OVERSIGHT

Regulatory Update

Plus ça change

It's more of the same this quarter, I'm afraid: one step forward and two steps back.

There are the various EMIR sagas and some new ones on the CSDR. But things are broadly going in the right direction on EMIR, even if they are taking an extraordinarily long time. This said, we do now have a final version of the Regulatory Technical Standards on Interest Rate Swaps and things do seem to be moving in a generally positive direction on licensing Third Country CCPs.

Nevertheless, it all makes it difficult to plan how to implement the potential changes brought in by the CSDR. This is becoming quite an issue for EU CSDs now.

In Switzerland, as the CSD, we have to also factor in the development of the Swiss Financial Market Infrastructure Act («FinfraG»), which is proceeding through the Parliament. Hopefully, once we're through all of these pieces of potential legislation, it will mean a slowdown in regulatory initiatives.

Not forgetting, of course, Capital Markets Union, including Recovery & Resolution Plans for CCPs, and also the initiation of various EU reviews including EMIR.

As always, I haven't got enough space here to detail every one of the other global initiatives which are potentially on the horizon… but we will cover them over the rest of the year.

Thomas Zeeb
CEO
SIX Securities Services

Oversight
Brought to you by
SIX Securities Services.

Welcome to Oversight – our quarterly 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.

SIX Securities Services

EU Initiatives Affecting the Value Chain

Signs of progress on EMIR. Problems with CSDR consultation. Other EU initiatives in progress, such as the TSFTR, the amendment to the SRD, as well as Recovery & Resolution Plans for CCPs.

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	**1 January 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 **(except Settlement Discipline Q2 2017 ?)**
Underpinning Law	Securities Law Legislation (SLL)	Q4 2015?	End – 2017?	2018?

b) Central Securities Depositories Regulation (CSDR)

As expected, ESMA published a number of extensive consultative papers and draft Regulatory Technical Standards (totaling some 400 pages) on 19 December. Through our trade association, ECSDA, we responded by last month's deadline. The main – and very visible bones of contentions - have been settlement discipline, including buy-ins and penalties, together with record-keeping requirements. ECSDA, together with other trade associations such as ICMA and AFME have pointed out the unworkability of ESMA's proposals on buy-ins, and their negative impact both on specific categories of assets such as repo, and overall financial stability. The only positive feature of the SD regime is that ESMA is proposing a longer lead-in time (see table above). It remains to be seen how receptive ESMA will be to market and industry comment; so far they have demonstrated limited flexibility, given that there is also a problem with the Level 1 text, which cannot be easily corrected (and should not be) by the Level 2 RTS. Oversight understands that, notwithstanding cuts in its 2015 Budget undermining its resources, ESMA remains committed to sending the revised draft RTS to the Commission by the deadline of 18 June. The RTS ratification process should then subsequently take a further six months or so, which suggest that the first RTS will enter into force early in 2016.

These dates are important (although still subject to some uncertainty), as they will determine the timing of applications for recognition under the CSDR for EU CSDs to national regulators, and Third Country CSDs to ESMA, respectively. Oversight will bring its readers further news in subsequent editions on the impact of the CSDR, as we move towards the finalization of the RTS.

Separately, the European Banking Authority launched, on 27 February, a consultation on (the components of) CSD capital requirements under the CSDR. The consultation runs until 27 April, and a hearing will be held in London later this month. At first glance, the proposals appear to be quite onerous for EU CSDs, which will be required to hold 110% of their minimum capital requirement at all times.

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

There is better news here in relation to the licensing of Third Country («TC») CCPs under EMIR. Following the publication by the Commission of the first Equivalence Decisions («EDs») for TC CCP requirements in October, ESMA has now concluded the first of its cooperation agreements with the authorities from Australia, Hong Kong and Japan. This also means that ESMA can begin the task of recognizing Third Country CCPs under EMIR, which it has confirmed – in its revised Work Plan - it is still intending to do by the end of this year. In relation to SIX x-clear's application to ESMA, we had our application declared «complete" by ESMA on 12 January, which means that ESMA has until October to rule on it. The Swiss authorities are in close contact with both ESMA and the Commission on the outstanding aspects, including the signing of a co-operation agreement.

