

1 February 2021

ISDA, FIA and FIA EPTA joint response to the European Commission Targeted Consultation on the CSDR Review

The International Swaps and Derivatives Association (**ISDA**), the Futures Industry Association (**FIA**) and the FIA European Principal Traders Association (**FIA EPTA**) (together, the **Associations**) welcome the opportunity to respond to the Commission's Targeted Consultation on the review of Regulation (EU) No 909/2014 (**CSDR**).

The primary focus of this response is on the CSDR settlement discipline regime and its potential impact on derivatives transactions (although we note that similar issues may arise for other (non-derivative) instruments and transaction types). In particular we are concerned that the CSDR mandatory buy-in regime was not drafted with derivatives transactions in mind and that applying it to derivatives transactions in its current form gives rise to significant uncertainties and would have unintended adverse consequences, as discussed below.

Margin transfers

Our primary concern relates to the potential application of the mandatory buy-in regime to settlement fails arising in the context of margin transfers (i.e. where a party is transferring margin in the form of financial instruments to support a derivatives transaction or netting set and the transfer is to be settled in an EEA CSD).

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 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.

Under Article 7(3) CSDR, a mandatory buy-in is triggered where a party fails to deliver in-scope financial instruments to settle a "transaction" in an EEA CSD on the intended settlement date, and the settlement fail continues past the end of the relevant extension period. However the term "transaction" is not defined in CSDR or in Commission Delegated Regulation (EU) 2018/1229 (**RTS on Settlement Discipline**). In some cases, it 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). This difference in scope is justified, as buy-ins occur at the trading level, whereas settlement fails monitoring and reporting occurs purely at the CSD level. However, confusion arises from use of the same undefined term to describe two different concepts (i.e. the commercial trade on the one hand and the post-trade settlement through transfer of securities in an EEA CSD on the other hand).

There seems to be an implicit assumption behind the mandatory buy-in regime that the receiving party has contracted to receive specific financial instruments and that it is important from a commercial perspective that they actually receive them (i.e., that delivery of cash or different financial instruments of the same value will not suffice). However, this assumption

does not hold true in the case of margin transfers, the purpose of which is to mitigate credit risk arising from an exposure created by an underlying trade and not to receive specific financial instruments.

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 of Union law concerning specific financial instruments". This supports the position that margin transfers were not intended to be captured by the mandatory buy-in rules.

We also consider that the carve out in Article 7(4)(b) CSDR for "operations composed of several transactions" where "the timeframe of those operations is sufficiently short and renders the buy-in process ineffective" should apply to margin transfers supporting derivatives transactions (to the extent they would otherwise be in scope of mandatory buy-in rules). This is because margin calls are usually made on a daily basis and even initial margin requirements must be recalculated every 10 business days at most (i.e. significantly shorter than the 30 business day timeframe referred to in Article 22 RTS on Settlement Discipline, which elaborates on when the timeframe of a securities financing transaction will be short enough to render the buy-in process ineffective). However, the fact that neither Article 7(4)(b) CSDR nor Article 22 RTS on Settlement Discipline expressly refers to margin transfers means that there remains uncertainty as to the scope of this carve out.

Physically settled derivatives

It is also somewhat unclear whether the physical settlement of a physically settled derivatives contract (where the underlying is an in-scope financial instrument) would be considered a "transaction" subject to the mandatory buy-in regime. 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, as discussed below. Therefore, we request that physical settlement of derivatives contracts is expressly carved out of scope of the mandatory buy-in regime.

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 (which could include failure to deliver due to a settlement fail, depending on the commercial terms agreed between the parties).

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. In some cases they may also include a contractual buy-in right, if this is appropriate in the commercial context of the contract. For cleared derivatives, CCPs already have appropriate buy-in regimes in their rulebooks and clearing brokers will have already addressed how those buy-in regimes are passed on (or not) to their clients in their existing agreements. These default and other provisions have been carefully crafted over the years, are well understood by the market and reflect the commercial agreement between the parties. They have proved adequate to address default and other risks over a period of time in the market and as such it is neither necessary nor desirable to supplement them with potentially disruptive regulatory buy-in provisions.

