OVERSIGHT

No. 14 | June 2014

Regulatory Update

Summer slumber? Not for us!

Welcome to this summer edition. As implied by the title, the regulatory agenda continues to command a lot of our time and attention. But at least the major pieces of legislation are well on their way to being finalised, and so our attention is switching from policy development and analysis, to implementation of the new requirements. This cuts across both domestic and international requirements. Our readers will have also noticed that we have been pretty busy on the product and service development front, with a number of major announcements at the beginning of May. It seems sensible to also cover in this edition the potential regulatory implications of these moves, which cover our purchase of Oslo Clearing, and the launch of a new Swiss repo trading platform, together with a collateral management facility for Swiss insurers. SIX SIS has also registered as an FFI under FATCA.

As usual, we also bring you up to date with our regular features on the big topics such as EMIR, the CSD Regulation and the amendments to MiFID II/MiFIR; though probably there is less to say about these topics this quarter than in the past. One particular aspect of the CSDR is troubling us, and as explained in the feature, we are in dialogue with the European Commission and others about it.

Finally, we thought it appropriate to take stock of where we are with the EU, and where the next five years may take us. As part of an exclusive "EU Institutional Developments" feature we look at the outcome of the May European Parliament elections, the Italian Presidency programme for the second half of 2014, and some first ideas about what the Commission programme for financial services might look like for 2014-19. This is hot on the heels of the Commission's publication of a 345-page Review of (the impact of) its financial reform agenda, which is also mentioned. My Head of Market Policy says he is keeping this tome (and others, such as the 164 pages of the CSDR – Council version) by his bedside, just in case he suffers from insomnia.

We wish all our readers a good summer, and look forward to regaling you with further regulatory tales in the Autumn.

Thomas Zeeb
Chief Executive Officer
Six Securities Services

Oversight
Brought to you by
SIX Securities Services.

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

If you would like to learn more about topics covered in this edition, please contact: Alex Merriman, Head of Market Policy (alexander.merriman@six-group.com) or at +44 (0)20 7550 5442.

SIX Securities Services

EU Initiatives Affecting the Value Chain

Both the MiFID and CSDR negotiations have been concluded and the texts are being finalised. A new proposal on Shareholders' Rights has issued.

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

b) Central Securities Depositories Regulation (CSDR)

The text of the CSDR is pretty well final, although the European Parliament was only able to provisionally accept it during its Plenary session on 9 April. The text must return, in July, for final ratification, to the Council and the second EP Plenary that month. The reason for the delay is that the body of experts known as "Juristes/Linguistes" have not yet met to iron out any inconsistencies in the text. This is expected to take place through June, which means that the text of the CSDR should now be published in the EU Official Journal in September.

The other main development on the CSDR is that ESMA published on 20 March a first discussion paper on certain aspects of the CSDR. These included settlement discipline and authorization and supervision requirements, such as risk parameters, links, access and record-keeping. SIS responded to the consultation via our trade association, ECSDA. ESMA is expected to publish a more formal Consultation Paper, with draft Regulatory Technical Standards, around September. Our analysis of the problems in relation to Article 25, and associated Articles, governing the free provision of services and access of Third Country CSDs to the EU market follows.

ARTICLE 25 OF THE CSDR – THIRD COUNTRY CSDs' ACCESS TO THE EU MARKET

Article 25(1) of the CSD enables TC CSDs to provide freely services into the EU. These services include all those listed in the annex to CSDR, covering core, ancillary and banking-type services. However, Article 25 (1) is qualified by Article 25 (2), which stipulated that a TC CSD must seek recognition from ESMA if it chooses to (i) to provide services by way of establishing a branch in an EU Member State; or (ii) if it handles the issue from a Member State company. This last part is spelt out in more detail in Article 49 on issuer access to the CSD of its choice. A number of questions have arisen as to what exactly constitute the MS company issuance, since the article refers to "securities… admitted to trading". For SIX SIS, there is the added complication that we handle Liechtenstein ISINs, and therefore whether these constitute MS company issuance. We have written to the European Commission on these aspects, and our note also covers other issues, such as the approval of links with TC CSDs and the very labyrinthine requirements of Articles 54-58, as these relate to the use of settlement banks for the cash leg of settlement. We will keep readers informed of the outcome of discussions in future editions of Oversight.

