OVERSIGHT

Regulatory Update

Jingle Bells, but well, we're still waiting...

Welcome to a festive bumper edition of Oversight. As I implied in our Fall edition, it's been very much a question of «one step forward, two steps back». That's particularly true of the continued slow progress of finalising EMIR, including getting Third Country CCPs licensed, and the next stage in the development of the CSD Regulation, where there may be some slippage. This is frustrating for us, as it must be for you, as it is hard at this point in time to bring you more concrete examples of how it will affect us, and potentially, your business as well.

But, it is not all doom and gloom (if you are a legislator, that is): at the EU level, a new European Commission has been successfully installed, and we know the shape of the new «DG FISMA»; and even more positively, good progress has been made by the Italian Presidency in finalising the proposal on Securities Financing Transactions and amending the Shareholders' Rights Directive. In this edition you will also find our first thoughts about the development of an EU Capital Markets Union, which promises to be the next Big Project for Lord Hill and his colleagues; if you like that sort of thing, that is.

And, as this is the season of good cheer and goodwill to all men, our legislators and overseers have also not been timid either at bringing forward even more new requirements for FMIs! As if we were not short of things to do, CPMI-IOSCO and the FSB have finally concluded their work on recovery and resolution plans for FMIs, and the CPMI have additionally offered us guidance on cyber-security. CCPs are also very much the flavour of the month, particularly as we move to a new age where more and more products are centrally-cleared and CCPs hold centre stage as lynchpins of the financial system. In this edition, apart from the RRPs, you will get a flavour of the debate about consolidating the next lines of defence, beyond the default fund, and further initiatives in relation to liquidity facilities for CCPs, and interoperability arrangements between CCPs.

The Compliments of the season to all our readers, and see you in 2015.

Thomas Zeeb
CEO
SIX Securities Services

> EU Initiatives Affecting the Value Chain 02
> EU Institutional Developments 04
> Market Infrastructure Initiatives by Other Standard-setters 05

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 Global & European Regulatory Affairs (alexander.merriman@six-group.com) or at +44 (0)20 7550 5442.

Securities Services

EU Initiatives Affecting the Value Chain

Not much new to report on EMIR and CSDR related issues. Better progress on the SRD and TSFT proposals.

a) General Overview

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	**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	28 August 2014	Q2 2016
Underpinning Law	Securities Law Legislation (SLL)	**Q4 2015?**	End – 2017?	2017 / 18?

b) Central Securities Depositories Regulation (CSDR)

Following the entry into force of parts of the CSDR on 17 September, we now await the publication of ESMA's extensive consultative paper, which is expected on 19 December. The consultation period is expected to last at most two months, as ESMA continues to be under pressure to deliver the necessary Technical Standards by the end of next year. Efforts by industry associations, including ECSDA, have continued in the meantime, in an attempt to shape important aspects such as settlement discipline, including buy-ins and penalties. Oversight believes that there is a better degree of understanding about the impact of these provisions, and that ESMA will propose an extended timetable for their introduction such that they do not conflict with the launch of T2S in June, and the continued work by CSDs to adhere to the revised PFMIs.

We will report more fully about the ESMA paper in the next edition of Oversight, as well as how we see SIX SIS's positioning under the new Regulation.

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

Slow progress continues on all fronts. The main development since the last issue of Oversight has been that the European Commission have published, on 30 October, the first Equivalence Decisions («EDs») for Third Country CCP requirements for the following jurisdictions: Australia, Hong Kong, Japan and Singapore. There is also the promise that a further four EDs will follow in short order, namely Canada, India, Mexico and New Zealand. This however, will still leave a further eight EDs outstanding, including Switzerland and the USA. The appearance of the EDs means that ESMA can begin the task of recognizing Third Country CCPs under EMIR. Ideally, it has set itself the target of doing so by the end of 2015. As a consequence of these delays, and as suggested in the last issue, the Commission also confirmed recently that it would be instituting a further delay in the implementation of the CRR distinction between Qualifying and Non-Qualifying CCPs. This extension will last until 15 June 2015.

