OVERSIGHT

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Regulatory Update

A lot has happened, but also not happened

The last edition of Oversight of the year is traditionally a time for reflection. And is it very much a case of glass half full, or glass half empty? Some things are clearer, but other things are not. We now look to 2014 for the completion of the comprehensive FMI regulatory program. And I bet that when I am writing the same account in a year's time, there are bound to be initiatives that have slipped into 2015.

In the 'done' category, SIX x-clear has submitted its application to ESMA for recognition under **EMIR** as a Third Country CCP. This is being processed, and we have to supply some additional material to ESMA by the middle of March. The process is bolstered by ESMA's technical advice to the European Commission that ruled that the Swiss CCP requirements were equivalent to those in EMIR. The Commission now needs to turn that advice into an equivalence decision, also anticipated in early 2014.

A further completion lies in the implementation of the CPSS-IOSCO Principles for FMIs into Swiss Law, via the National Bank revising its **National Bank Ordinance** as this relates to the Oversight of FMIs. Where possible, the SNB brought in additional elements present in EMIR. SIX Securities Services is well into the implementation project to ensure compliance with the new National Bank Ordinance by July 2014. As a complement, a new Swiss Financial Market Infrastructure Law (**"FinfraG"**) is in preparation (see feature in this edition) and is currently in consultation.

Also in the 'to do' category, the **CSD Regulation** has to be finalised, with the Lithuanian Presidency narrowly failing to conclude the discussions, as we went to press. However, it should not be long into 2014 before this happens, and ESMA can then start consulting on its further regulatory technical standards. FMI **Recovery and resolution plans** is another hot topic; we expect the CPSS-IOSCO and FSB frameworks to be finalised in the early months of 2014. So, there is plenty to get our teeth into during the coming year, which I hope will be a prosperous one for our readers.

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EU Initiatives Affecting the Value Chain

Negotiations on the CSD Regulation in the inter-institutional "Trialogues" near their end. While SIX x-clear has submitted its application to ESMA, there are still some outstanding measures to be taken under EMIR. MiFID Trialogue discussions will also drag on into 2014, while the Securities Law Legislation (SLL) is delayed again.

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	**Q1 2014**	2016?
Clearing	Regulation on OTC Derivatives, central counterparties & Trade Repositories (EMIR)	15 September 2010	July 2012	15 March 2013
Settlement	Central Securities Depositories Regulation (CSDR)	7 March 2012	**Q1 2014**	Mid - 2015
Underpinning Law	Securities Law Legislation (SLL)	**Q4 2014**	End - 2016?	2017 / 18?

a) Central Securities Depositories Regulation (CSDR)

Under the Lithuanian Presidency in the second half of 2013, the pace of Council discussions picked up, such that the Council was able to agree its general approach at the end of September. Since then the three EU institutions have been closeted in behind the doors of the "Trialogue" discussions, which came close to agreement at the end of 2013, but which will now be concluded in early 2014. Among the issues which required continued debate, we understand that those relating to settlement discipline, authorisation and supervision of CSDs, links, issuance into an unrelated CSD and banking-type services were prominent. SIX SIS also lobbied quite intensively on the Article 23 provisions governing the access of Third Country CSDs, which were not quite as we would have wished in the Council version of the text.

There is still a fair amount of technical drafting to be done, such that we do not expect the Level 1 text to be finalised before the end of Q1. In the early months of 2014, ESMA will issue a discussion paper beginning to formulate some of the aspects that will need to be taken into account in the 30 or so Level 2 Regulatory Technical Standards (RTS).

T+2

Related to the CSDR is the proposal to shorten the settlement cycle to T+2, in time for the start of the ECB's Target 2 Securities project in mid-2015. A number of European markets such as the Euroclear ESES and EUI ones have already concluded that the move to T+2 can be effected earlier via a change in market convention, in their case to be implemented by 6 October 2014. Something similar could also happen in the Swiss market, and SIX SIS, together with the Swiss Exchange, will be actively engaging with market participants in the early weeks of 2014 (e.g. at the next SPTC in February) to analyse and plan for bringing about this change if desired by the market.