Meanwhile, only a couple of EU CCPs remain to be authorized under their national regimes, although ESMA has also been advised of at least two EU CCPs, which have had the clearing of additional categories of products and services approved by their national regulators, since their original recognition.

Notwithstanding this progress, Oversight believes that the Commission may need to institute a further delay in the implementation of the CRR distinction between Qualifying and Non-Qualifying CCPs, by extending it further to 15 December 2015. The main reason for this is the continued disagreement between the US and EU on the mutual recognition of CCP regimes, notably on margins. The EU Commissioner Lord Hill has made this a priority to resolve.

Elsewhere, the delivery of the EU clearing obligation (in relation to IRS and CDS) is getting closer. In a letter dated end-January, the Commission confirmed it was rejecting aspects of ESMA's technical advice on the IRS. Notably, the Commission decided to confirm its earlier view that intra-group transactions involving third country non-financial counterparts should be exempted, and FX NDFs also be excluded from the scope. This clears the path for the final adoption of the IRS RTS, and also means that the Commission can proceed with the second part on CDS, where it should be able to rule on ESMA's technical advice by the summer.

Finally, although all the final elements of EMIR are not yet in place, and a number of EU and non-EU CCPs are still not yet recognized, the Commission is already obliged to undertake a **review** of EMIR, the deadline for which occurs in mid-August. We are expecting the launch of the consultation imminently.

d) The EU Regulation on the Transparency of Securities Financing Transactions

With the Council having finalized its version of the text and its negotiating mandate at the end of last year, attention has switched to the European Parliament's ECON Committee, which will vote on its amendments on 23 March. Particular issues that have been brought up in the Rapporteur's report include a re-defining «re-hypothecation» as «re-use»; the extent of disclosure of SFTs; together with limitations on re-use, haircuts on collateral, and use of identifiers such as LEIs and UTIs. Trialogues are expected to begin before the end of the Latvian Presidency.

e) Amendment to the Shareholders Rights Directive

Over 400 Amendments were proposed by the EP JURI Committee, a number of which concern shareholder identification («SI»), as well as transparency of costs, which are levied by intermediaries for processing SI. The JURI vote was postponed to May. Meanwhile, discussions in the Council are continuing, with the Latvian Presidency still attempting to finalise the Council position before the end of its term.

f) Forthcoming EU Proposal on Recovery and Resolution Plans (RRPs) for CCPs

Oversight has seen a further discussion paper issued by the Commission to Member States in December. In it, the Commission seeks views on a range of potential other CCP defences, over and above the Default Waterfall, which CCPs could employ to prevent insolvency, in the event of a capital wipe-out. Such defences could include:

- A Total Loss Absorption Capacity (TLAC), reflecting the recent Basel proposal for banks;
- Margin haircutting/cropping
- Other ex-ante and pre-funded funds

We are still expecting the Commission to issue a proposal in H2.

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

The Commission has published its Green Paper on Capital Markets Union (CMU), while the ESAs have funding problems

a) European Commission

To re-cap the thrust of this initiative is rather about regenerating growth in Europe, by restoring finance to SMEs. We previewed the potential contents of the CMU Green Paper in the December edition of Oversight and there were consequently no surprises in the paper published by the Commission («COM») on 18 February. From a post-trade perspective, the Green Paper has mentioned the following:

- A proposal on RRPs for CCPs (see above)
- Collateral: the COM seeks views as to whether it should «facilitate an appropriately regulated flow of collateral throughout the EU»
- SLL: the COM asks whether there should be any targeted changes to legislation on securities ownership rules
- Legal certainty: the COM will publish a report this year examining problems and recommending solutions in relation to the legal certainty of cross-border transfer of claims and the order of priority of such transfers, particularly in cases such as insolvency, across a range of products including financial collateral.