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

The General Affairs Council of 13 May applied the rubber stamp to the EU legislative process. The aim the two legislative measures is as follows:

- A Regulation - MiFIR which covers the improvement of transparency and competition of trading activities; by limiting the use of waivers on disclosure requirements and; by providing for nondiscriminatory access to trading venues and central counterparties (CCPs) for all financial instruments; and requiring derivatives to be traded on organised venues;

- An amending Directive - MiFID which amends rules on the authorisation and organizational requirements for providers of investment services and on investor protection. The directive also introduces a new type of trading venue, the organised trading facility (OTF). Standardised derivatives contracts are increasingly traded on these platforms, which are currently not regulated.

The overall aim of the legislation is to ensure that all organised trading is conducted on regulated trading venues: regulated markets, multilateral trading facilities and organised trading facilities. Strengthened requirements are introduced in relation to organisation, transparency and market surveillance in all three types of venue. Transparency requirements are calibrated for different types of instrument, notably equity, bonds and derivatives, and for different types of trading, notably order book and quote-driven systems. High-frequency trading will be limited.

Commodity trading will be controlled with the introduction of position limits aimed at preventing market abuse, including cornering of the market, and supporting orderly pricing and settlement. Market participants will have to report their positions at least daily. Coal and oil derivatives will be temporarily exempted from requirements to go through clearinghouses. The Directive and Regulation cover the provision by banks and investment firms of services such as brokerage, financial advice, dealing, portfolio management and underwriting. They are aimed at overcoming problems that have emerged in the implementation of rules that entered into force in 2007 and which essentially abolished the possibility for member states to require trading to take place on specific exchanges, enabling competition from alternative venues.

Both the directive and the regulation will for the most part become applicable 30 months after entry into force. In a statement before the Council, the Commission once again made its feelings clear on the limited progress made on access provisions: "While agreeing that a gradual transition towards a complete opening may be useful, the agreement reached by the co-legislators will not reach the purpose intended by the Commission proposal. Transitional periods of more than two years after the entry into application - 30 months have been agreed by the co-legislators, would further consolidate vested market positions."

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

Following the submission (by 12 March) of a first set of additional information to ESMA in relation to SIX x-clear's **application** for recognition under EMIR as a Third Country CCP, ESMA has replied requesting further data on our major clearing participants, currencies cleared and potential oversight and supervisory authorities. This further information has to be supplied by 12 June.

As mentioned in the last issue, the **recognition process** for both EU and Third Country (TC) CCPs is taking longer than expected. To date, only eight out of about twenty EU CCPs have received the go-ahead under EMIR, while the first of the non-EU CCPs has yet to be recognized by ESMA. ESMA has to process applications from about 40 TC CCPs, and in many cases is still awaiting Equivalence Decisions (on CCP requirements) from the Commission. The first of these is still expected. More positively, the recognition of the first EU CCPs means that the Commission can get on and produce its Regulatory Implementing Standard on the **Clearing obligation**, one of the two major parts of the OTC derivatives (the other being the capital treatment of **non-centrally cleared derivatives**, which is currently in consultation by the joint ESAs). These can be expected by the year-end.

Having failed to obtain the Commission's approval for a postponement of the reporting requirements in relation to exchange-traded derivatives, ESMA has now written to the Commission to suggest that the date for **front-loading** these should be deferred. OTC Derivative regulators meet again in June to continue discussions on mutual recognition of OTC derivative regimes, which is also a major "to do" for the G-20 Brisbane summit in November.