Article 7(3) CSDR expressly states that the mandatory buy-in regime should be without prejudice to the right of the parties to bilaterally cancel a transaction. The same should apply with respect to other contractual rights and remedies agreed between the parties in case of a failure to deliver – i.e. regulatory measures to address post-trade settlement fails should not prejudice or limit the contractual freedom of the trading parties to agree the commercial terms of the transaction, including rights and remedies where there is a failure to deliver securities arising from a settlement fail. However, 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.

For example, it may be unclear whether and how the buy-in requirements interact with netting arrangements amongst other things (e.g. if the parties have not expressly agreed whether buy-in costs, cash compensation and other amounts relating to a buy-in should be included in close out netting calculations). In addition, the provisions at Article 32 RTS on Settlement Discipline specifying how the price difference and cash compensation are to be calculated will not generally take into account the economics of derivatives transactions.

Client clearing and indirect clearing arrangements also add a further layer of complexity. We are concerned that application of mandatory buy-ins to remedy settlement failures at multiple levels of a clearing chain would be unduly burdensome. Applying multiple buy-ins in this case would be unnecessary, as a single buy-in would remedy all of the connected settlement fails. Moreover, we are concerned that the regulatory buy-in rules could create asymmetries in the clearing chain as drafted (e.g. if the regulatory buy-in period is extended at some levels of the chain but not others), undermining the principle that each transaction in the chain should be on identical commercial terms. Asymmetries in this regard could potentially affect a clearing firm's analysis of the limited recourse nature of its obligations and the associated capital treatment for these transactions, making client clearing more expensive and ultimately serving as a barrier to client clearing.

Whilst it may be possible to compensate for some of these issues through contractual drafting, this would be complex to achieve for little or no overall benefit. Indeed, the grace period for delivery failures under ISDA/FIA documentation is typically 1-3 business days, i.e. shorter than the buy-in extension period. Therefore in practice, parties may seek to exercise their agreed contractual rights and remedies to address a failure to deliver before they are disrupted by a mandatory buy-in. As such, members expect that it would be very rare for a mandatory buy-in to be triggered in the context of physical settlement of derivatives transactions, or indeed in the context of margin transfers.

However, unless there were a clear carve out from the mandatory buy-in regime for margin transfers and physical settlement of derivatives transactions, members would still need to carry out significant operational and contractual implementation (including client outreach to repair agreements) in order to comply with Article 25 RTS on Settlement Discipline. This would be extremely disproportionate, as it would require firms to devote a significant amount of time and resources to the implementation of regulatory requirements that firms expect to have little practical impact on derivatives transactions at best and which may have significant unintended adverse consequences at worst.

Cost-benefit and proportionality considerations

If margin transfers and physical settlement of derivatives were not excluded from scope of mandatory buy-in requirements, this would have the negative consequences discussed

elsewhere in our response, including undermining of the risk-mitigating purpose of regulatory margin requirements under EMIR and unduly restricting trading parties' contractual freedoms. It would also place a disproportionate implementation burden on firms.

This is because firms would need to carry out significant operational and contractual implementation (including client outreach to repaper agreements) in order to comply with Article 25 RTS on Settlement Discipline. The repapering process itself will create a significant implementation burden for firms, particularly when viewed in the context of other new regulatory requirements due to apply over the next couple of years that also require amendments to contractual documentation. In particular, -IBOR transition and compliance with Article 28(2) Benchmarks Regulation, contractual stays requirements under BRRD2 and EMIR initial margin requirements for Phases 5 and 6 counterparties may all require members to agree contractual changes to their derivatives documentation over the next couple of years. However, all of these new requirements start to apply at different times, meaning that it is not possible to streamline client outreach effectively. This leads to concerns that multiple rounds of client engagement and related amendment processes can themselves lead to amendment fatigue and lower levels of counterparty engagement.

Whilst ISDA has been considering whether the development of a protocol might be necessary to aid with agreement and adoption, the very broad agreement and counterparty scope of the CSDR settlement discipline regime, coupled with the substantive impact that a buy-in would have on the substantive terms of transactions, means that a protocol may be difficult to achieve in this context. Indeed, no current solution exists and the development and widespread adoption of a protocol to meet the requirements of Article 25 RTS on Settlement Discipline in respect of derivatives transactions would be a complex exercise, requiring amendment of multiple documents including master agreements and terms of business, clearing addenda, collateral documentation and related custody documentation.

