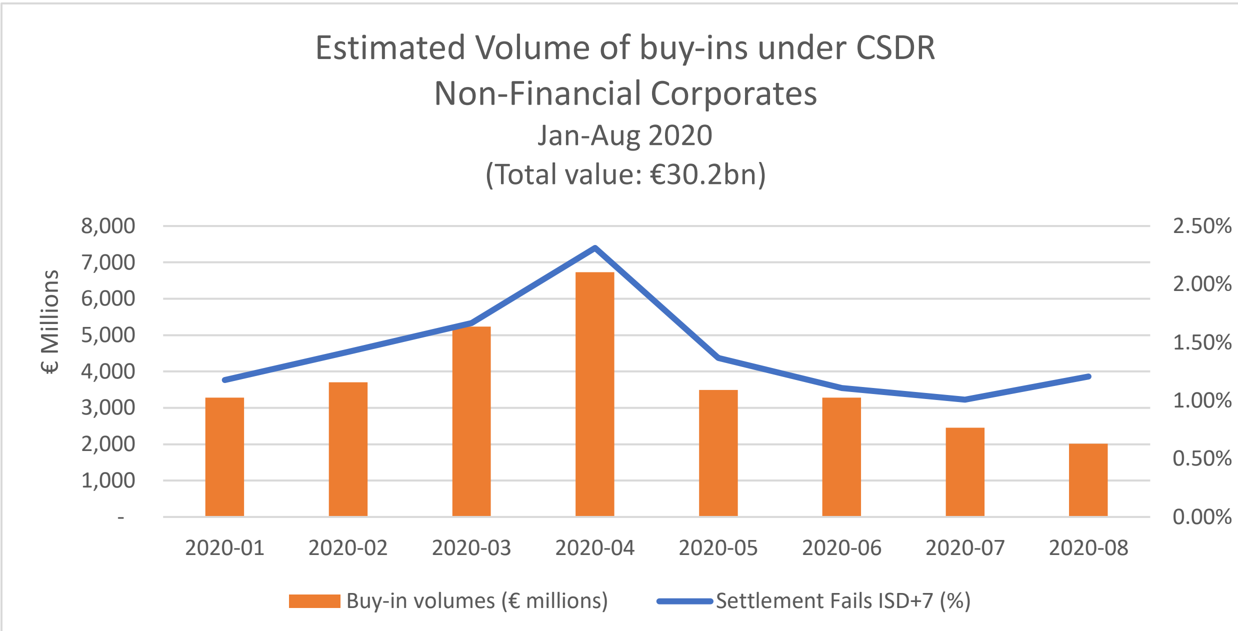
Source: ICMA analysis using Euroclear Bank data

Figure 11: MiFID volumes for secondary market transactions in non-financial corporates (Jan-Aug 2020)



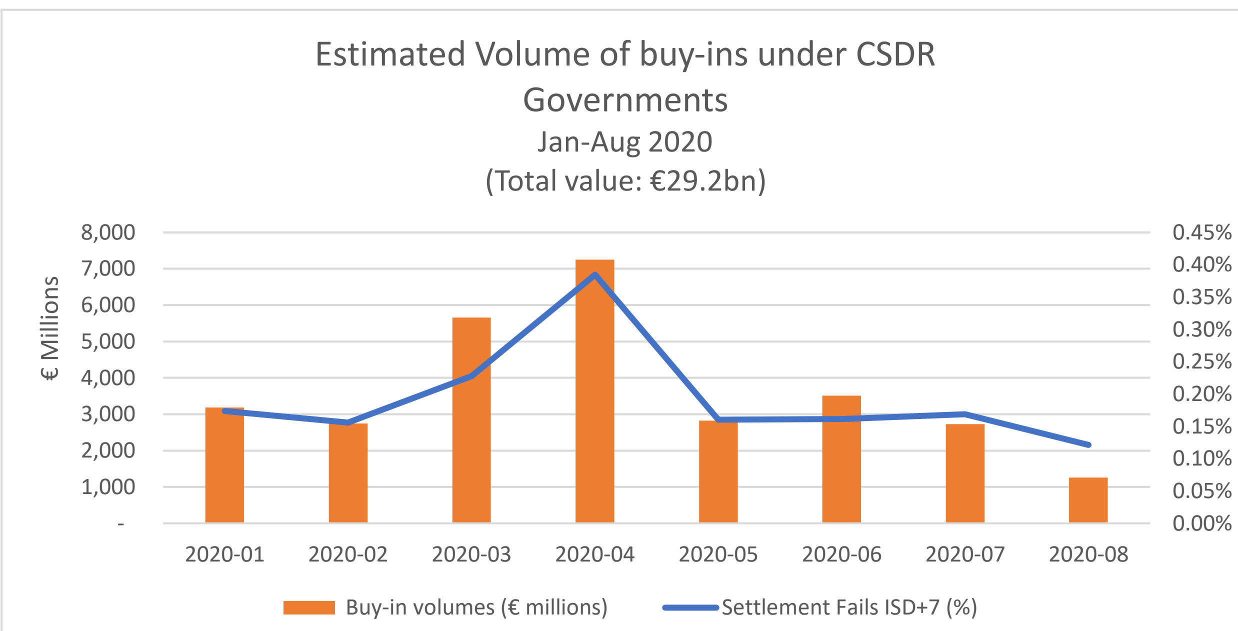
Source: ICMA analysis using Bloomberg data

