OVERSIGHT

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Regulatory Update

The real work starts now

Across the entire regulatory agenda pieces are beginning to fall into place. And we now have greater clarity on the impact each piece will have on SIX Securities Services.

The main development has been the finalisation of six Regulatory Technical Standards under EMIR. Two, in particular, concern SIX x-clear Ltd: the CCP capital requirements and the CCP prudential requirements.

The main effect of these is to trigger the start of the application process by SIX x-clear Ltd for recognition under EMIR as a third-country CCP. We have a project team in place to take this forward.

At the CSD level, discussions on the CSDR have stalled in the EU Council but, more positively, the European Parliament has finished its work. The result, is the usual mixture of positive, harmless and potentially harmful amendments.

The CSDR is also important for T2S and here, too, I can announce progress: our Board has decided that we will connect directly to the T2S system through SIX SIS Ltd from our operating center in Switzerland.

We are currently rolling out a comprehensive plan to ensure that our clients are fully appraised of the phases – planning, analysis, development and testing – in order to actively contribute to them.

In the last edition, I also mentioned that we were undertaking a self-assessment against the revised CPSS-IOSCO Principles. This is now being followed up – after discussion with the Swiss National Bank – and the new Principles framework will be initially reflected in the revision of the National Bank Ordinance. This reflection is necessary as the framework applies to the oversight of systemically important payment and settlement systems. We expect this to be adopted by the summer.

As always, much to look forward to.

Thomas Zeeb
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Securities Services

EU initiatives affecting the value chain

A number of EMIR Technical Standards have been finalised and enter into force on 15 March; Negotiations on the CSD Regulation in Council continue in a slow vein; MiFID discussions are not concluded; an EU proposal for a Financial Transaction Tax has also been issued.

EU Legislative Programme affecting Market Infrastructures

Changes since the last edition of Oversight are highlighted in bold in the table below:

Segment of the Value Chain	Measure	Proposed (Published)	Adopted (Finalised)	Entry into Force (after Technical Standards)
Trading	Review of Market in Financial Instruments Directive (MiFIDII/MiFIR)	20 October 2011	**Q3 2013/Q1 2014?**	2016?
Clearing	European Market Infrastructure Regulation (EMIR)	15 September 2010	July 2012	**15 March 2013**
Settlement	Central Securities Depositories Regulation (CSDR)	7 March 2012	**End - 2013?**	Mid - 2015
Underpinning Law	Securities Law Directive/ Legislation (SLD/SLL)	**Q2 2013**	End - 2015?	2017/18?

a) The EU Regulation on OTC Derivatives, central counterparts, and trade repositories (EMIR)

After the European Parliament's ECON Committee had initially threatened to reject two of the six EMIR Regulatory Technical Standards finalised by the Commission on 19 December (see below), both institutions agreed to their approval. The RTS were subsequently published in the Official Journal on 23 February and will enter into force on 15 March. The main consequences are to trigger the application process for EU and third country CCPs for recognition under EMIR (see box below), the notification to ESMA of OTC transactions subject to central clearing, and a phasing in of dates for reporting these transactions to Trade Repositories (as well as the authorisation of TRs themselves).

Regulatory co-operation efforts continue to ensure that a degree of mutual recognition between jurisdictions exists to meet the G-20 commitments of trading, clearing and reporting OTC derivatives. In a parallel development, the European Commission has extended, ESMA's deadline for the provision of technical advice on the equivalence of OTC and other rules between the EU, the USA and Japan, to mid-June. The deadline for the assessment of other third countries, such as Switzerland, has been extended to mid-July.

The Commission's work does not stop there. Three RTS are still outstanding: CCP colleges, standardised contracts for clearing, and capital treatment of non-centrally cleared OTC derivative transactions (awaiting finalisation by the Basel Committee/IOSCO – see below).

FEATURE ON EMIR: RE-AUTHORISATION OF CCPs BY ESMA

The entry into force on 15 March 2013 of the Regulatory Technical Standard on requirements for CCPs means that the clock has started ticking for the re-authorisation of all CCPs operating on the EU market. Article 25 (4) specifies that all Third Country CCPs have six months to submit an application to ESMA. The detailed information to be supplied is laid down in Article 2 of the relevant RTS. ESMA has 180 working days to process SIX x-clear's Ltd's application, taking us to about the middle of June 2014. In the meantime, ESMA must assess the "equivalence" or compatability of the third country's rules for CCPs and give its advice to the Commission. In Switzerland's case, ESMA must deliver that advice by 15 July 2013. The Commission then has to take a formal "equivalence decision". Until such time as ESMA makes a decision on SIX x-clear's Ltd's application, SIX x-clear's Ltd's existing authorisations to operate in certain member states (e.g. in the United Kingdom) remain in place; they are "grandfathered" in EU jargon.

b) Central Securities Depositories Regulation (CSDR)

As mentioned in the last issue, the weight of other Council dossiers has meant that no discussion has taken place in the Council working group under the Irish Presidency. This has particularly exercised the European Central Bank, which is dependent on the CSDR to introduce legislative provisions, such as the shortening of the settlement cycle to T+2, to complement their Target 2 Securities Project. More positively, the European Parliament has considered and voted (on 4 February) its report on the CSDR. A particularly favourable outcome is that ECON members have accepted that CSDs can maintain a single legal entity in order to continue to offer commercial bank settlement services, but will need a separate authorisation for this activity (the so-called "1 + 2" model). However, the EP has also inserted a review clause, and the continuation by the CSD of this service (rather than a settlement agent bank) will be subjected to a range of rigorous additional risk management requirements, over and above CRD IV requirements. ECON also voted to process the dossier at First Reading, which puts the spotlight back on the Council to get on with their deliberations.

