

Regulatory Update

Yet again, more of the same

We have reached more or less the mid-year point, and I wish I had more concrete news to bring to you, about the various regulatory initiatives affecting us. It seems such a long time since ESMA produced its technical advice that Swiss CCP requirements line with those in EMIR. But nearly two years later we are still waiting for all the EU procedural/process issues to be sorted out. More positively, the first Third Country CCPs (from Australia, Hong Kong, Japan and Singapore) were recognised by ESMA at the end of April. A few more, including SIX x-clear, are still waiting, but I hope I can now say that it is just a question of time before matters are finally brought to a head.

The whole EMIR process seems to have become bogged down on a number of fronts, with the recent spectacle of the Commission initiating a review (into, largely, CCP requirements), before all the EMIR building blocks are in place, particularly the clearing obligation for Interest Rate Swaps and CDSs. Again, there has been a difference of opinion between EU agencies, but finally an agreement is in sight to begin the clearing of OTC derivatives, by sometime next year. Fully four years after EMIR was enacted.

Delays in regulatory implementation are not unusual, however; after all, it is better to get the rules right than not, but this is at a time when a continuing focus is maintained on FMIs. We will have to soon contend, with further enhancements to rules, particularly in relation to CCPs, for instance on recovery and resolution plans, stress testing, and collateral management. This at a time when we have hardly been able to assess how the first set of rules will impact our business.

But the news is not all bad: there have been some positive «gives» on the CSDR, and the Swiss Law on FMIs, FinfraG are moving through the Swiss Legislative process. It could well be finalised by the summer recess, meaning that it could enter into force on 1 January 2016. There's even a chance that it will be in place before the EU sorts itself out!

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Oversight

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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

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EU initiatives affecting the value chain

CSDR standards being finalised; Some progress on EMIR aspects, but still lots to do. Other EU initiatives in progress, such as the TSFTR, the amendment to the SRD, as well as Recovery & Resolution Plans for CCPs and the FTT.

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)

At the time of writing, both ESMA and EBA were in the process of finalizing their draft RTS, with the intention of sending these to the Commission by the deadline of 18 June. Following intensive lobbying by the CSD industry, Oversight understands that some positive changes have been made in alleviating some of the problematic aspects. In particular, it would appear that CSDs will not be made responsible for initiating buy-ins for settlement fails, and that the record-keeping requirements will be reduced. There should also be a lengthier implementation periods for both. In contrast, we also understand that the EBA regulators do not appear to be willing to change their framework for CSD capital requirements, notably insisting on their «cumulative» approach, which also means a certain amount of double counting of capital elements, notably against investment risk, as well as punitive charges for outstanding intra-day credit risk. The RTS will be subject to a further ratification process when delivered to the Commission, and we now expect to see their finalisation sometime in Q1 2016.

As mentioned before, this date is important, as it will determine the start of the application process for CSDs requiring recognition under the CSDR. We

have been in discussion with the European Commission for some time on exactly when this date might become binding for SIX SIS, but there is not as yet an arrived at view.

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

There are a number of recent developments.

Recognition of Third Country («TC») CCPs under EMIR: Following the conclusion of MoUs with the relevant authorities, ESMA recognised the first 10 CCPs from Australia, Hong Kong and Japan on 29 April. A number of further TC CCPs, including SIX x-clear, are in a «second wave» of approvals, once the Commission has finalised the individual jurisdictional equivalence decisions. Our best guess, at this stage, is that this process will be completed for us by the end of this year, perhaps even, potentially, slipping into the early months of 2016. Meanwhile, it should be emphasized that SIX x-clear remains «grandfathered» for access to the EU market, with existing permissions, such as ROCH status from the Bank of England, remaining in place, until such time as ESMA delivers recognition under EMIR.

EU-US Discussions: It is conceivable that CCPs

from the US will not form part of this second wave, as the EU and US continue to try and narrow their differences over the comparative prudential frameworks in EMIR and Dodd-Frank. Having had sight of a – leaked – EU briefing document, Oversight understands that the main bone of contention continues to be over margining requirements, and particularly the variances between «house» and client accounts, with the EU insisting that its margining model is more robust.

Qualifying and Non-Qualifying CCPs in the CRR:

As a consequence of this further delay, Oversight believes that the Commission is instituting a further delay in the implementation of the CRR distinction between, QCCPs and NQCCPs, by extending it further to 15 December 2015. We have sight of a relevant document approved by the European Banking Committee on 24 April, and we expect to see the Commission's Implementing Decision published in the Official Journal shortly.

