OVERSIGHT

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Regulatory Update

Finally, it's all systems, go!

We are well into the New Year, and I can finally report that a number of the regulatory building blocks are beginning to fall into place. This means that there will be implications for us as a firm, you as our clients and the markets in general. In this edition, we begin the process of examining and quantifying some of these potential changes and will continue to do so throughout this year.

But, first to the achievements. As foreseen in the last edition of Oversight, both the CSD Regulation (CSDR) and the amendments to MiFID II/MiFIR have completed their EU legislative processes (barring a couple of minor procedural hoops). We examine, in particular, some of the key features of the CSDR and how we think these will affect us all. Most importantly, we announced on 4 March that the settlement cycle of the Swiss market would be shortened to T+2 on 6 October (in common with most other European markets); this is an important pre-requisite of being part of T2S. Our preparations for the latter continue apace and we also feature some of the key milestones for clients in this issue.

Although the legislative process in the EU will now slow down (as explained in our July issue), this has not stopped other infrastructure-related proposals from being issued. Perhaps – somewhat surreptitiously – on the coat-tails of the Bank Structure Regulation, the European Commission also issued, in late January, a proposal on the Transparency of Securities Financing Transactions, tackling certain aspects related to shadow banking. We are also expecting an amendment to the Shareholder Rights Directive; a leaked draft enables us to lay out some of its potential features. This edition is completed by the usual features on EMIR and the work on Recovery and Resolution Plans for FMIs, and some thoughts on how we assess what the mass immigration popular vote might mean for our aspect of EU – Swiss relations. I expect in our June edition, as we get deeper into the detail, to be able to update you again on our progress in examining the implications of all these moves, and how we expect to tackle them. In the meantime, it's back to the regulatory grindstone for us, and in the hope that we have not frightened you too much about the road ahead.

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Welcome to Oversight – our quaterly update on market policy developments and the regulatory landscape. If you would like to subscribe to this newsletter electronically please send an e-mail to oversight@six-group.com

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EU Initiatives Affecting the Value Chain

Both the MiFID and CSDR negotiations have been concluded. A new proposal on SFTs has issued, and a further measure on Shareholders' Rights is imminent. Is the SLL dead?

a) General Outlook

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	**2016/17?**
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	**Q1 2015**
Underpinning Law	Securities Law Legislation (SLL)	Q4 2014?	End – 2016?	2017/18?

b) Central Securities Depositories Regulation (CSDR)

Following provisional agreement reached in Council before Christmas, further discussions in the EU institutional Trialogues meant that the text was finalized and could be approved without further discussion at the COREPER meeting on 26 February, and by the EP's ECON Committee on 3 March. Two further procedural steps remain: the EP Plenary on 2 April, followed by the Ecofin Council on 6 May. It is expected that the text of the CSDR will then be published in the EU Official Journal in early June, and come into force 20 days after publication. That is for the Level 1 text; ESMA will still have to produce 30 or so regulatory technical standards (RTS) at Level 2. It has nine months to do so, so we can expect the whole of the CSDR package to come into force in early 2015. This is important because of the start date of the T2S project in mid-June 2015. ESMA will be issuing discussion/consultation papers, and draft RTS, in the months to come. The box below outlines some of the main provisions of the agreed text. If there has to be a disappointment, it is that the Trialogue discussions were held behind closed doors, with little or no potential for the CSD community to help with the drafting. As a result, the text is garbled and difficult to interpret in places and particularly the outcome on Third Country CSDs' access to the EU is less than optimal.

T+2

As mentioned last time as well, a key aspect of CSDR is the proposal to shorten the settlement cycle in the EU to T+2. After consulting the Swiss market, and approval by the SIX Executive Board in late February, SIX was able to announce on 4 March that it would be proceeding with the shortening of the settlement cycle in the Swiss market as well on 6 October. This brings to 14, the number of European markets that have announced a move to T+2 on 6 October. Detailed discussions on implementation between the Swiss market and SIX will continue in the weeks ahead.