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

As mentioned before, the main priority under EMIR has been to re-authorise national CCPs and non-EU CCPs (such as SIX x-clear) wishing to clear markets in the EU. To this end, SIX x-clear submitted by the due date in mid-September, its application to ESMA for recognition as a Third Country CCP under EMIR. This followed close on the heels of ESMA publishing its

technical advice to the European Commission that the rules in force in Switzerland relating to the prudential regime for CCPs could be considered equivalent. ESMA's technical advice now needs to be confirmed by the Commission in an "equivalence decision", also expected in Q1. ESMA's initial response to SIX x-clear was to ask for some limited additional information in certain areas such as stress-testing. SIX x-clear has until the middle of March to submit this information. Thereafter, ESMA will continue to process the application, with a decision expected before the end of the year.

The whole issue of the re-authorisation of Third Country CCPs (though not for Switzerland) has become fraught on two counts. One continues to be the general incompatibility between EMIR and frameworks such as the Dodd Frank Act. Second, the Asia Pacific (AP) Committee of IOSCO has written to the Commission complaining that most AP CCPs only clear domestic markets and they do not seen why their regimes need to be equivalent to EMIR. Allied to this, is the requirement in CRD IV, for all Third Country CCPs to be deemed as "Qualifying" ("QCCP") by mid-June. Without this kite mark, clearing members from these CCPs will be obliged to risk weight their (margin, default fund) exposures to the CCP at a higher risk weight. The AP Committee have suggested postponing for six months this obligation.

In terms of completing the legal framework for OTC Derivatives under EMIR, EU RTS are still awaited on the standardised list of OTC products to be centrally-cleared (now not expected until the middle of next year), together with the (EU) capital treatment of non-centrally cleared contracts, which was finalised by the Basel Committee and IOSCO in September. Also in draft is an RTS on derivative transactions by non-EU counterparties, which was out to consultation until the middle of November.

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

As with the CSDR, Trialogue discussions occupied most of Q4 under the Lithuanian Presidency, also just failing to reach complete agreement at the end of the year. Oversight understands that relatively rapid agreement was reached on high frequency trading; dark pools; the treatment of the new organised trading facility (OTF) venue category, including the inclusion of relevant asset classes; position limits, particularly for commodity derivatives; and even treatment of Third Country firms. However the vexed question of rules granting central counterparties non-discriminatory access to exchanges was not resolved, and will have to be taken up by the Greek Presidency in Q1 2014. An associated issue has been the treatment of CSDs under MiFID II, with SIX SIS supporting the ECSDA position of seeking an exemption for CSDs, in order to avoid double regulation with the CSDR. At the time of writing, this has only been partially successful: while "safekeeping" remains an ancillary service, a recital suggests that CSDs are subject to MiFID if they offer investment services (as defined) or investment advice.

d) Securities Law Legislation

There has been little progress to report since the last edition. Oversight understands that the Commission has postponed the issuing of a proposal in the near future such that it may now not see the light of day until the end of 2014, if not later. If, as seems likely, the Commission will recast the key issues to be tackled, it is possible that the SLL will concentrate less on legal aspects relating to the holding and disposition of securities, and more about alleviating legal impediments where they arise in the value chain in the re-use, re-hypothecation and transformation of collateral and transparency of collateral movements.

e) FMI Recovery and Resolution Plans

There are three strands of work on this. First, the December Plenary Session of the European Parliament approved Kay Swinburne's own initiative report, which broadly favoured the prioritisation of CCPs, and accepted that requirements for CSDs should be calibrated accordingly, on account of the different risk profile. Second, the EP's report was designed to accelerate the Commission's own work on a proposal on RRPs for CPPs (only). This was the subject of an October discussion paper for Member States, which rehearsed some of the key aspects of RRPs, including Default Waterfalls and other loss-sharing arrangements, and close-out. The paper was also discussed with EACH members in mid-December. Timing of the Commission proposal is unclear (possibly end-2014), with one source suggesting that the Commission is planning a preceding consultative paper early in 2014.