The broad extraterritorial reach of the CSDR settlement discipline requirements to any trading parties that settle transactions in in-scope financial instruments on EEA CSDs would also necessitate a global repapering exercise. Counterparty engagement is likely to be particularly challenging with respect to non-EEA counterparties whose only EEA nexus is the location of the settlement system and/or counterparties that *may* enter into in-scope transactions under existing agreements, even if they do not do so at present. Further, the lack of clarity in CSDR and the RTS on Settlement Discipline on various points of detail relating to the mandatory buy-in regime also reduces the likelihood of a protocol being effective in this context. Therefore, any potential repapering solution for derivatives would be costly and was not foreseen in the cost-benefit analysis of CSDR.

The high implementation burden and negative consequences arising from mandatory buy-ins may also disincentivise firms from using EEA-settled securities in transactions where non EEA-settled securities or other assets may serve as a substitute (e.g. when posting margin).

Changes requested to the CSDR settlement discipline regime

We request that prescriptive buy-in rules are deleted from CSDR altogether as a result of the current review. In this case, it would no longer be necessary to address many other problematic aspects of the current buy-in rules, including those raised elsewhere in our response.

However, at the very least we request that the CSDR settlement discipline regime is revised to clearly provide that settlement fails arising in the context of (a) margin transfers; and (b)

physical settlement of derivatives are not subject to mandatory buy-ins. We note that since CCPs may be involved in some but not all of the scenarios discussed, our request applies with respect to settlement fails arising in the context of both cleared and uncleared transactions.

We ask that clarity is provided quickly on any proposed changes to the CSDR settlement discipline regime. This will be crucial to avoid the need for firms to implement CSDR settlement discipline requirements twice (i.e. first based on the existing requirements and then to take account of any changes arising from the current consultation) in a short space of time. Such a duplication of time and effort would be extremely inefficient and would divert resources away from other important regulatory priorities and challenges such as adapting to the post-Brexit environment and supporting economic recovery from the COVID-19 pandemic.

It is also impracticable for firms to embark on client outreach for the purposes of repapering agreements to comply with Article 25 RTS on Settlement Discipline before changes to the settlement discipline rules are finalised, and clarity of messaging to clients is crucial for a successful outreach. In members' experience, repapering exercises of this sort generally take several months, underlining the need for clarity to be provided quickly, leaving sufficient time before the current 1 February 2022 application date for firms to adapt their implementation plans.

Finally, we also note that including emissions allowances in scope of the CSDR settlement discipline regime could act as an impediment to the future development and expansion of the market and so we request that they are removed from scope of the settlement discipline regime.

About ISDA, FIA and FIA EPTA

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 75 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry.

FIA's mission is to:

- support open, transparent and competitive markets,
- protect and enhance the integrity of the financial system, and
- promote high standards of professional conduct.

As the leading global trade association for the futures, options and centrally cleared derivatives markets, FIA represents all sectors of the industry, including clearing firms, exchanges, clearing houses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.

About FIA EPTA

The FIA European Principal Traders Association (FIA EPTA) represents 30 independent European Principal Trading Firms (PTFs) that deal on own account, using their own money for their own risk, to provide liquidity and immediate risk-transfer in exchange-traded and centrally-cleared markets for a wide range of instruments, including shares, bonds, options, futures and ETFs. As market makers and liquidity providers, our members contribute to efficient, resilient, and high-quality secondary markets that serve the investment and risk management needs of end-investors and companies throughout the EU.

Specific answers (Section 6: Scope)

Question 31: Question 31. Do you consider that certain requirements in CSDR would benefit from targeted measures in order to provide further legal certainty on their scope of application?

-Yes

-No

-Don't know / no opinion

Question 31.1 If you answered "yes" to Question 31, please specify what clarifications/targeted measures could provide further legal certainty. (5000 character(s) maximum)

As set out in the covering letter accompanying this response, our primary concern relates to the potential application of the mandatory buy-in regime to settlement fails arising in the context of margin transfers (i.e. where a party is transferring margin in the form of financial instruments to support a derivatives transaction or netting set and the transfer is to be settled in an EEA CSD).