CSDR – KEY FEATURES AND IMPACTS OF THE AGREED TEXT

Article 3	**Dematerialisation** of all transferable securities in the EU by 1.1.2025
Article 5	Shortening of **settlement cycle** in the EU to T + 2 by 1.1.2015
Article 6 & 7	harmonization of **settlement discipline** requirements, fails & penalties
Article 10-21	authorization of CSDs, including outsourcing (Article 19)
Article 23	provision of **CSD services** into the EU
Article 25	**access** of Third Country CSDs to the EU market
Article 27	**Governance**, including a third of independent directors on CSD Board

Article 28	Maintenance of **User Committees**, including powers to offer opinions
Article 30	**Outsourcing:** subject to conditions
Article 34	**Transparency** of pricing
Article 38	**Segregation** of Client assets
Article 44-48	Mitigation of **risks,** including operational risks and links
Article 49	Freedom for EU issuers to **issue** into an EU CSD of choice
Article 50-53	definition of types of **links** and access to CSDs
Article 54-60	additional authorization and prudential requirements for **banking –type services**
Article 61-66	**sanctions** and enforcement
Article 67-76	final provisions, including entry into force and **review**

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

Almost contemporaneously with the CSDR, after reaching a provisional agreement in mid-January, the EU institutions also agreed in Trialogue the texts relating to the revision of MiFID. So it is more or less on the same timelines as the CSDR for finalization, although there will be more work for ESMA at Level 2, involving over 80 RTS, and so a later date is likely for the full package to be effective. The box below reproduces the main features of the proposals. On completion, a number of Member States and the Commission expressed dissatisfaction with the outcome of the negotiations. In particular, Member States stressed that they did not think that the pre- and post-trade transparency provisions for non-equities (notably the maintenance of waivers) had gone far enough; nor was, in their view, the commodity regime sufficiently rigorous. The Commission singled out that the access provisions (from trading venues and trade feeds) to CCPs and CSDs had not been liberalized sufficiently. It will therefore still be possible for infrastructure silos, for a minimum of thirty months, until review, to limit access by other infrastructures to the component elements of their value chain. A clear disappointment for proponents of more competition among infrastructures in the EU. Our colleagues at the Swiss Exchange will be examining all these elements closely and inputting their thoughts on how Swiss legislation relating to trading venues – the Financial Market Infrastructure Act ("FinfraG"), currently in consultation, and the primary markets act ("FidleG") – should be framed.

REVISED MiFID II/MiFIR– MAIN FEATURES

- The **OTF** category covers non-equities only
- The operator of the OTF can engage in matched **principal trading** in bonds and non-standardised derivatives provided that the client has consented to it
- On **pre-trade transparency**, the four waivers remain available but with a double volume cap for equities on the Negotiated Trade Waiver and on the Price Reference Waiver
- The Minimum **resting time** requirement for HFT firms has been deleted
- A binding written agreement between the **HFT firm** and the trading venue in relation to participation in the market making scheme has been introduced
- The ban on **inducements** for independent advice has been adopted and it also applies to discretionary portfolio management
- **Safekeeping and administration** has been removed from the list of core investment services and are considered ancillary services except for the maintenance of securities accounts at the top tier level ('central maintenance service') – a positive outcome for CSDs
- On the **third country** regime, an EU passport is obtainable for the cross-border provision of services to professionals (the so-called "eligible counterparties") only, while national systems will remain for the provision of services by third country firms to retail investors and allow that Member State the option of requiring the firm to open a branch in that jurisdiction

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

As far as SIX x-clear's application to ESMA is concerned, it will be supplying in a timely fashion (by 12 March) the additional information requested by ESMA. In relation to the equivalence decision by the Commission on Swiss CCP requirements, this is still being processed – the timing being uncertain, and can now be expected no earlier than Q2. A major factor in this delay relates to the need for the Commission to prioritise the equivalence decisions for CCPs from the USA and Japan (which were presented in draft to the European Securities Committee on 19 February),

rather than anything specifically to do with Switzerland. We have recently spelled out, in a market communication, the impacts previously mentioned in Oversight, on clients, particularly in relation to account segregation and portability.