The consultation runs until 13 May.

b) European Supervisory Authority (ESAs) Budgets

While the ECB's supervision of key euro-zone banking institutions went live in November, with a complement of 1,000 staff, the ESAs found their 2015 Budgets cut. With a shortfall in its budget, ESMA revised at the beginning of February its Work Plan for this year, stating that the following (post-trade) areas would be impacted:

- Delayed development of technical standards and technical advice on some regulations and limited cost benefit analysis, particularly for the CSDR
- Postponement to 2016 of the launch of IT projects implementing CSDR (Articles 7 and 9).

At the time of writing, there is no further news on exact timing delays. However, it seems likely that the Commission (as part of the CMU) will re-visit ESA funding, and particularly, whether a further shift to industry funding, from the current Commission/ national regulators mix should occur.

Market Infrastructure Initiatives by Other Standard-setters

The FSB and partners indicate follow-up work on CCPs; a focus on CCP stress-tests; IOSCO publishes risk mitigation standards for OTC derivatives; CPMI-IOSCo publish PFMI-related reports, while the T2S and FinfraG projects continue;

a) G-20/FSB/IOSCO Follow up work on CCPs

There is no sign of a let-up in the scale of regulatory attention towards CCPs. Following the G-20 Istanbul summit at the beginning of February, the G-20 set out the follow-up work on CCPs and affirmed in its communique that the FSB will: «work with CPMI, IOSCO and BCBS to develop and report in April on a work plan for identifying and addressing any remaining gaps and potential financial stability risks arising relating to CCPs that are systemic across multiple jurisdictions and for helping to enhance their resolvability.» In particular, it will review RRP frameworks for multi-jurisdictionally and systemically important CCPs, and assess the adequacy of the CCP's loss absorbing capacity in resolution.

b) Further Work on CCP stress-testing

Oversight is aware of a number of initiatives in this field. At the global level, the CPMI under the chairmanship of the CFTC, and the ECB's Daniela Russo, is examining historical examples of the sizing of Default Funds. An ESMA task force is also undertaking a similar exercise, as it seeks to meet an obligation to review the stress-testing component of EMIR. In preparation for this, EACH's Risk & Policy Committee is developing a set of harmonized principles which can be shared with regulators.