Readers will know that we completed our purchase of **Oslo Clearing** (OC) at the beginning of May. This is an important addition to our clearing business, with added functionality in the areas of derivatives (both exchange-traded and OTC) and SLB. Initially, OC will be a wholly-owned subsidiary of SIX x-clear AG, but will convert to branch status, probably by September. The Swiss and Norwegian regulators have been overseeing this process, and will continue to be involved as the hard work begins in respect of taking major integration decisions such as in the areas of risk management, choice of clearing platform and, governance. These are expected to be rolled out over the next 24 months or so.

e) Amending Directive on Shareholder Rights (SRD)

This Amending Directive saw the light of day on 9 April. It has broadly followed the lines of the leaked draft seen earlier by Oversight. Compared to the draft, the final proposal includes a few rather minor changes. To re-capitulate, the main aspects potentially relevant to CSDs, include:

- The definition of 'intermediary' in Article 2(d) is unchanged and potentially includes CSDs
- Instead of, in Article 3(a)(1) (identification of shareholders), giving companies a general right to identify their shareholders, it now reads: "Member States shall ensure that intermediaries offer to companies the possibility to have their shareholders identified"
- Article 3 (d) (1) (transparency of costs) now more explicitly allows intermediaries to charge fees for services on shareholder transparency
- The previously foreseen Commission delegated acts to specify Articles 3(a),(b) and (c), have been transformed into Commission implementing acts, implying a different procedure for adoption

Council working group meetings are scheduled for 6 and 20 June, and Oversight understands that the Italian Presidency will also want to progress this.

f) Securities Law legislation (SLL)

There have been no real developments of consequence since the last Oversight. An EU legislative proposal remains in abeyance. Although technically, the new European Commission, which comes into office in September, could potentially adopt a proposal before the end of 2014, it is felt that it is far more likely that it will see the light of day in 2015.

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

EU Institutional Developments

This occasional Oversight feature covers the results of the European Parliament elections in May, the programme of the incoming Italian Presidency, personnel changes in DG Markt, future financial services priorities, and the Commission's Review of its Financial Regulation Agendas.

As widely foreshadowed, the elections to the **European Parliament** on 22-25 May across the 28 Member States of the Eurpean Union resulted in a greater fragmentation of political parties. While the European Peoples Party (EPP), with 213 seats and the Party of European Socialists (PES) with 190 remain the largest two parties, the EPP lost ground, and the parties on the extreme fringes of left and right made significant gains, notably in Denmark, France, Greece, Hungary and the United Kingdom. It remains to be seen how this will affect ongoing business in the chamber, but it can be expected that the two major political groupings will dominate the Presidency of the EP, and the Committee Chairmanships. The EP is now engaged in the process in selecting these officials, and will resume normal legislative business during two Plenary sessions in July.

The EP is also holding out for a major say in the selection of the new president of the European Commission, traditionally selected just by Member States. The widely-touted front-runner is the former Prime Minister of Luxembourg, Jean-Claude Juncker.

The Italians, who take over the **Presidency of the EU** on 1 July, have made a priority of progressing Banking Union, and notably the Single Supervisory Mechanism, the Single Resolution Mechanism and a common Deposit Guarantee Scheme. Other key dossiers include:

- Bank Structure Regulation
- ELTIFs
- Money Market Funds
- Benchmarks

On the tax agenda, the Italians will also advance the FTT.

Personnel changes at the European Commission. As well as the changes in the European Parliament, the direction of DG Markt, the Commission Directorate-general responsible for financial services, is also changing. Internal Market Commissioner Michel Barnier is stepping down, while two of the officials at the top of DG Markt, Director-general Jonathan Faull, and Deputy Director-general, Nadia Calvino (the latter replaced by Olivier Guersin), are also moving on. A vacancy also still exists at Director, Financial Services level, following the retirement, last July, of Emil Paulis. The effect of all this is that the new Commission, which will take office in September, may well look with a renewed critical eye at the financial services programme.