Globally, Oversight believes that a shift can now be detected in the priorities relating to CCPs from the standard setting bodies, notably the G-20 and the FSB, and that this will become progressively more evident as 2014 progresses. With all EU CCPs due to be re-licensed by their national authorities by the end of March; reporting requirements for exchange-traded and OTC derivatives in place (but perhaps not functioning as well as they should); and the bulk of OTC derivative contracts now subject to central clearing; the regulators' thrust has moved to ensuring that the regulation of this global cross-border business actually works. For this to happen, an acceleration in mutual recognition of respective regulatory regimes (or "exemptive relief") needs to occur. Not just between the EU and the USA, but also with other jurisdictions, notably in the Asia-Pacific region.

e) UCITS V

Trialogue negotiations on this measure bringing in investor protection and intermediary liability provisions on UCITS business have also concluded. Despite intensive lobbying by our association, ECSDA, and its members, one unsatisfactory aspect remains. A Recital in the amending Directive (no 16) but not in the text of an Article, spells out, with not much clarity, the extent to which the holding of UCITS with a CSD is separate from custody and therefore a delegation of liability. Much will depend on how Member States interpret this.

f) Proposal for a Regulation on the Transparency of Securities Financing Transactions (SFTs)

As part of its initiatives affecting the structure of banking in the EU, the Commission issued this proposal on 29 January, which will bring in new requirements in relation to the shadow banking-like aspects of repo and securities lending and borrowing. Broadly speaking, the main features of the proposal can be summarized as follows:

- Included in the scope are SFTs between Third Country entities and a counterpart in the EU
- SFTs include re-hypothecation and other financing structures having a similar economic effect to a SFT
- SFTs have to be reported to a trade repository, which is licensed by ESMA, and the data is made accessible to relevant authorities
- Adds to investor transparency frameworks in the UCITS and AIFMD rules
- Re-hypothecation can only be permitted with the express permission of the collateral provider
- Designation of competent authorities in the MS and co-operation with Third Countries

Given, the impending EU legislative hiatus, this proposal is not expected to make rapid progress in either the Council or the EP.

g) Proposed review of the Shareholder Rights Directive (SRD)

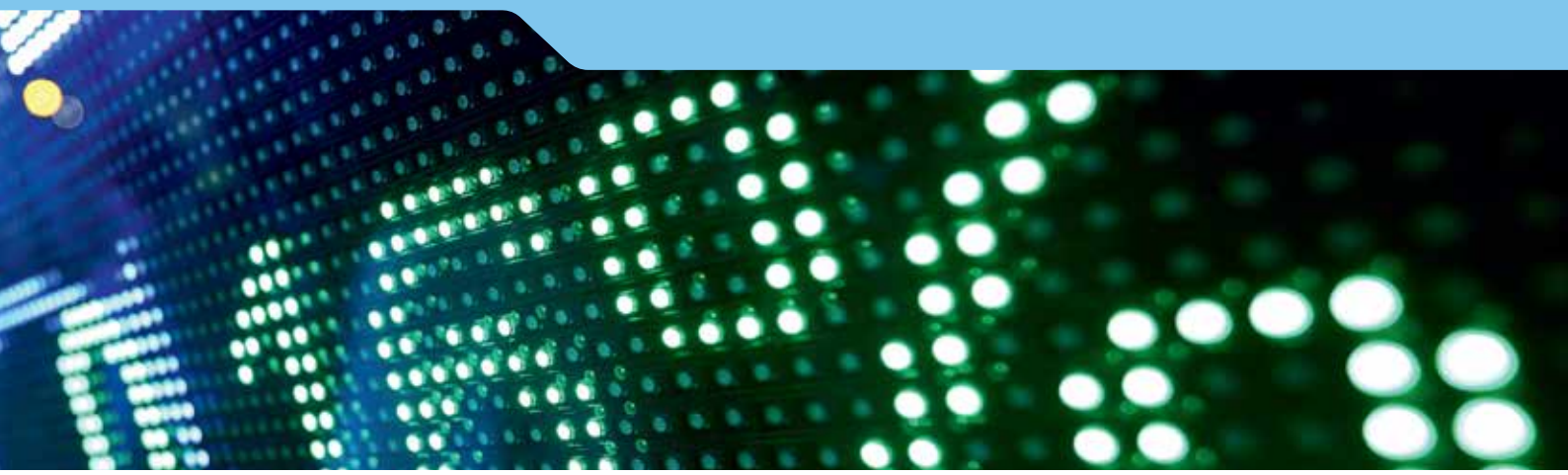
Oversight has obtained a leaked draft of the preliminary text, which has been in Commission inter-service consultation, but is expected to be adopted during this month. The two broad objectives of the SRD review are to enhance transparency and encourage more long-term engagement of shareholders. One specific objective of relevance to infrastructures such as CSDs is "to facilitate transmission of cross-border information (including voting) across the investment chain in particular through shareholder identification".