We do not consider that margin transfers should be (or were intended to be) captured by the mandatory buy-in regime, as imposing a buy-in in this scenario would undermine the risk-mitigating purpose of regulatory margin requirements under EMIR and the timeframe of regulatory margin transfers is generally too short for a buy-in to be effective. However, a lack of clarity on the meaning of "transaction" under CSDR and the absence of an express carve-out creates uncertainty, as explained below.

Under Article 7(3) CSDR, a mandatory buy-in is triggered where a party fails to deliver in-scope financial instruments to settle a "transaction" in an EEA CSD on the intended settlement date, and the settlement fail continues past the end of the relevant extension period. However the term "transaction" is not defined in CSDR or in the RTS on Settlement Discipline. In some cases, it 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). This difference in scope is justified, as buy-ins occur at the trading level, whereas settlement fails monitoring and reporting occurs purely at the CSD level. However, confusion arises from use of the same undefined term to describe two different concepts (i.e. the commercial trade on the one hand and the post-trade settlement through transfer of securities in an EEA CSD on the other hand).

It is also unclear whether the carve out in Article 7(4)(b) CSDR for "operations composed of several transactions" where "the timeframe of those operations is sufficiently short and renders the buy-in process ineffective" applies to margin transfers supporting derivatives transactions (to the extent they would otherwise be in scope of mandatory buy-in rules). We consider that it should apply because margin calls are usually made on a daily basis and even initial margin requirements must be recalculated every 10 business days at most (i.e. significantly shorter than the 30 business day timeframe referred to in Article 22 RTS on Settlement Discipline,

which elaborates on when the timeframe of a securities financing transaction will be short enough to render the buy-in process ineffective). However, the fact that neither Article 7(4)(b) CSDR nor Article 22 RTS on Settlement Discipline expressly refers to margin transfers means that there remains uncertainty as to the scope of this carve out.

Therefore, we request that the CSDR settlement discipline regime is amended to clarify that margin transfers are not subject to mandatory buy-in requirements.

It is also somewhat unclear whether the physical settlement of a physically settled derivatives contract (where the underlying is an in-scope financial instrument) would be considered a "transaction" subject to the mandatory buy-in regime. Again, we request that these settlements are expressly carved out of scope of the mandatory buy-in regime. This is on the basis that it would be inappropriate and disproportionate to impose mandatory buy-ins in the context of physical settlement of derivatives contracts, as discussed further in our responses to questions 34.1 and 36 and our covering letter accompanying this response.

Question 31.2 If you answered "yes" to Question 31, please specify which provisions could benefit from such clarification and provide concrete examples. (5000 character(s) maximum)

CSDR should clearly distinguish between commercial trades and post-trade settlements through transfer of securities in an EEA CSD.

We therefore request that the term "transaction" should be used to refer to commercial trades only and that it should be clearly defined.

As discussed in our response to Q34.1, we request that the mandatory buy-in regime is removed from CSDR altogether. However, to the extent that any regulatory rules relating to buy-ins are retained, these rules should apply with respect to "transactions" only, with both margin transfers and physical settlement of physically settled derivatives expressly carved out of scope.

Where it is necessary to refer to post-trade settlements through transfer of securities in an EEA CSD more broadly (for example, in the context of CSD settlement fails monitoring), we request that a different term such as "transfer order" is used. We note that "transfer order" is already used and defined in the RTS on Settlement Discipline (but it is not currently clear how this term relates to "transactions" as referred to in CSDR itself).

Question 32. Do you consider that the scope of certain requirements, even where it is clear, could lead to unintended consequences on the efficiency of market operations?

- Yes

- No

- Don't know / no opinion

Question 32.2 If you answered "yes" to Question 32, please specify which provisions are concerned. (5000 character(s) maximum)

Our concerns relate to the potential application of mandatory buy-in rules to settlement fails arising in the context of margin transfers and physical settlement of derivatives.