Finalising the EU clearing obligation: Throughout the early months of this year, we have reported the disagreement between the Commission and ESMA over the latter's technical advice on the IRS, notably over the exemption of intra-group transactions involving third country non-financial counterparts, and the exclusion of FX NDFs. But just as we went to press, the Commission confirmed that it had reached agreement with ESMA, paving the way for the final adoption of the Standards on IRS, and the production of the second part on CDS. It is now believed that the first aspects of these two component elements of the EU's clearing obligation will be in place by April of next year, as announced by Lord Hill during the EMIR Review meeting. The agreement with ESMA also covers a longer transitional period for non-financial end-users, as well as an extension, for a further two years, of the exemption for pension funds. The final piece in this jigsaw is the capital treatment of non-cleared OTC derivatives, where this is promised «in the next few months».

The Review of EMIR: As it is obliged to do by EMIR, the Commission also launched, on 21 May, a review of certain aspects of this legislation. The Consultation, supplemented by a Hearing at DG FISMA on 29 May, majors significantly on CCP requirements (eschewing those aspects such as the clearing obligation which have not yet been finalized). CCP aspects include margining, central bank facilities, risk mitigation and the operation of colleges. The consultation closes on 13 August

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

The text is now subject to triologue discussions between the EU institutions, with an expected conclusion in July. Areas of difference between the three texts include central bank exemption, inclusion of various types of swaps, transparency and definition of re-hypothecation. In a parallel development, the European Central Bank has enhanced institutions' reporting requirements, which now include daily trade level reporting on SFTs. This will be applied to the Top 50 euro-area domiciled institutions from April 2016, and extended to other institutions in 2017.

e) Amendment to the Shareholders Rights Directive

After the EP JURI Committee narrowly voted on its report in May, the measure will return to the EP Plenary session for a final vote in the middle of June. The outcome has been broadly favourable in terms of the obligations for intermediaries such as CSDs, with other shareholder-representatives groups criticizing the legislators for not going further on shareholder identification and mandatory votes on executive pay. Once the EP vote takes place, triologue discussions can begin with the Council and Commission, on finalizing a common text.

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

There has been little in the way of new information in recent months. Except in remarks heard by Oversight towards the end of March about the difficulty the Commission faces in coming up with a harmonised framework. While it was recognised that no one wanted (failing) FMI to fall back on tax payers, there were difficult decisions to be made because, whichever way one looked, favouring one system over another has implications for the transfer of risk onto the CCP itself or back onto its clearing members. A proposal is now likely to issue no earlier than September.

f) Financial Transactions Tax (FTT)

After some months of inaction, Discussions resumed in the Council Working Group on 29 May. Outstanding issues include the ranking of the residence and issuance principles and the resulting distribution of revenues, scope and collection model. The FTT should be discussed again at the Eurogroup meeting later in June. Luxembourg, which assumes the Presidency of the EU on 1 July, is not one of the 11 Member States supporting the FTT, and it is not expected to advance the proposal enthusiastically.



EU institutional developments

The Commission's consultation on Capital Markets Union (CMU) closes, they propose a Better Regulation agenda, while significant staffing changes occur in DG FISMA.

a) EU Capital Markets Union (CMU)

The CMU consultation closed on 13 May and will also be the subject of hearing on 8 June in Brussels. As mentioned before, there are only a few post-trading relevant themes, and the bulk of commentary has focused on the way in which capital formation and capital-raising can be mobilized again to get EU companies contributing further towards employment and growth. Comments by Commission officials have also stressed that they do not view the CMU as an all-embracing Action Plan like the Single Market Programme; instead envisaging that a small number of targeted initiatives will be deployed, involving both legislative and market-led initiatives.

b) Better Regulation

As part of a series of reforms to its procedures, the Commission launched its «Better Regulation Agenda» on 19 May. This is not about the widespread withdrawal of legislative proposals, but instead focusses on better law-making, including prior assessment of the need for proposals and impact assessments, as well as a continuous cycle of

keeping existing laws under review. A novel feature is the proposal to subject Commission draft delegated and implementing acts to prior public consultation. Currently these acts, of which a number are mentioned in this issue, do not become public until they are being considered by the Council or Parliament. Finally, the Commission intends to complete a new Interinstitutional agreement on Better Regulation with the Council and Parliament.