Also significantly, the proposed amendments to the SRD would introduce a definition of "intermediaries" which would appear to include CSDs (and basically any institution maintaining securities accounts). The Commission intends to impose the new requirements on all "intermediaries", such as the obligation to provide (i) information on the identity of shareholders at the request of companies; and (ii) transparency of prices and fees related to shareholder identification and shareholder voting services.

h) Securities Law legislation (SLL)

At the time of writing, Oversight has no further concrete information about this much-delayed proposal, which would complete the value chain legislative programme (see box on page 2). Oversight notes that known elements of the SLL, such as transparency, integrity of securities accounts, and re-hypothecation of collateral, are being introduced through the Regulation on the Transparency of SFTs, and potentially through the amendment of the SRD as well. We therefore suggest that we are seeing a change of emphasis from the Commission, such that the SLL may no longer appear, or at any rate at least not until after a new Commission takes office after September of this year.

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)

Preparation of the T2S project continues, while an assessment framework for CSD links in T2S has been devised, and harmonisation efforts on collateral management and repo practices are maintained.

a) Target 2 Securities (T2S)

Our preparation with the Swiss market continues apace, and as mentioned earlier, the shortening of the settlement cycle to T+2 will also be introduced in the Swiss market in advance of the start of T2S on 22 June 2015, when SIX SIS will be part of the first migration wave. The ECB has recently approved SIX SIS's migration plan. As we move increasingly towards testing both at the community level and in T2S itself, there are an increasing number of deadlines and milestones which need to be met by clients whose institutions are linking into T2S via SIX SIS. These are detailed below.

TARGET 2 SECURITIES PROJECT – KEY MILESTONES FOR SIX SIS CLIENTS

These are the main deadlines:

- Provide the T2S Project Team with the details of your Single Point Of Contact (SPOC) and a deputy for T2S co-ordination within your organization **(NOW)**
- Officially inform SIX SIS if you plan to select DCP connectivity **(28 Feb14)**
- Obtain T2S information to ensure operational readiness from SIS T2S web portal **(28 Feb14)**
- Inform SIX SIS of your preferred T2S account set-up **(30 Sep14)**
- Implement T2S related adaptations within your organisation and ensure operational readiness for T2S **(31 Dec14)**
- Start of T2S Community Testing (mandatory for all SIX SIS clients) **(Mar 2015)**
- Start of T2S Business Day Testing (mandatory for all SIX SIS clients) **(May 2015)**
- GO LIVE with T2S settlement in Migration Wave 1 **(22 Jun 2015)**

b) Assessment Framework for SSS and Links, and their eligibility for Eurosystem operations

The ECB Governing Council has approved this framework which will govern the assessment by the ECB's staff of links between CSDs in T2S. The intention is to draw as much as possible on the assessment frameworks under the CESR-ESCB standards, as well as collectively, rather than individually, to approve the links between CSDs in T2S that already exist. New links, as well as those, with "out" CSDs, will however be assessed de novo. As the framework only applies to EEA countries, our understanding is that SIX SIS is outside the scope, not being involved in handling eligible collateral from ECB monetary policy operations.