Third, another reason for the delay is that the CPSS-IOSCO framework (on FMI recovery) and that of the Financial Stability Board (on resolution) will not be concluded until the end of Q1. This is because of the amount of comment by market participants. As part of ECSDA, SIX SIS have notably engaged with the European Central Bank (which is attempting to put across a coherent European view in, notably, the CPSS discussions). Some of the stresses have included a CSD-specific framework; sufficient flexibility in (the use of) recovery tools; a clear boundary between recovery and resolution; and a

preference, at the EU level, of CSDs being subject to an FMI regime, rather than the Bank Recovery and Resolution Directive, as well as preserving legal integrity via "1 + 2" rather than "2 + 2". Where necessary (in a group structure), a consolidated view of R & R defences should also be taken.

f) UCITS V

The Fifth UCITS Directive, introducing, inter alia, new requirements relating to remuneration, and particularly liability provisions, has also been under discussion in Brussels under the Lithuanian Presidency. Belatedly, there have been attempts by a small minority of Member States to try and differentiate the liability regime for CSDs in UCITS V from that in the AIFMD, notably by introducing a distinction between funds held in the securities settlement system, and those held "in custody", and also through separating the role of issuer and investor CSDs. This could lead to confusion and has been resisted by ECSDA.

g) Financial Transaction Tax Directive

The Commission's proposal was largely ignored by the Lithuanian Presidency with no Council discussion taking place between September and early December. Much of this was the result of awaiting the result of the German elections, and the stance to be taken by the new German government. While there continues to be some doubt about how strongly an FTT is supported by the Coalition, Council discussions have resumed, albeit in a fairly desultory way. Oversight understands that the most likely outcome continues to be a reduction in the scope of the proposal, with particular carve-outs for products such as repo, which would be significantly undermined by the FTT.

A further indication of the differing viewpoints lies in two legal opinions, one from the Council Legal Service which questioned the legality of the FTT, and the other from the Commission Legal Service which declared the FTT compatible with the European Treaties. Meanwhile, the United Kingdom has launched a challenge before the European Court, which is the sole body which can rule on the legality of the proposal. Finally, the Commission has reigned back its enthusiasm, by suggesting that nothing will be adopted before 2015. Notwithstanding this, other work continues in the background with a firm of consultants appointed to draft a report on possible collection mechanisms. Two further reports form Price Waterhouse and the UK House of Lords have highlighted the damage to the European financial services industry from the tax. SIX has set up an internal task force which is closely monitoring developments.

FEATURE: CONSULTATION ON THE SWISS FINANCIAL MARKET INFRASTRUCTURE ACT

The Swiss Federal Council launched, on 13 December, a consultation on the draft FMIA, or "FinfraG". This will:

- introduce (remaining) prudential requirements relating to CCPs, CSDs and Trade Repositories,
- overhaul the requirements relating to the authorization and supervision of FMIs in Switzerland, thus bringing Swiss requirements into line with global and EU standards,
- as well as introducing the necessary provisions to trade, centrally-clear and report OTC derivatives in Switzerland (the G-20 commitments),
- also incorporate the revised National Bank Ordinance of 1 July, as this relates to the oversight of FMIs,
- transfer some provisions from the Swiss Stock Exchange Act, for instance in relation to the supervision of market operators such as brokers.

The consultation runs to 31 March 2014. The SIX group will be responding.

If you would like to find out more on EU financial market infrastructure legislation or on any other regulatory topic, please contact: Alex Merriman, Head of Market Policy (Alexander.Merriman@six-group.com) or by 'phone to +44 (0)20 7550 5442. Previous editions of Oversight and other regulatory information about us are also available at: www.six-securities-services.com

Market Infrastructure Initiatives by the European Central Bank (ECB)

Work on building SIX SIS's direct connection to T2S continues. The ECB is finalising its assessment framework for links in T2S, together with continuing its efforts to identify and mitigate outstanding issues relating to the harmonisation of collateral frameworks in Europe. CPSS are also analysing global collateral trends.

a) Target 2 Securities (T2S)

The project to build SIX SIS's direct connection to T2S, dubbed "T2S Direct", from SIX SIS's operations centre in Olten continues, and the SIX Board has approved the resourcing and financial outlays for the project. The staffing of the internal project team is complete and a series of client-focussed roadshows (including one in London) have been, and continue to be held. Discussions with the Swiss financial community continue in the T2S Direct Committee, as well as the Swiss Post-trading Council. One further positive bit of news is that the ECB has approved the Omnibus Account structure for our participants