(c) Personnel Changes in DG FISMA

A regular rotation of personnel at the Level of Head of Unit took place with effect last month. The key one involves Patrick Pearson, formerly head of the market infrastructure unit moving to Head of Crisis Management. Oversight understands that Mr Pearson will continue his responsibilities for both RRP for CCPs, as well as the EU/US negotiations over CCP requirements. We are also led to believe that Maria Teresa Fabregas Fernandez, currently head of the securities unit dealing with MiFid will move across to replace Pearson.

Market infrastructure initiatives by other standard-setters

T2S goes live as intended on 22 June; International bodies publish Securities Handbook; Bank of England publishes consolidated CCP rules and consults on Contractual Stays; FSB follow-up work on CCP resilience; ISSA work on transparency in value chains; Collateral the next regulatory target; FinfraG advances.

a) European Central Bank

The T2S Board confirmed on 28 May that the T2S project would go live on 22 June as intended. This followed earlier remarks by a T2S Board official, casting doubt on a go-live date, because of the large number of testing defects. However, the T2S Board concluded that the platform was in a sufficient state of stability for the launch to go ahead as planned. SIX SIS is in the first migration wave.

b) BIS, ECB and IMF Publish Handbook of Securities Statistics

The Bank for International Settlements (BIS), the European Central Bank (ECB) and the International Monetary Fund (IMF) jointly released the Handbook on Securities Statistics last month. The aims are:

- The joint handbook assists the production of internationally comparable securities statistics.
- It covers the conceptual framework for statistics on debt and equity securities.
- Set of detailed presentation tables using the concepts and guidelines.

The importance of securities markets in intermediating financial flows, both domestically and internationally, underscores the need for relevant, coherent and internationally comparable statistics. This need was recognised by the G20 Data Gaps Initiative, launched in the aftermath of the 2007-08 global financial crisis

with the support of the G20 finance ministers and central bank governors and the IMF's International Monetary and Financial Committee.

Good securities data, along with monetary and financial statistics, are regarded as providing important indications on the level of diversification of financial intermediation. The Handbook supports this analysis by strengthening the collection of securities data through conceptual advice and guidance to harmonise the presentation of securities statistics. It describes the main features of debt and equity securities as well as the institutional units and sectors as issuers and holders of securities, and discusses the statistical recording rules to be applied.

The Handbook is a milestone in that it is the first publication of its kind dealing exclusively with the conceptual framework for the compilation and presentation of securities statistics. Prepared jointly by the BIS, the ECB and the IMF working in close cooperation, the Handbook has also benefited from comments by experts from national central banks, national statistical agencies and international organisations.

It is expected that the Handbook will be widely applied, fostering harmonisation of the international securities statistics that support global economic, financial and macro-prudential analyses.

c) Bank of England Publishes consolidated CCP Rules

On 8 May, the Bank of England, which supervises and oversees the largest number of CCPs in a financial centre, published a consolidated version of its rules for Recognized Clearing Houses («RCHs»). As well as consolidated rules for RCHs, these included financial penalties, as well as rules relating to qualifying holdings.

UK-based RCHs are regulated by the Financial Services and Markets Act 2000 and are subject to the FSMA 2000 (Recognition Requirements) Regulations 2001. With the introduction of EMIR, (the European Market Infrastructure Regulation), different recognition requirements apply to RCHs which are Central counterparties (CCPs) and those which are not CCPs. For RCHs which are CCPs, the recognition requirements require compliance with EMIR and its technical standards as well as certain additional domestic requirements. RCHs which are CCPs have a transitional period to apply under the EMIR provisions.

RCHs which are not CCPs continue to be assessed against domestic requirements and do not need to re-apply. For these RCHs (not authorised under EMIR), the Bank will be guided by the international CPSS-IOSCO Principles for financial market infrastructure in interpreting the recognition requirements. The Bank has also retained some existing FSA guidance material in relation to financial resources requirements.

d) Bank of England Publishes Consultation on Contractual Stays in Financial Contracts Governed by Third-Country Law

On 26 May, the bank published this consultation to propose a new rule in the Prudential Regulatory Authority Rulebook requiring the contractual adoption of UK resolution stays in certain financial contracts governed by the law of a jurisdiction outside the European Economic Area (EEA) (a «third country»).