Oversight understands that some progress has been made in the discussions between the US and EU on the mutual recognition of regimes, and Lord Hill has also made this a priority to resolve. Elsewhere, the finalization of the EU clearing obligation (in relation to IRS and CDS) has been delayed. Although ESMA has provided its technical advice to the Commission on the categories of IRS to be included in the clearing obligation, the Commission has recently written to ESMA postponing the delivery of its required advice on CDS, as it believes that the first

set of advice has given rise to a number of issues, which it needs to consider further. The slow move towards meeting the G-20 Pittsburgh commitments of trading, centrally-clearing and reporting OTC derivatives is reflected in the recent FSB report to the Brisbane Summit which showed only 3 compliant jurisdictions; there is the expectation that this will not be fully rolled out until next year. To date, globally, only about 50% of IRS and 30% of CDS are being centrally-cleared.

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

As with the CSDR, the next steps involve ESMA producing consultative papers and draft Regulatory Technical Standards, which are also expected later this month.

e) Regulation on the Transparency of Securities Financing Transactions

The Italian Presidency has made good progress on this proposal, such that the Council is ready to agree a General Approach in view of beginning discussions with the European Parliament in the New Year to finalise the text.

f) Amendment to the Shareholders Rights Directive

Although the Italian Presidency made good progress in Council discussions, notably in teasing out the main issues, it will be handing over the dossier to the Latvians for progressing during 2015. Deliberations have also only just begun in the European Parliament. A number of questions remain unresolved:

- The exact scope of the definition of intermediaries (including CSDs)
- Whether there is an explicit «right» or obligation to identify beneficial owners
- The extent to which the provision of such information should be centralized in a part of the value chain; and
- The extent to which penalties should be applied in the event of non-disclosure of information

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 Global & European Regulatory Affairs (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

A new Commission has taken office, with Lord Jonathan Hill confirmed as Commissioner for Financial Stability, Financial Services and Capital Markets Union (CMU). We also feature the CMU.

a) European Commission

The new Commission took office on 1 November, after relatively benign hearings in the European Parliament which saw only one prospective candidate replaced. Lord Jonathan Hill of the UK survived a scare during his first hearing and was confirmed as Commissioner for Financial Stability, Financial Services and Capital Markets Union (DG FISMA),

There are a number of innovations in the structure of the new Commission introduced by President Jean-Claude Juncker, including the appointment of seven Vice-presidents that will be responsible for clusters of dossiers. So, Lord Hill for instance notionally reports to both Vice-presidents Dombrovskis and Katainen, and must take into account the views of allied (subject) Commissioners, such as Pierre Moscovici. In addition, Vice-President Frans Timmermans, in charge of Better Regulation, has the final say on whether new legislative initiatives are approved or not.

The Commission is expected to present its **work programme** for 2015 before Christmas. Latvia will hold the **Presidency of the EU** in the first half of next year, succeeding Italy. Luxembourg will follow on 1 July.

b) DG FISMA

As widely expected, the old DG Markt has been re-shaped, with Jonathan Faull remaining as Director-general for the time being, and Olivier Guersent as his Deputy. The main changes involve the non-financial parts of the old Directorate-general (mainly single market issues) moving to the Polish Commissioner for Enterprise, Bieńkowska. The Unit responsible for company law (including the amendment to the Shareholder Rights Directive, and remuneration) moves to DG Justice. Also, as expected, financial stability and financial markets units move from DG Ecfin. A separate unit in DG FISMA covering Capital Markets Union (see below) has been created.

c) EU Capital Markets Union (CMU)

This notion, widely trialled during the late summer and early autumn, is beginning to gain traction. During his Parliamentary hearings, Lord Hill confirmed that he was committed to the idea of completing the construction of a CMU by the end of his term (2019). The Commission has been analysing the issues and will set out its thoughts in a Green Paper in the New Year. The intention is that a road map will then be fleshed out by the summer of 2015. Oversight readers should be in no doubt that this is an important initiative at the EU level, which could shape much of DG FISMA's workload in the coming months and years.