If mandatory buy-ins were applied to settlement fails arising in the context of margin transfers and physical settlement of derivatives, this would have the negative consequences discussed in our response to Q34.1, including undermining of the risk-mitigating purpose of regulatory margin requirements under EMIR and unduly restricting trading parties' contractual freedoms. It would also place a disproportionate implementation burden on firms as explained in our response to Q36.

We also note that including emissions allowances in scope of the CSDR settlement discipline regime could act as an impediment to the future development and expansion of the market. Emission allowances are expressly referred to in Article 5(1) CSDR, bringing them into scope of the settlement discipline regime when settled on an EEA CSD. We understand it is relatively uncommon for emissions allowances trades to be settled through a CSD today. However, as this market expands and becomes more mainstream (due to the increasing focus on ESG issues) firms may look to settle these instruments through more conventional financial markets infrastructure such as CSDs. There is a risk that the CSDR settlement discipline regime could act as an impediment to this and so slow the development and expansion of the EU emissions allowances market in future.

Question 32.1 If you answered "yes" to Question 32, please specify what targeted measures could be implemented to avoid those unintended consequences while achieving the general objective of improving the efficiency of securities settlement in the Union? (5000 character(s) maximum)

We request that prescriptive buy-in rules are deleted from CSDR altogether as a result of the current review. In this case, it would no longer be necessary to address many other problematic aspects of the current buy-in rules, including those raised elsewhere in our response.

However, at the very least we request that the CSDR settlement discipline regime is revised to clearly provide that settlement fails arising in the context of (a) margin transfers; and (b) physical settlement of derivatives are not subject to mandatory buy-ins. We note that since CCPs may be involved in some but not all of the scenarios discussed, our request applies with respect to settlement fails arising in the context of both cleared and uncleared transactions.

We also request that emissions allowances are removed from scope of the CSDR settlement discipline regime.

Specific answers (Section 7: Settlement discipline)

Question 33: Do you consider that a revision of the settlement discipline regime of CSDR is necessary?

-Yes

-No

-Don't know / no opinion

Question 33.1: If you answered yes to Question 33, please indicate which elements of the settlement discipline regime should be reviewed:

- Rules relating to the buy-in

- Rules on penalties

- Rules on the reporting of settlement fails

- Other

Question 33.2: If you answered "Other" to Question 33.1, please specify to which elements you are referring. (5000 character(s) maximum)

N/A

Question 34: The Commission has received input from various stakeholders concerning the settlement discipline framework. Please indicate whether you agree (rating from 1 to 5) with the statements below:

1 (disagree) 2 (rather disagree) 3 (neutral) 4 (rather agree) 5 (fully agree) No opinion

- **Buy-ins should be mandatory – 1**
- **Buy-ins should be voluntary – 5**
- **Rules on buy-ins should be differentiated, taking into account different markets, instruments and transaction types – 5**
- **A pass on mechanism should be introduced¹ – 5**
- **The rules on the use of buy-in agents should be amended – 5**
- **The scope of the buy-in regime and the exemptions applicable should be clarified – 5**
- **The asymmetry in the reimbursement for changes in market prices should be eliminated – 5**
- **The CSDR penalties framework can have procyclical effects – 5**
- **The penalty rates should be revised – no opinion**
- **The penalty regime should not apply to certain types of transactions (e.g. market claims in cash) – no opinion**

¹E.g. a mechanism providing that where a settlement fail is the cause of multiple settlement fails through a transaction chain, it should be possible for a single buy-in to be initiated with the intention to settle the entire chain of fails and to avoid multiple buy-ins being processed at the same time, and that where a receiving trading party in a transaction chain initiates the buy-in process, all other receiving trading parties in that transaction chain are relieved of any obligation to initiate a buy-in process

Question 34.1 Please explain your answers to question 34, providing where possible quantitative evidence and concrete examples. (5000 character(s) maximum)

As set out in our response to Question 31.1 and the covering letter accompanying this response, our primary concern relates to the potential application of the mandatory buy-in regime to settlement fails arising in the context of margin transfers. We do not consider that margin transfers should be – or were intended to be – captured by the mandatory buy-in regime, as imposing a buy-in in this scenario would undermine the risk-mitigating purpose of regulatory margin requirements under EMIR and the timeframe of regulatory margin transfers is generally too short for a buy-in to be effective.