Figure 12: Estimated volume of buy-ins of NFCs that would have been triggered by CSDR



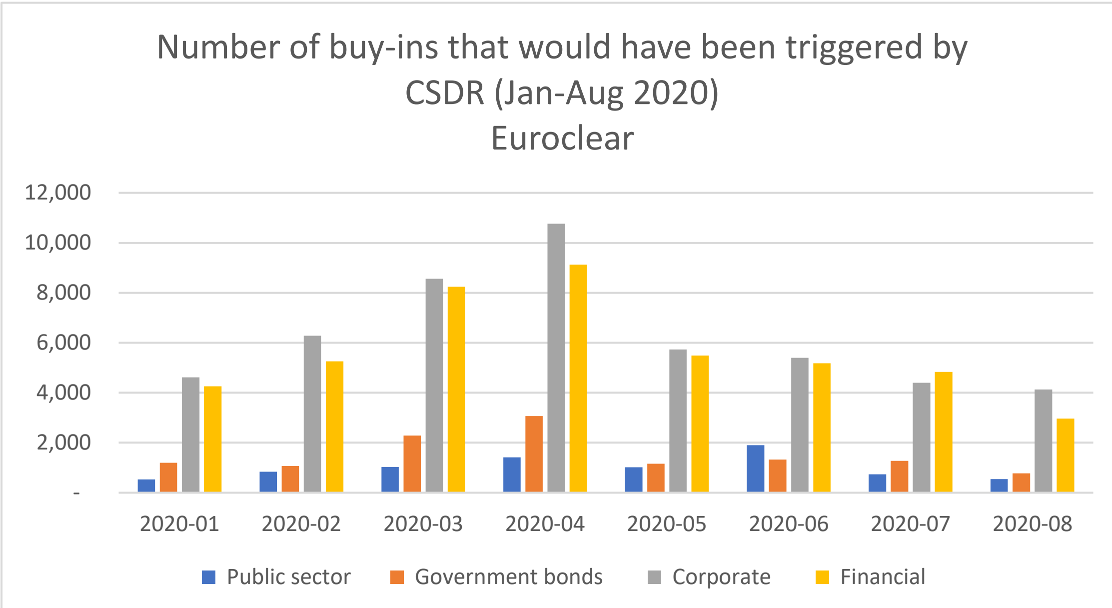
Source: ICMA analysis using Euroclear and Bloomberg data

Figure 13: Estimated volume of buy-ins of government bonds that would have been triggered by CSDR



Source: ICMA analysis using Euroclear and Bloomberg data

Figure 14: Estimated number of buy-ins triggered by CSDR (Euroclear only)



Source: ICMA analysis using Euroclear Bank data

Table 3: costs and benefits of alternative suggestions to improve CSDR-SD

Suggestion	Benefits	Costs
Implement cash penalties but not regulatory buy-ins	There is evidence to suggest that appropriately calibrated cash penalties can improve settlement efficiency, particularly in cases of high settlement fails. The investment and resources required to support the implementation of the CSDR buy-in regime is vast and could be better allocated by investment firms, particularly in supporting the post-COVID economic recovery. Investors and issuers in EU bond markets would not be subject to likely negative impacts of detrimental pricing, reduced liquidity, and potential market instability resulting from the CSDR buy-in regime. Investment and work by infrastructures and investment firms to support implementation of the penalty regime has largely already been committed or undertaken. In preparing for the SD regime, investment firms and market infrastructures have already undertaken extensive work to develop processes and architecture to improve settlement efficiency.	Investment and resource allocation required to support the implementation of cash penalties.

All EU investment firms required to have in place contractual buy-in provisions or equivalent	*All of the above, plus:* Markets or products where buy-in mechanisms (or the equivalent) do not exist would be required to introduce them, enhancing the overall structure for settlement efficiency. In many cases these provisions already exist, significantly reducing the overall industry cost and effort of implementation.	Investment firms would be required to develop and implement contractual arrangements with their counterparties for products and markets where these do not already exist.
Proceed with regulatory buy-in regime, with appropriate revisions	Markets or products where buy-in mechanisms (or the equivalent) do not exist would be required to introduce them (through Article 25 of the RTS), enhancing the overall structure for settlement efficiency. *However, in many cases this will be suboptimal since it will be duplicating what already exists, only with an inferior/less appropriate alternative.*	The investment and resources required to support the implementation of the CSDR buy-in regime is vast, both in terms of the extensive contractual papering (and re-papering) and the necessary architecture build. There is also the risk that much of this implementation work could be redundant or may need to be repeated. Depending on whether the buy-in requirement is mandatory, or any revision of the extension periods, investors and issuers in EU bond markets could be subject to the likely negative impacts of detrimental pricing, reduced liquidity, and potential market instability (the extent of which having been highlighted earlier in this response).

Source: ICMA