So what would CMU consist of? For a start, it is not really like Banking Union (see below), as it notably covers all 28 Member States. It is less about centralising and harmonising supervisory structures, and more about removing barriers to the efficient functioning of capital markets, with a particular thrust in restoring finance to European companies, and reducing their dependence on bank finance. In the latter respect, Europe compares unfavourably with the US, with its much deeper capital markets and sources of finance, and lower (20% vs 80%) dependence on bank finance. Some key potential initiatives have been already identified both by Lord Hill and market commentators, as follows:

- Liberalisation and harmonisation of **financing instruments** such as securitisation, private placements, covered bonds, Green bonds, private equity and long-term infrastructural finance
- Overhaul of **legal frameworks** relating to investor protection, company and securities law
- Overhaul of the **accounting** (IFRS) and **tax frameworks** notably in reducing the bias towards bond, rather than equity, finance
- Making it easier for **SMEs** to raise finance, notably through simplifying procedures such as prospectuses, accessing pools of investment capital such as crowd-funding and improving transparency through credit registers

And the impact on market infrastructures? Oversight believes that there will be EU initiatives in three key areas, thus:

- A revival of the Securities Law Legislation proposal (potentially for early 2016)
- Recovery and resolution plans for FMIs (beginning with RRPs for CCPs by the end of 2015)
- A review and overhaul of relevant legislation such as EMIR (due by summer 2015), and particularly those aspects which are deemed not to be working properly. Reviews of MiFID and the CSD Regulation can also be expected through 2019.

d) Banking Union

After the publication of the results of the Comprehensive Assessment (CA), covering both the Asset Quality Review and stress-tests at the end of October, the European Central Bank formally took responsibility for the Single Supervisory Mechanism (SSM) on 4 November. The ECB's banking supervision function now, with the assistance of national competent authorities, directly supervises some 120 large banking institutions from the 19 euro-zone countries, and keeps an eye on the rest. This is also a key development, which will shape the EU banking supervisory landscape, since the ECB can produce its own supervisory practice through the development of its own single rulebook, to some extent by-passing the role of the European Banking Authority. As yet, no non-euro countries have joined the SSM, although both Denmark and the Czech Republic are said to be contemplating such as decision.

Market Infrastructure Initiatives by Other Standard-setters

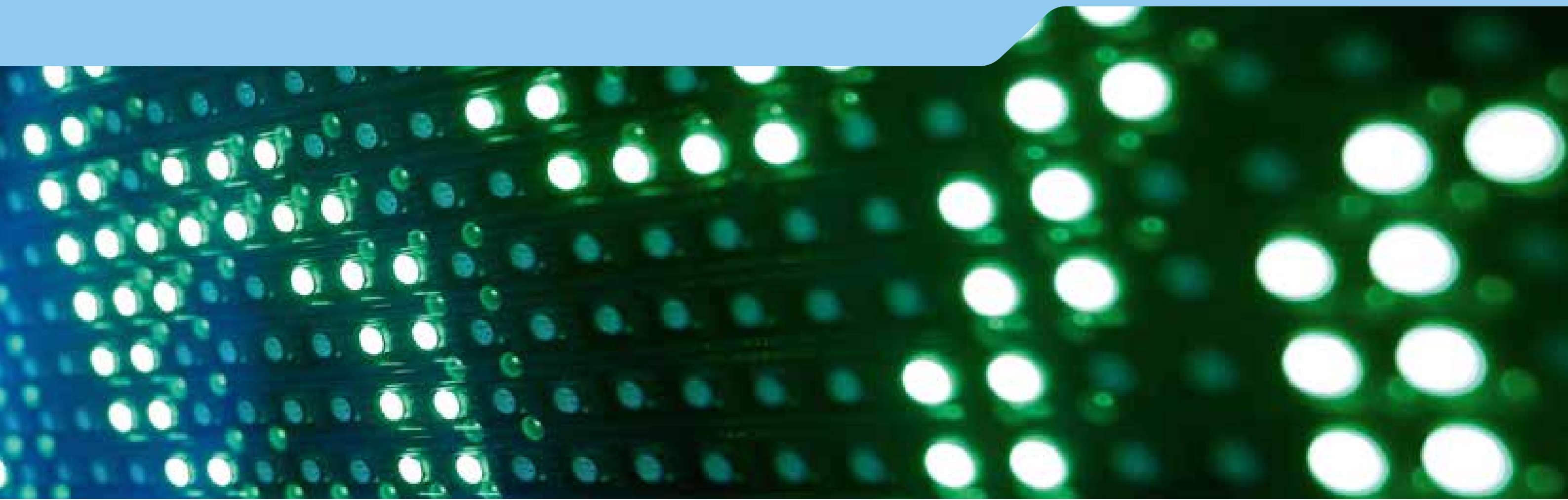
The CPMI-IOSCO and the FSB recovery and resolution frameworks were published; and the CPMI has also produced a report on FMI cyber-security; The Bank of England makes available sterling funding facilities to CCPs and consults on CCP inter-operability arrangements; FinfraG has begun its passage through the Swiss Parliament; IMF reports on FMI sector financial stability resilience.