c) Revision of the Market in the Financial Instruments Directive (MiFID II/MiFIR)

Discussions in the Council Working Group continue, though sources suggest that agreement is still some way off. Areas discussed in the last CWG included market structure, OTFs, post-trade transparency for bond markets, portfolio compression and a reference price waiver (by way of a volume cap) for dark pool transactions. The Irish Presidency continues to chair CWG discussions, but an agreement between member states may elude them in the first half of this year, thus delaying the adoption of all the implementing measures until potentially well into 2015 or even 2016.

d) Securities Law Legislation

According to the latest information available, a Commission proposal on the SLL is still due for release in Q2. However, "Oversight" understands that the revised proposal still had to receive the go ahead from the Commission's Impact Assessment Board; its first effort having been rejected by the IAB.

e) Financial Transaction Tax Directive

Having received the go ahead in the December Ecofin for a proposal based on the "enhanced co-operation" process, the Commission issued its draft Directive on 4 February. 11 participating member states (all in the Eurozone) are taking part. Notwithstanding this limited subset of member states, the proposal has potentially severe consequences, both in terms of extra-territorial effects, and potentially wide implications for all links in the value chain. The FTT will operate at the level of the transaction (financial instruments, broadly defined) thus impacting organised markets, including stock exchanges. There is also a broad definition as to origin or issuance of the instrument, so that potentially, not only non-participating countries are caught, but also, say, two Swiss banks trading a French security. Although CSDs and CCPs are notionally excluded, the method of collecting the tax is not laid down in the Directive, and will instead be subject to later agreement. The suspicion remains that CSDs could well become liable for the collection of the tax, as Euroclear France has become for the French FTT introduced last year. The FTT proposal is regarded as a priority, with the Commission pushing for entry into force by 1 January 2014.

f) Level 2 Legislative Process: Institutional Questions

It is some time since "Oversight" reported on how this process has been operating, and we should comment again. As readers will know, increasingly, EU financial services legislation consists of a Level 1 (Directive or Regulation) text, which is supplemented by Regulatory or Implementing Technical Standards at Level 2. These add detail to usually generic requirements in the main Articles in a Regulation or Directive (for instance the format of records to be kept or detailed risk management provisions). The process is that these ITS or RTS are produced by the Commission or one of the European Supervisory Agencies, such as ESMA. The Council and the European Parliament are consulted on these texts, but the responsibility for their entry into force remains with the Commission. We have now had a number of occasions (Short Selling Regulation, EMIR and the AIFMD) where disputes have arisen between the EU institutions. In both cases of the SSR and the AIFMD, it has led to complaints by a number of member states in the Council that the Commission had not observed the spirit of the Level 1 text and imputed additional regulatory requirements. As recorded above, in the EMIR case, the EP felt similarly about the imposition on non-financial companies of OTC derivative collateral requirements. It also felt that the Commission had not properly observed the timelines for its response. In its declaration, following the EP's agreeing to lift its objections, the Commission has stated that it will review with the other institutions how the Level 2 process is supposed to function.

Market infrastructure initiatives by the European Central Bank (ECB)

SIX SIS Ltd has decided to connect "directly" to T2S. Elsewhere, the ECB is stepping up its efforts to identify and mitigate outstanding issues relating to the harmonisation of collateral frameworks in Europe.

a) Target 2 Securities (T2S)
The SIX Board has now decided that SIX SIS will participate in T2S via a direct connection from SIX SIS's operations centre in Switzerland. SIX SIS Ltd will still form part of the first migration wave in T2S, anticipated in July 2015 (assuming all is well with the adoption of the CSDR – see above). Over the next few weeks we will be developing a comprehensive project structure and implementation programme, dubbed "T2S Direct", and sharing this, for instance via the Swiss National User Group and the Swiss Post-trading Council, with the Swiss financial community.

A future task for the ECB's oversight work will be in the assessment and "approval" of CSD links into T2S. Through our European association, ECSDA, we will be discussing how best to address these future requirements.

(b) Collateral Harmonisation
Following on from the postponement of the CCBM 2 project, the ECB is continuing its collateral harmonisation work via an ad-hoc working group of its infrastructure market committee, COGESI. A particular focus has been the facilitation of cross-border tri-party collateral management, and the issues focus on harmonisation of CSD cut-off times, the facilitation of repo transactions, and notably an improvement in the bridge between Euroclear and Clearstream. These and other issues will also be discussed at a conference on Post Trade Harmonisation organised jointly by the ECB and the European Commission on 19 March.

Other legislative and regulatory initiatives impacting on market infrastructures and the value chain

A second consultation on the margining requirements for non-centrally cleared OTC derivative products.

BCBS/IOSCO Consultation on capital treatment of non-centrally cleared OTC contracts
The Basel Committee and IOSCO have released a second consultative paper for comment until 15 March. This covers eight principles including scope (all non-centrally cleared OTC derivative transactions), exchange of initial and variation margin, eligible collateral covering all risks with a high degree of confidence, being liquefiable and available against default, together with the avoidance of jurisdictional overlap, being phased in over an appropriate time scale. Appendices propose the level of initial margin and standardised haircuts.

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