In addition, we do not consider it appropriate to impose mandatory buy-ins in the context of physical settlement of derivatives transactions. Industry standard derivatives trading and clearing 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, which have been carefully crafted over the years, are well understood by the market and reflect the commercial agreement between the parties.

Article 7(3) CSDR expressly states that the mandatory buy-in regime should be without prejudice to the right of the parties to bilaterally cancel a transaction. The same should apply with respect to other contractual rights and remedies agreed between the parties in case of a failure to deliver – i.e. regulatory measures to address post-trade settlement fails should not prejudice or limit the contractual freedom of the trading parties to agree the commercial terms of the transaction, including rights and remedies where there is a failure to deliver securities arising from a settlement fail. However, 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.

We therefore request that the CSDR settlement discipline regime is revised to clearly provide that settlement fails arising in the context of (a) margin transfers; and (b) physical settlement of derivatives are not subject to mandatory buy-ins. In light of broader market concerns around the mandatory buy-in regime, we request that this is achieved through removing the mandatory buy-in regime altogether. As set out in our response to question 34, we consider that buy-ins should instead be voluntary and should respect trading parties' contractual freedoms to agree appropriate rights and remedies in case of a default arising from a settlement fail. In particular, by "voluntary buy-in" we mean that parties should have freedom to agree a contractual buy-in right, if this is appropriate in the commercial context of the contract. However, they should not be forced to do so, as regulatory measures to address post-trade settlement fails should not prejudice or limit the contractual freedom of the trading parties to agree the commercial terms of the transaction.

Our preferred solution is therefore that prescriptive buy-in rules are deleted from CSDR altogether as a result of the current review. In this case, it would no longer be necessary to address other problematic aspects of the current buy-in rules, such as those raised in the third row onwards of the table at Question 34. However, to address these points directly:

- Different rights and remedies are likely to be appropriate for different markets, instruments and transaction types and so if any regulatory requirements relating to buy-ins are retained, they should be drafted broadly enough to cater for these differences. It is also important that any nuances in buy-in requirements for different markets and transaction are drafted in

a flexible manner, so that they do not prevent pass-ons from occurring where a chain of settlement fails involves different markets or transaction types.

- Pass-ons should be permitted (whether expressly via a pass-on mechanism or because buy-ins are made voluntary) and there should be sufficient alignment between rules for different transaction types to allow for effective and efficient pass-ons. As with other aspects of buy-ins, pass-ons should be optional and not mandatory.
- The lack of buy-in agents in the market is likely to cause significant practical challenges for firms seeking to comply with the buy-in rules as currently drafted. Therefore, it should not be mandatory to appoint a third-party buy-in agent.
- The scope of any revised buy-in regime should clearly exclude margin transfers and physical settlement of derivatives from mandatory buy-ins.
- The asymmetry in the reimbursement for changes in market prices should be eliminated.

Question 35: Would the application of the settlement discipline regime during the market turmoil provoked by COVID-19 in March and April 2020 have had a significant impact on the market?

- Yes

- No

- Don't know / no opinion

Question 35.1: Please explain your answer to Question 35, describing all the potential impacts (e.g. liquidity, financial stability, etc.) and providing quantitative evidence and/or examples where possible. (5000 character(s) maximum)

Members expect that it would be very rare for a mandatory buy-in to be triggered in the context of derivatives transactions, including in times of market stress or turmoil. This is because 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 (which could include failure to deliver due to a settlement fail, depending on the commercial terms agreed between the parties).

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. The grace period for delivery failures under ISDA/FIA documentation is typically 1-3 business days, i.e. shorter than the buy-in extension period. Therefore in practice, parties may seek to exercise their agreed contractual rights and remedies to address a failure to deliver before they are disrupted by a mandatory buy-in.