c) IOSCO Finalises Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives

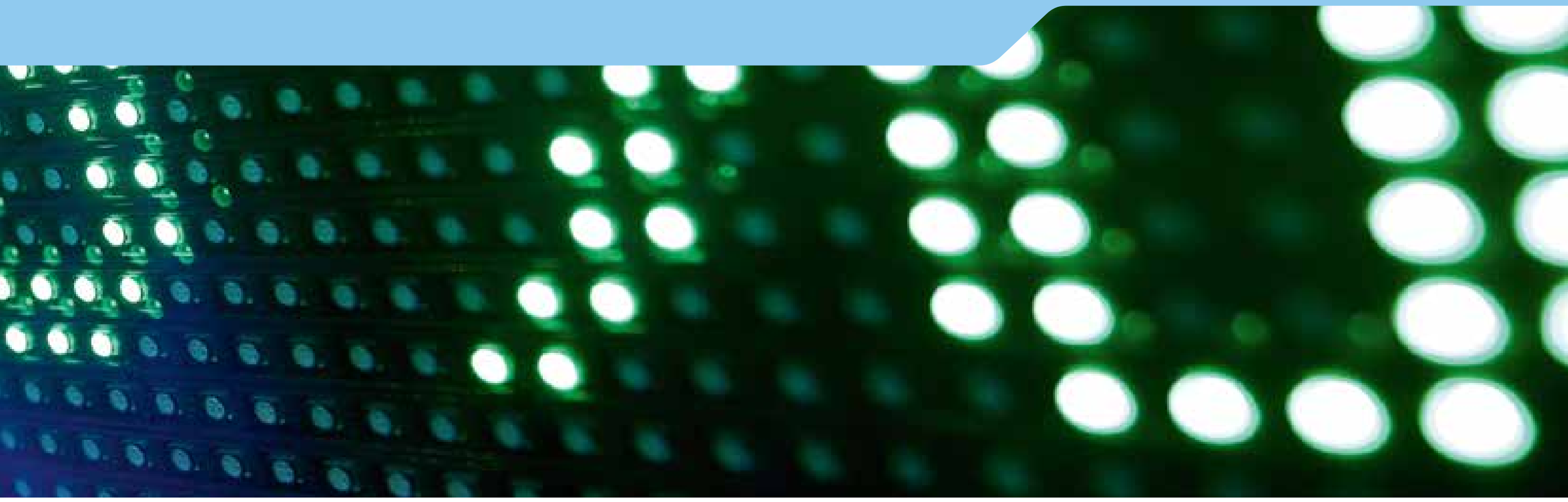
On 28 January, IOSCO published its final report on «Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives». These set out nine standards aimed at mitigating the risks in the non-centrally cleared OTC derivatives markets. These standards encourage the adoption of sound risk mitigation techniques to promote legal certainty over the terms of the non-centrally cleared OTC derivatives transactions, to foster effective management of counterparty credit risk and to facilitate timely resolution of disputes. The risk mitigation standards cover the following key areas:

- Trading relationship documentation and trade confirmation
- Process and/or methodology for determining valuation
- Portfolio reconciliation
- Portfolio compression
- Dispute resolution

This follows the consultation report issued in September 2014. The risk mitigation standards, are the companion piece to the finalised margin requirements for non-centrally cleared OTC derivatives. They are designed to assist market participants in better managing risks in transacting in, and improving the resilience of, the non-centrally cleared OTC derivatives market.

d) CPMI publishes Public quantitative disclosure standards for central counterparties

In December 2012, the CPSS (now CPMI) and IOSCO published a Disclosure Framework to improve the



overall transparency of financial market infrastructures. This followed the CPSS-IOSCO Principles for financial market infrastructures («PFMIs»), published in April 2012, which stipulated that CCPs needed to make relevant information publicly available, to help ensure that the risks of using CCPs were properly understood. The Framework primarily covered qualitative data that needs relatively infrequent updating, for example, when there is a change to a CCP's risk management practices. In order to complement that Disclosure Framework, the document published on 26 February sets out the quantitative data that a CCP should disclose more frequently.

Taken together with the Disclosure Framework, the newly proposed disclosures are intended to help stakeholders, including authorities, participants (direct, indirect and prospective) and the public, to:

- compare CCP risk controls, including financial resources to withstand potential losses
- have a clear and accurate understanding of the risks associated with a CCP
- understand and assess a CCP's systemic importance and its impact on systemic risk; and
- understand and assess the risks of participating in a CCP directly, and, indirectly

e) CPMI/IOSCO Publish Level 2 Assessments of PFMI implementation for CCPs and Trade Repositories

On 26 February, as part of its on-going work, the CPMI and IOSCO also published three progress reports on the implementation of the PFMIs as they relate to CCPs and trade repositories (TRs), capturing the state of play as of 18 April 2014 in the following jurisdictions:

- The European Union
- Japan
- The United States

The three Level 2 assessment reports are based on peer reviews of whether, and to what degree, the content of the jurisdiction's legal and regulatory or oversight framework is complete and consistent with the PFMIs. The CPMI and IOSCO consider the implementation monitoring exercise to be very important, not least given the increasingly significant role played by CCPs and TRs in the OTC derivatives market arising from the regulatory reforms agreed by the G20.