In terms of possible Commission **Priorities in Financial Services** 2014-19, Oversight gathers that the agenda will be very much focussed on delivering higher growth and employment, and facilitating the part played by finance for it, notably in relation to SMEs. In this last respect, moves to revitalise securitisation, and private placement, together with investment in long-term infrastructural development, as well as looking at more novel forms of finance, such as crowd-funding, could be key. The start of the Single Supervisory Mechanism under Banking Union and its refinement will also feature. Other aspects could include reviewing the regulatory framework for collateral; deepening investor protection, notably client security and safety through account segregation, and reporting to Trade Repositories; and further measures deepening the common retail payments infrastructure. In the next few years or so, the Commission will also have to formally review the functioning of EMIR (already in 2015), aspects of MiFID (30 months after entry into force) and the CSDR (2018).

Commission Review of the Impact of the Regulatory Reform Programme: Not surprisingly, this weighty 345-page tome has presented a relatively positive picture, maintaining that regulatory gaps have been filled, risk management practices enhanced, the financial system made safer, and unregulated parts such as shadow banking brought to heal. In a controversial assessment, the Commission also insists that the "expected total benefits of the financial regulation agenda… will likely outweigh the expected costs". However, effective implementation and consistent application of the measures is still needed, together with more global regulatory convergence, and the need for a more diversified European financial system, tackling Europe's long-term financing needs.

Market Infrastructure Initiatives by Other Standard-setters

Preparation of the ECB's T2S project continues; while the ECB's efforts to harmonise collateral management and repo practices are maintained; SIX launched new repo and collateral management facilities; and there is still no definite news of the finalisation of the CPSS-IOSCO and the FSB recovery and resolution frameworks; CPSS-IOSC also publish the updated results of their PFMI Level 1 assessments; SIX group companies register as FFIs under FATCA and SIX launches a trade repository.

a) European Central Bank (ECB)

Since our extensive feature on T2S in the last edition, we can only report that preparations for linking the Swiss market to **T2S** continue on track. Much of the recent work has focussed on harmonising various aspects related to the settlement platform, including corporate actions, and recommended practices relating to the T+2 Settlement Cycle.

The ECB's COGESI Ad hoc working group on harmonisation of **collateral and repo practices** is also close to finalising a number of reports which were mentioned in the last edition of Oversight. A first document examining comparative collateral frameworks and practices among selected central banks, including types of collateral held, haircuts, and estimates of available collateral, should be published soon. Two other papers are also nearing finalisation. The first covers "Efficient Commercial Bank Money (CoBM) settlement arrangements", and addresses enhancements to the settlement of securities in CoBM. The second, entitled "Euro repo market – improvements for collateral and liquidity", and proposes a number of improvements for collateral and liquidity management in this market, notably to accommodate end of day Treasury settlements.

b) Developments in the Collateral Management and Repo space

SIX Securities Services has also been active in the collateral management and repo spaces. At the beginning of May, we successfully launched a new **repo trading and clearing platform** for repo in the Swiss market, which had been formerly provided (as a joint venture) with Eurex. No fewer than 137 participants have joined the new facility, and initial volumes totalled CHF 60bn. The platform will be subject to the oversight of the National Bank. We have received regulatory approval to offer custody and collateral services to Swiss Insurers and their Pension Funds for the collateralization of obligations arising from FX Prime Brokerage transactions. This has also been largely driven by regulatory considerations, as non-bank end-users such as insurers and pension funds are increasingly obliged to collateralise their hedging and other financial operations, and are required to use a safe depository such as a CSD. In time, SIX SIS would also welcome broadening its SSS participant base (which is currently limited to authorised banks and brokers only), and handling collateral for insurers can be regarded as a first step.

