EFAMA

3 QUESTIONS TO

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on the CSDR Settlement Discipline Regime (SDR)

Q #1 *What is the CSDR's Settlement Discipline Regime (SDR) and what does it seek to achieve?*

The CSDR Settlement Discipline Regime (SDR), that will become applicable in February 2022, aims to encourage prompt settlement of European equity and fixed income trades by addressing delays and fails with cash penalties and mandatory buy-ins. The SDR will be applicable in the entire European Economic Area. However, it will have a broader global impact as it will apply to all in-scope trades clearing through European CSDs, regardless of where the trading counterparty or beneficial owner is located.

The first order of business for most market participants in preparing for these new requirements is to focus on reducing their rate of settlement delay and failure. There is fresh energy to address operational root causes for settlement delays and failures. For example, missing or incorrect Standard Settlement Instructions (SSIs).

> *"There is fresh energy to address operational root causes for settlement delays and failures"*

The mandated settlement discipline regime seeks to incentivise market participants to improve settlement efficiency, including by making partial settlement less manual, therefore also contributing to achieving its objective of improving settlement discipline.

Q #2 *From a buy-side perspective, is there a need to review the existing Settlement Discipline Regime and if so what are the key points that should be taken into consideration?*

Some aspects of the Settlement Discipline Regime should be improved to allow for a more balanced consideration of different interests and avoid unintended consequences. In their responses to the CSDR consultation in February 2021, EFAMA and its members advocated mainly for measures to protect investors from being impacted by settlement issues outside of their control. Chief among our recommendations is the removal of the mandatory buy-in requirement.

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Mandatory buy-in could indeed bring unintended consequences, such as deteriorating liquidity, particularly for already less liquid assets. This could impact the availability of securities for loan and, hence, the revenues derived from securities lending. It also seems to ignore long-standing market practices. Although today’s European settlement discipline does not have a regulatory incentive, settlement delays can have important consequences and buy-side firms place high importance on establishing long-term trusted relations with their trading counterparties. This will be difficult to maintain in the future on the basis of a mandatory buy-in regime which disregards the knowledge of the counterparties and their track record.

There are also important implications for investors to consider, as mandatory buy-ins will impact all funds’ shareholders. By disregarding the fact that the shareholders’ base changes on a daily basis, such measure can impact shareholders disproportionately in absence of the direct link to the initial activity that incurred the penalty or buy-in.

Another suggestion is to review the scope of the penalties regime so that it differentiates more between instrument types. The difference between equity and fixed income markets in terms of what is considered good settlement discipline needs to be fully recognised and properly calibrated. The guiding principle of the Settlement Discipline Regime needs to correctly identify the ‘at fault’ party. Restoring parity via bilateral claims does not meet this key objective. A modification is needed to ensure that in the event of a bilateral claim, the ‘at fault’ party is the one that pays the penalty.

Q #3 *What challenges are asset managers facing in their preparation for the Settlement Discipline Regime and how can these be addressed? What level of engagement are you seeing?*

Since the adoption of CSDR, important concerns have been raised by a wide range of stakeholders as to the appropriateness of some of the settlement discipline measures, in particular those related to penalties and sanctions. The European Commission has launched a public consultation on CSDR, including the settlement regime, and is expected to address the industry concerns via a targeted review of the Regulation.

Whilst essentially welcomed as an opportunity to address some of the issues mentioned above, the ongoing CSDR review – because it takes place only a few months before the new SDR regime is due to become applicable – also brings new sources of uncertainties for all market participants.

We have, understandably, witnessed a slowdown of progress as participants seek to limit their efforts until there is more certainty. To get back on track, we support the setting of clear goals for the CSDR review and targeted improvements of the SDR before the new regime goes live.

In terms of timing, a delay in the preparation for the implementation of the new rules has led to their implementation date being pushed back to February 2022.

Preparing for the Settlement Discipline Regime requires collaboration across all participants in the settlement life cycle. As downstream users of information, asset managers are dependent on the data created upstream. The sooner we can view prototypes and see samples of what we will receive, the better.

On a positive note, we have seen strong engagement from all market participants involved: custodians, vendors, brokers and securities lending agents are actively seeking to understand the asset manager's requirements so that they can deliver quality solutions.

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