As such, we do not consider that the application of the settlement discipline regime during the market turmoil provoked by COVID-19 in March and April 2020 would have had a significant impact on derivatives transactions. However, we emphasise that this is due to the specific features of derivatives transactions and of industry standard derivatives trading and clearing

documentation. We do not express a view on how the CSDR settlement discipline regime may have impacted other markets or transaction types during the market turmoil provoked by COVID-19, as our response focuses on derivatives markets only. However, we note that other industry associations including the Association for Financial Markets in Europe (AFME), the International Capital Market Association (ICMA) and the International Securities Lending Association (ISLA) have addressed broader financial market impacts, including detailed quantitative evidence, in their responses.

Question 36. Which suggestions do you have for the improvement of the settlement discipline framework in CSDR? Where possible, for each suggestion indicate which costs and benefits you and other market participants would incur. (5000 character(s) maximum)

We request that prescriptive buy-in rules are deleted from CSDR altogether as a result of the current review. In this case, it would no longer be necessary to address many other problematic aspects of the current buy-in rules, including those raised elsewhere in our response.

However, at the very least we request that the scope of any revised buy-in regime should clearly exclude margin transfers and physical settlement of derivatives from mandatory buy-ins.

If margin transfers and physical settlement of derivatives were not excluded from scope of mandatory buy-in requirements, this would have the negative consequences discussed elsewhere in our response, including undermining of the risk-mitigating purpose of regulatory margin requirements under EMIR and unduly restricting trading parties' contractual freedoms. It would also place a disproportionate implementation burden on firms.

This is because firms would need to carry out significant operational and contractual implementation (including client outreach to repaper agreements) in order to comply with Article 25 RTS on Settlement Discipline. This would be extremely disproportionate, as it would require firms to devote a significant amount of time and resources to the implementation of regulatory requirements that firms expect to have little practical impact on derivatives transactions at best and which would have the negative consequences discussed elsewhere at worst.

The repapering process itself will create a significant implementation burden for firms, particularly when viewed in the context of other new regulatory requirements due to apply over the next couple of years that also require amendments to contractual documentation. In particular, -IBOR transition and compliance with Article 28(2) Benchmarks Regulation, contractual stays requirements under BRRD2 and EMIR initial margin requirements for Phases 5 and 6 counterparties may all require members to agree contractual changes to their derivatives documentation over the next couple of years. However, all of these new requirements start to apply at different times, meaning that it is not possible to streamline client outreach effectively. This leads to concerns that multiple rounds of client engagement and related amendment processes can themselves lead to amendment fatigue and lower levels of counterparty engagement.

Whilst ISDA has been considering whether the development of a protocol might be necessary to aid with agreement and adoption, the very broad agreement and counterparty scope of the CSDR settlement discipline regime, coupled with the substantive impact that a buy-in would have on the substantive terms of transactions, means that a protocol may be difficult to achieve in this context. Indeed, no current solution exists and the development and widespread adoption of a protocol to meet the requirements of Article 25 RTS on Settlement Discipline in

respect of derivatives transactions would be a complex exercise, requiring amendment of multiple documents including master agreements and terms of business, clearing addenda, collateral documentation and related custody documentation.

The broad extraterritorial reach of the CSDR settlement discipline requirements to any trading parties settling transactions in in-scope financial instruments on EEA CSDs would also necessitate a global repapering exercise. Further, the lack of clarity in CSDR and the RTS on Settlement Discipline on various points of detail relating to the mandatory buy-in regime also reduces the likelihood of a protocol being effective in this context. Therefore, any potential repapering solution for derivatives would be costly and was not foreseen in the cost-benefit analysis of CSDR.

Again, for these reasons relating to cost-benefit implications and the disproportionality of the scale of implementation action that would be required, we request that margin transfers and physical settlement of derivatives are excluded from regulatory buy-in requirements, including any requirements that would force parties to repaper existing agreements.

We ask that clarity is provided quickly on any proposed changes to the CSDR settlement discipline regime. This will be crucial to avoid the need for firms to implement CSDR settlement discipline requirements twice (i.e. first based on the existing requirements and then to take account of any changes arising from the current consultation) in a short space of time. Such a duplication of time and effort would be extremely inefficient and would divert resources away from other important regulatory priorities and challenges such as adapting to the post-Brexit environment and supporting economic recovery from the COVID-19 pandemic.