a) Recovery and Resolution Plans for FMIs

The final versions of the Frameworks devised by the CPMI-IOSCO for recovery and the Financial Stability Board (FSB) for resolution of FMIs were published on 15 October.

The final guidance on the «Recovery of financial market infrastructures» by the CPMI and IOSCO specifies how CSDs and other infrastructures are expected to develop plans to enable them to recover from threats to their financial viability that might prevent them from continuing to provide critical services to their participants and the markets they serve. It takes into account some of the comments made by market participants, including ECSDA, during the consultation process last year. The framework is still, to a large extent, directed at CCPs, but the fine-tuning means that there is greater distinguishing of the particular features of other FMIs such as CSDs, and notably in the flexibility in the use of a menu of recovery tools.

Simultaneously, the FSB issued a new version of the «Key Attributes of Effective Resolution Regimes for Financial Institutions»: Appendix II, Annex I of the report includes guidance for the Resolution of FMIs and FMI Participants. Unlike recovery plans, for which FMIs are primarily responsible, resolution plans are to be developed by regulators to ensure that financial institutions, including CSDs, can be resolved in an orderly manner without taxpayer exposure to loss from solvency support, while maintaining continuity of their vital economic functions.



Recovery and resolution, particularly for CCPs, has been very much in the news of late. In particular, Lord Jonathan Hill has explicitly mentioned that an EU proposal will be one of his first legislative initiatives, perhaps during H1 of next year; it remains to be seen how much of a copy and paste job it will be from the CPMI-IOSCO work. Although there is some doubt whether the Commission might not launch a consultation first. Further, in widely trailed remarks, market intermediaries (e.g. ISDA) have been actively advocating that, as part of a supplemental suite of protective measures beyond the default fund, CCPs should have higher levels of own funds and more «skin in the game». This is also gaining traction with regulators and overseers as well, notably as CCPs begin to centrally clear increasing volumes of OTC derivatives and become an essential lynchpin of the financial system (see also item below on the availability of liquidity facilities for CCPs).

In further work, the CPMI will next look at aspects of CCPs' risk management practices, notably stress tests.

b) CPMI Report on FMI Cyber-security

Oversight has commented in the past on the CPMI's interest in this topic and on 12 November, it published on cybersecurity practices at FMIs. The report is primarily a stocktaking exercise, but it also includes some general guidance. From a CSD perspective, the following is noteworthy:

- Cyber threats should be addressed as part of CSDs' compliance with the CPMI-IOSCO Principles for financial market infrastructures (PFMIs), and especially Principle 17 on Operational Risk. In particular, the objective of a «2-hour recovery time» applies to all types of operational incidents, including cyber-attacks.
- Each FMI must develop its own approach and tools to deal with cyber security threats, but CSDs are expected to pay particular attention to the possible consequences a cyber-attack could have on basic ownership rights (when the CSD acts as registrar) and on information that is not available elsewhere.
- Settlement finality should not be affected by a cyber-event, even in cases where a transfer order has been incorrectly processed as a result of the attack.
- In some cases, the risk management and business continuity protocols used in the event of physical attacks can actually exacerbate a cyber-attack (e.g. automated backup systems may help preserve sensitive data in the event of a physical attack, but can also create a vulnerability and might in some instances help the malware propagate faster), so a balance has to be found.
- The focus of the majority of cyber-attacks continues to be on compromising confidentiality (e.g. stealing sensitive data) and degrading system availability. However, more recently, the risk of attacks impacting the integrity of either the software or the data (or both) of an FMI has been receiving increasing attention.
- Because of increasing interdependencies in the financial system, adequate cyber security is dependent not only on the CSD's defences, but also on that of interconnected infrastructures, of critical service providers and of CSD participants. A cooperative approach to cyber security is therefore important, including the sharing of information on threats, forensics and testing.
- The report describes what an integrated approach to cyber resilience should look like, including in relation to governance, measures to prevent and detect attacks, and procedures for the resumption of services

c) Bank of England makes Sterling financing facilities available to CCPs

On 6 November, the Bank of England announced that it would be expanding the availability of Sterling Market Facilities to CCPs. The key aspects of the revised SMF Operational Framework include:

- the scheme is being extended to CCPs: «a central counterparty operating in UK markets which is either authorised under EMIR by a competent

authority or recognised under EMIR by the European Securities and Markets Authority«

- This is subject to a number of conditions including demonstrating operational and liquidity integrity, nihil obstat from the PRA and FCA, no legal obstacles (e.g. liens over collateral) to the movement of collateral and liquidity, and additional reporting requirements;
- CCPs incorporated outside the UK must supply to the Bank a number of legal opinions, for instance that it can enter into a legal agreement for the various facilities and that these are legally enforceable;
- CCPs will not have access to the Bank of England's Open Market Operations, but (a) will be eligible to participate in the Reserves Account Facility, subject to being an Operational Standing Facilities Participant; and (b) to be eligible to participate in the Contingent Term Repo Facility, an institution must be a Discount Window Facility Participant. Presumably, all this entails opening an Account at the Bank.

This is an important development, as overseers grapple with the concept that CCPs should mutualise debts in the event of participant default and not require public support in the event of failure, other than having access to official facilities for liquidity purposes. Other central banks are expected to follow suit.

d) Bank of England consults on CCP Inter-operability arrangements

The Bank of England published on 20 November a consultation paper entitled «Implementation by the Bank of England of ESMA's Guidelines and Recommendations on CCP interoperability arrangements». The consultation runs until 16 January. The consultation follows an earlier ESMA paper mentioned in the last edition of Oversight. The Bank is consulting on the supervisory approach that the Bank is considering taking to implement the ESMA Guidelines in certain specific areas, as follows:

1) the level of margin that should be provided by each CCP to the other (inter-CCP margin);
2) the means by which CCPs source this inter-CCP margin;
3) the application of CCP default resources (other than inter-CCP margin) to exposures to interoperating CCPs;
4) arrangements to manage the impact on one CCP of the deployment of loss allocation rules by the other; and
5) the application of the Guidelines to interoperable arrangements for derivative products.

e) European Central Bank (ECB

As in September, our T2S preparations remain on track, with user acceptance testing having recently been completed, and the Swiss market fully appraised of progress. We will report more fully in the March edition of Oversight on the state of preparedness, as T2S moves towards the launch date of 22 June 2015.

f) The Swiss Legal Framework for FMIs

Following the publication of the revised draft of, the FMI Act («FinfraG») in September, the Swiss Parliament has been deliberating the contents of the draft Act, and receiving evidence during in camera hearings both in October and again as we went to press. Oversight understands that the main amendments tabled by Swiss MPs relate to high frequency trading and dark pools. As there are no fewer than 90 amendments tabled, many overlapping, the Federal Department of Finance will propose to reduce this number (perhaps by half). There are also suggestions that the overall parliamentary timetable for FinfraG has slipped, perhaps putting into question the enactment of the measure beyond the original estimate of the summer of next year. .Other controversial aspects continue to be the establishment and scope of Organised Trading Facilities («OTFs») in the Swiss market and the retention of self- regulation for the Stock Exchange, as well as FINMA's powers in relation to OTC derivatives.

g) IMF Report on the Oversight, Supervision and Risk Management of FMIs in Switzerland

As part of its routine Article IV consultations and Financial Stability assessment (in April), the IMF published, in September, its technical note on the above. While the Swiss system was found to be generally sound, the IMF made some recommendations, notably in the areas of the Swiss authorities strengthening their oversight and supervisory co-operation arrangements and challenge capabilities, implementing FinfraG as soon as possible, and some specifics for SIX as well. The latter fell broadly in relation to risk management practices and the PFMIs, on mitigating credit and liquidity risks. In particular, the IMF made recommendations in the areas of intra-group practices, including Group management focus, devising liquidity risk management and, recovery and resolution, plans, and segregation and portability. All these issues are being taken forward, as part of continued compliance in relation to the implementation of the PFMIs in Switzerland, via the revised National Bank Ordinance.

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