Oversight detects that regulators (e.g. FSB, ECB, CPSS) in general have been intensifying their efforts to understand the **size and operation** of the collateral market, aware that regulatory initiatives such as Basel 3/CRD IV (capital and liquidity), EMIR (margining) and T2S/CSDR (shortening the settlement cycle) have varying degrees of impact on the holding, disposal, circulation and re-hypothecation of collateral in financial operations. As mentioned in the last edition of Oversight, the Commission's proposal on the

Transparency of Securities Financing Transactions will also make it mandatory for the collateral lender's permission to be sought for the re-hypothecation of collateral.

c) Recovery and Resolution Plans for FMIs

At the time of writing, the final version of the Frameworks being devised by the CPSS-IOSCO for **recovery** and the Financial Stability Board (FSB) for **resolution** of FMIs, are expected imminently, perhaps sometime in June. Oversight is not expecting much change from the draft proposals, although some softening in the approach to CSDs, for instance in recognizing the unique nature of CSDs and on loss-sharing arrangements, has been flagged. These finalized papers in turn will trigger the issuance of the European Commission's proposal on RRPs for CCPs, which is still expected in Q4.

d) CPSS-IOSCO first Level 1 assessment report update on Implementation monitoring for the PFMIs

The BIS and IOSCO joint working group has published an update report. It shows that significant progress has been made by the 28 participating jurisdictions, including Switzerland, since the initial Level 1 report in August 2013. Overall there is encouraging progress across all FMI types, with implementation well advanced for central counterparties (CCPs), trade repositories (TRs) and payment systems (PS) but less advanced for central securities depositories (CSDs) and securities settlement systems (SSS). The ratings for Switzerland were generally good, with an implemented legal framework in place (the revised National Bank Ordinance – a rating of "4") and good progress by infrastructures in meeting the revised Principles (a rating of "3").

Level 2 assessments will follow and the joint regulators will conduct a detailed evaluation and a peer-review assessment as to whether the adopted measures are complete and consistent with the principles for CCPs and TRs in the European Union, Japan and the United States. Other jurisdictions and other categories of FMI will be covered in subsequent rounds. Results from the first round of Level 2 assessments are expected to be published in the fourth quarter of 2014.

e) FATCA

On 14 April, SIX registered those group companies affected by the Foreign Account Tax Compliance Act (FATCA) with the US Internal Revenue Service as FATCA-compliant. To remind readers, FATCA is a US tax reporting system that enables financial institutions around the world (foreign financial institutions, or FFIs) to identify account holders and investors who are subject to US tax and to report their investment income and assets to the US Internal Revenue Service (IRS) in accordance with US requirements. Account holders who refuse to disclose their foreign income may be subject to penalty taxes on their US-based income. FATCA has been implemented through a tax agreement between Switzerland and the US in conjunction with national FATCA legislation that is binding for all Swiss financial institutions. As some legal entities of SIX financial institutions qualify as FFIs, we need to comply with all the FATCA provisions. This has generated a number of projects at SIX, with the spotlight on SIX SIS Ltd, which is the largest depositary for US securities in the Swiss market. PayLife Bank and various holding companies are also affected as they are considered FFIs under FATCA. The FATCA reporting and taxation processes are complex and they will be rolled out in stages between now and 2017.

f) SIX launches trade repository

The Swiss Financial Market Infrastructure Act (FMIA), which is currently in consultation, represents the legal basis for the creation of a trade repository. The Swiss Financial Market Infrastructure Act (FMIA) provides for the creation of a trade repository for derivative transactions. The Act is set to enter into force at the end of 2015 or in early 2016. The aim is to enhance the transparency and traceability of both over-the-counter (OTC) and exchange traded derivatives. This information will allow supervisory authorities to identify risk concentrations and, therefore, systemic risk at an early stage. By establishing a trade repository for derivative transactions, the new Swiss legislation implements the G20 obligations agreed in 2009 in response to the financial crisis. Following discussions with Swiss banks, SIX has decided to establish and operate a central trade repository for the whole financial market.

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.