Overall, the reports demonstrate that the three jurisdictions have made good progress in implementing the PFMIs in their legal and regulatory or oversight frameworks. This is especially evident for CCPs, where the jurisdictions have generally developed frameworks that completely and consistently implement either all, or the majority, of the PFMIs applicable to systemically important CCPs. Progress towards completely and consistently implementing the Principles for TRs has been more varied. Where appropriate, the reports highlight gaps and make recommendations to address them.

Further Level 2 assessments covering other jurisdictions and FMI types are scheduled for 2015-2016.

f) Bank of England publishes Report on Supervision of UK FMIs

The Bank's annual report into its supervision of FMIs was published on 11 March. This is the first report since the Bank became the supervisor, as well as the overseer, of FMIs. The Bank reports that the importance of FMIs is only set to increase in light of global regulatory initiatives such as the mandatory use of CCPs for clearing certain derivatives contracts. Recognising this, the Bank has intensified its focus on them as part of its Strategic Plan which was launched in March 2014.

The report sets out how the Bank has exercised its responsibilities for FMI supervision over the past year. The report highlights a number of significant developments with respect to FMIs such as the

implementation of EMIR which the Bank believes has encouraged significant improvements in UK CCPs' risk management over the past year. For example, features have been introduced into their margin models to better guard against pro-cyclicality, and in the management of their credit and liquidity risks. Furthermore, all UK FMIs supervised by the Bank of England now have in place recovery plans designed to ensure the ongoing provision of their critical services should they, or their operating companies, suffer financial distress. In particular, UK CCPs have introduced arrangements to manage losses arising from their investment activities which might otherwise threaten their solvency.

Finally, UK securities markets moved to a T+2 settlement cycle on 6 October 2014 in line with requirements in the CSDR. This, the Bank believes, has reduced counterparty credit risk in these markets by moving trades to settlement after two rather than three days.

Given the importance of supervised UK FMIs to global financial markets, the report also describes how the Bank co-operates in its FMI supervision with other authorities not just within the UK but also internationally. The report concludes by setting out the Bank's current priorities for supervised UK FMIs in 2015. These include:

- Credit & Liquidity Risk
- Recovery & Resolution
- OpRisk Management
- Governance, and
- Disclosure

g) European Central Bank (ECB)

Preparations continue apace for the launch of **T2S** on 22 June, when SIX SIS will participate in the first Migration Wave. Our recent work has focussed on meeting the ECB's requirements for an assessment and legal opinion that Swiss laws relating to CSDs are compatible with EU ones, and community testing. Notwithstanding some glitches here, the timetable remains broadly on track, and within normal tolerance limits. The preparedness of our clients has also been assessed as good, with the major volume providers accounted for, and no opposition to process changes such as those relating to the T2S accounts.

The next meeting of its infrastructure group, **COGESI**, takes place on 23 March in Frankfurt. It will primarily involve an exchange of views on a long term vision for efficient collateral management in the EU.

On 4th March, the European General Court ruled in the Case of the UK vs the ECB which dates from 2011. In it the Court annulled the ECB's proposed (eurozone) **location policy** as this applied to non-eurozone CCPs handling significant volumes of euro-denominated transactions. The ECB, which can appeal, said it was studying the judgement carefully. The Bank of England commented that the important aspect was that authorities should continue to swap information on systemically-important CCPs and that they would continue their «shared approach" with the ECB on CCPs handling significant euro-denominated transactions.

h) The Swiss Legal Framework for FMIs

The FMI Act («FinfraG») continues its passage in the National Chamber of the Swiss Parliament, with the expectation that its Economic Affairs Committee will conclude its deliberations by the end of March. The legislation will then move to the National Chamber and its parallel Committee, in April; and by the summer, for reconciliation with the National Chamber's position, with the expectation that the Act will enter into force in Q1 2016, may be even by 1 January.

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

SIX Securities Services
Brandschenkestrasse 47
P.O. Box
CH-8021 Zurich
www.six-securities-services.com