As mentioned last time, we are also participating in the ECB's future work in relation to the assessment and approval of CSD links into T2S. Our European association, ECSDA, and its members (including SIX SIS) attended a further meeting in mid-December in Frankfurt, where the ECB laid out its first thoughts on the assessment of links between participating CSDs in T2S. This is largely intended to use existing national assessments (from e.g. the PFMIs), supplemented by additional legal opinions for non-general and customised links.

b) Collateral Harmonisation

We continue to closely follow the work of the ECB's COGESI ad-hoc working group on collateral harmonisation. The ECB published an initial comparative report on collateral frameworks in the summer at the same time that Euroclear, Clearstream and Eurex Clearing signed an agreement to progress the further facilitation of cross-border tri-party collateral management for repo. The ECB is continuing its analysis of collateral management issues, notably in the areas of quantifying eligible collateral; examining collateral transformation issues, types and risks; and the use of haircuts in collateral management. During 2014, as announced at SIBOS in September, the ECB it will lift the collateral repatriation requirement in the eurosystem's monetary policy operations.

In a parallel development, the BIS's CPSS is also researching aspects of the global collateral management industry, notably to understand the extent of collateral use and the means to which it is put in the financial system. Oversight understands that the report will be purely descriptive, and it is not intended to make any policy recommendations.

Global Legislative, Regulatory and Other Initiatives Impacting on Market Infrastructures and the Value Chain

The FSB continues its work on shadow banking. The IMF FSAP for Switzerland has also taken place.

a) Shadow Banking

The Financial Stability Board continues its efforts to analyse and mitigate the potential effects of shadow banking on the global financial system. In an end-August release from Work Stream 5, it focussed on the risks arising from securities lend and borrowing (SLB) and repo. However, it recommended action only on transactions on uncollateralised trades with the non-banking sector, developed an appropriate haircuts regime (which will be refined further during 2014), but eschewed the idea of mandatory clearing for repo and SLB products.

Separately, further proposals are awaited from the Commission. While some tightening of capital treatment (of lending between the bank and non-bank sectors) is possible, together with tweaking of the securitisation regime, a Commission official has recently gone on record, before a UK House of Lords Committee, suggesting that tougher shadow banking measures should be avoided lest an important source of finance is interrupted for restoring growth and employment in the EU.

b) IOSCO

There has been a notable uplift in the pro-activeness of the International Organisation of Securities Commissions which, notably following its October Board meeting has "underscored its commitment to tackling emerging risks to investors and securities markets in a proactive and forward way". This is very much inspired by the vision of its Secretary-general, David Wright, that has consistently argued for a bigger role for IOSCO, particularly in resolving cross-jurisdictional regulatory and other disputes, and becoming the global policeman. For FMIs, this means continued emphasis on checking the implementation of the PFMIs, OTC derivative regulation and unintended consequences of more centralised clearing through CCPs, monitoring systemically-important firms, use of collateral, shadow banking and SLB (see above).

c) CPSS-IOSCO CP on assessing FMI Critical Service Providers

In a further refinement of its assessment framework under the PFMIs, CPSS-IOSCO has launched a consultation on an assessment methodology, which is designed to provide guidance for regulators, supervisors and overseers in assessing an FMI's critical service providers against the oversight expectations in Annex F of the principles. The consultation runs to mid-February 2014.

d) IMF FSAP on Switzerland

During December, as part of the Article IV Consultations with Switzerland, the International Monetary Fund carried out a Financial Sector Assessment of the Swiss financial system. As noted in Oversight previously, a particular IMF priority during the 20 or so "FSAPs" covering 20 jurisdictions in 2013, was the financial stability assessment of major systemically-important institutions such as large banks and FMIs. Particular aspects covered included the implementation of the PFMIs in Switzerland, risk management (both governance and processes) as well as the roll out of RRPs. A team from SIX took part in discussions with IMF Staff. The outcomes will be discussed in the IMF Board early next year, with publication of the main findings expected in March.

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