The proposed rule would apply to UK banks, building societies and designated investment firms as well as their qualifying parent undertakings («firms») in respect of financial contracts (such as for derivative,

repo/reverse repo or securities financing transactions) governed by the law of a non-EEA jurisdiction. It would prohibit firms from creating new obligations or materially amending an existing obligation under such a financial contract without the required counterparty agreement. The prohibition applies unless the counterparty has agreed in writing to be subject to similar restrictions on termination, acceleration, close-out, set-off and netting as would apply as a result of the firm's entry into resolution, or the write-down or conversion of the firm's regulatory capital at the point of non-viability, if the contract were governed by the laws of the UK (and, where the relevant firm is not a credit institution or investment firm, as if it were one).

Firms would also be obliged to ensure that, where their subsidiary credit institutions, investment firms and financial institutions trade in these products under third-country law, the subsidiaries, regardless of location, also obtain agreement to the stay from their counterparties. The consultation closes on 26 August.

e) FSB Follow-up work on CCP Resilience

At a meeting at the ECB in April, a representative of the FSB outlined to FMI representatives, including SIX, its follow-up work on recovery and resolution. The Key Priorities for CCP Supervision emphasise the continuing three prong approach of work (with the CPMI, IOSCO and the BCBS) of:

- Refining and implementing the RRP approach;
- Stress-testing; and
- Participant exposure to CCPs.

Not surprisingly, the FSB's emphasis will be on rolling out the Key Attributes («KAs») of resolution for CCPs this year. This has a number of legs:

- First, a stock-take of national CCPs' loss absorption capacity and liquidity – FSB will launch a survey with NCAs; and
- An annual implementation monitoring exercise of the key attributes by FSB members – just for CCPs this year; then a focus on:
- CCP recovery planning;



- An assessment of existing national CCP resolution regimes, and resolution planning arrangements; leading possibly to the development of minimum standards for CCP resolution planning strategies and tools (but not TLAC), and
- An assessment of (national) capacity to deliver resolution regimes, and whether more resources were necessary; obstacles to resolution; and potentially guidance to align national practices.

The FSB also need to consider further (in terms of the existing KA framework):

- The point of intervention: the borderline between recovery and resolution, with factors such as the exhaustion of clearing members' resources, following loss;
- The principle of "no creditor being worse off" was difficult to implement
- Ex ante availability of resources, including whether these acted as a disincentive to central clearing;
- The financial stability implications of recovery and resolution regimes;
- The structure and resolvability of FMIs, and the feasibility of transferring functions as a resolution tool;
- The availability of funding;
- Resolution tool for FMIs other than CCPs

f) ISSA Work on addressing the issue of transparency in securities transactions and custody chains

The International Securities Services Association (ISSA) has established a new Working Group (WG) to explore and understand the challenges and activities in financial crime compliance. The WG is comprised of leading industry practitioners, including SIX, many also represented in the Board of ISSA, who will review the growing range of transparency regulations with a view to arriving at a series of clear, actionable and measurable principles for the industry to follow.

Through the WG, ISSA is currently reviewing the impact of various forms of regulation relating to financial crime. The scope of ISSA's review is limited to the post-trade landscape and relates only to securities

transactions. The regulation under review primarily addresses cross-border transactions. Objectives will include developing the principles that should govern the securities intermediation process and the tools that are available to the industry to provide greater transparency where required. As a result, the WG will aim to put forward a final set of principles and solutions for broader discussion in the near future.

g) Future direction of Regulatory Travel on Collateral Management

In a speech to the Euroclear Collateral Conference in late May, the National Bank of Belgium's Executive Director responsible for FMI supervision outlined the broad range of regulatory and structural challenges facing CSDs. While opportunities for CSDs were thought to lie in collateral optimization, transformation and mobilisation, the speaker also believed that this also intensified CSDs' exposure to operational, legal, counterparty and concentration risks. These will arise as a result of greater inter-dependencies between market actors, potential greater maturity mismatches in collateral transformation and stressed scenarios when demand for high-quality collateral is high. So this required an intensification of risk management systems, notably the ability to aggregate exposures across different locations, as well as necessitating higher degrees of protection, through enhanced capital requirements and collateral haircuts.

g) The Swiss Legal Framework for FMIs

As expected the FMI Act («FinfraG») concluded its passage in the National Chamber of the Swiss Parliament in March, and the legislation has now moved to the States' Chamber, with first discussions taking place in its Economic Affairs Committee in April and last month. As before, the main areas of interest centre around HFT and the powers of FINMA. The National Chamber is due to consider any differences between the two chambers later this month, such that the draft act could have passed all its legislative steps by the summer recess. The expectation is that the act will still enter into force in Q1 2016, perhaps by 1 January.

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