c) Collateral and repo initiatives

Work also continues in the ECB's COGESI ad hoc working group on harmonisation of collateral and repo practices. A first document which has examined comparative collateral frameworks and practices among selected central banks, including types of collateral held, haircuts, and estimates of available collateral is being readied for publication, perhaps by the summer. Other work streams continue to follow up on a variety of issues designed to facilitate the movement of collateral and repo operations by European banks, most notably in the refinement of Tri-party Collateral Inter-operability across the Euroclear-Clearstream "Bridge", the standardisation of CSD opening hours for commercial bank money settlement, and other practices to accommodate end of day Treasury settlements.

Other Legislative and Regulatory Initiatives Impacting Market Infrastructures and the Value Chain

This Quarter's focus falls on delay in finalising the CPSS-IOSCO and the FSB recovery and resolution frameworks, and concluding on the FSB's initiatives, that affect FMIs, by the end of the year.

a) Recovery and Resolution Plans for FMIs

At the time of writing, the Frameworks being devised by the CPSS-IOSCO for recovery and the Financial Stability Board (FSB) for resolution have still not been finalized. Oversight understands that this is due to delays at the FSB end, and the reluctance of the CPSS-IOSCO stream to publish its work without the FSB contribution on resolution. Meanwhile the CPSS continues to roll out its assessment of the transposition and implementation of the Principles for Financial Market Infrastructures, which includes RRPs. Its consultation on the outsourcing to critical service providers has recently closed, and further thrusts in this direction can be expected in the future.

b) Completing regulatory repair by global standard setters

In its letter to the Sydney G-20 summit, the Chairman of the FSB recommended that jurisdictions should "defer to each other's market regulatory regimes where they achieve equivalent outcomes." The practical effects for FMIs mean that:

- The FSB will publish by September a report enabling jurisdictions to defer to each other's rules in a cross-border context
- By the Brisbane summit in mid-November,
  - the FSB will complete its work on mitigating risks arising from (shadow banking) SLB and repo
  - the Basel Committee and others will finalise capital standards for treatment of bank exposures to CCPs, and
  - CPSS-IOSCO and FSB will finalise their RRP frameworks

End Piece: EU-Swiss Relations

THE MASS IMMIGRATION REFERENDUM: IMPLICATIONS FOR SIX

While it is inappropriate for us to comment on the result of the vote itself, Clients will be wondering whether the success of this popular initiative has any implications for an EU-facing organization such as SIX Securities Services. To begin with, it is perhaps too soon to tell, and the details of the Federal Council's legislative proposal, due in June, will perhaps offer a better guide. However, what we can say at the moment is that the answer, as far as we can tell, is that there should be little or no change in the way that SIX SIS and SIX x-clear are treated as Third Country entities accessing the EU market, even were the EU to repudiate existing bilateral agreements. The reason for this, quite simply is that there is no existing bilateral agreement between Switzerland and the EU in Trade in (financial) services (relying on the GATS provisions instead), and crucially, no formally negotiated equivalence in the areas of securities (and banking). As a result, we are subject to formal equivalence tests for each (separate) measure, and the practical effect now, with the introduction of EU legislation such as EMIR, is that we have to apply (to ESMA) for continued recognition as Third Country entities for providing services into the EU. This will continue. We have no reason to anticipate that our applications for recognition will be treated in a different way. In fact, when this issue was recently raised informally with the Chairman of ESMA, the answer was that he could not see why the referendum result would make any difference to SIX x-clear's application (which in any event, is largely judged on technical and prudential considerations). In addition, the ECB continues to be facilitative of SIX SIS's participation in T2S and there is no suggestion here that we will be treated as anything other than equally with other partner CSDs.

For further information on any of these issues, please contact: Alex Merriman, Head of Market Policy (Alexander.Merriman@six-group.com) or by 'phone to +44 (0)20 7550 5442.