

OVERSIGHT

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Regulatory Update

A big Summer read.

For many Swiss companies, Switzerland is a mature and maybe even saturated market. We can offer new products and services but, as I outlined in my last Oversight editorial, our clients may be on the look-out for alternatives. As a consequence we, as SIX Securities Services, have to look beyond the Confederation at Europe and further afield to provide meaningful and distinctive services.

To achieve this objective, we proactively sought the EU Passport for our clearing and settlement businesses. Being able to comprehensively clear flows from many EU trading venues is a prize worth having. This is also the reason why we joined T2S, despite the concerns I have expressed about revenue flows and the (in)efficiencies, that some of you may have read about. Also, the acquisition of Oslo Clearing (now SIX x-clear's Norwegian Branch) is a good fit for our clearing business and enables us to make a comprehensive offer to our Nordic client base.

Finally, having built a new repo trading and clearing platform for the Swiss market, we are looking to expand into additional currencies and expanding our collateral management offering.

And so on to the regulatory part: while the bulk of the rules that we are exposed to (CSDR, EMIR, MiFID) are European in origin, their provenance and origin is very often global. The G-20 push for trading, clearing and reporting OTC derivatives is one such example. And there continues to be a global focus on CCP resilience. In this edition, you will find examples of regulatory thinking on a number of CCP issues, as well as the usual commentary on where we are with the EU and the global regulatory agenda. It is still big, and it is still on-going.

Should make for some interesting Summer reading. I imagine that you will have plenty to do, as will we.

Thomas Zeeb
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> EU Initiatives Affecting the Value Chain	02
> CCP Regulation & OTC Derivatives Clearing	05
> EU Institutional Developments	08
> Market Infrastructure Initiatives by Other Standard-setters	11



Oversight

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Securities Services

EU Initiatives Affecting the Value Chain

SIX x-clear receives EMIR Recognition; adoption of the CSDR package faces more delays; new Implementation deadline for MiFIDII/MiFIR; other EU initiatives in progress, such as the TSFTR, the SRD as well as the FTT.

a) General Overview

Changes since the last edition of Oversight are highlighted in **bold** in the table below. The finalisation of the CSDR package has been delayed once again:

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	3 January 2018
Clearing	Regulation on OTC Derivatives, central counterparties & Trade Repositories ("EMIR")	15 September 2010	4 July 2012	15 March 2013 (main Text) 21 June 2016 (Clearing Obligation)
Settlement	Central Securities Depositories Regulation (CSDR)	7 March 2012	28 August 2014	Q4 2016 (except Settlement Discipline Q4 2018)
Underpinning Law	Securities Law Legislation (SLL)	Further Work in CMU Action Plan by end-2017	?	?

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

As foreshadowed in the last Oversight, SIX x-clear's was granted **recognition under EMIR** by ESMA at the end of March. This means that that SIX x-clear has the EU passport to clear EU markets in the designated asset classes covering cash products, such as equities, bonds and ETFs, and others (via its Norwegian branch), such as OTC derivatives and SFTs. It is the culmination of a lengthy process, which began in September 2013, when our application to ESMA was made. We are all relieved!

Following SIX x-clear's recognition, ESMA has further recognised CCPs from (South) Korea and the US, bringing to 19 the number of **Third Country CCPs** which have the EU passport. Notwithstanding this progress (and particularly the agreement between the EU and the US CFTC over mutual recognition of CCP regimes – see below), this still leaves some 20 TC CCPs awaiting EMIR recognition. As a consequence of this, and again as predicted by Oversight, the Commission was once again obliged, on 6 June, to extend the deferral of the distinction in the **CRR between Qualifying and Non-Qualifying CCPs** for a further six months to 15 December 2016, Whether this will needs to happen

again, will depend on how quickly ESMA can finalise the recognition of the remaining TC CCPs.

Following the February agreement with the United States CFTC, the Commission has amended EMIR in respect of the **holding period** (as laid down in Article 26 of the RTS on CCP requirements), also known as "MPOR". This entered into force on 6 June, and means that EU CCPs can opt for a holding period of one day on instruments other than OTC derivatives held in omnibus client accounts or in individual client accounts, subject to:

- (I) the CCP keeping separate records of the positions of each client at least at the end of each day, calculating the margins in respect of each client, and collecting the sum of the margin requirements applicable to each client on a gross basis;
- (II) the identity of all the clients is known to the CCP;
- (III) the positions held in the account are not proprietary positions of undertakings of the same group as the clearing member;
- (IV) the CCP measuring the exposures and calculating for each account initial and variation margin requirements on a near to real-time basis and at least every one hour during the day using updated positions and prices;



(V) where the CCP does not allocate new trades to each client during the day, the CCP collecting the margins within one hour where the margin requirements calculated in accordance with point (iv) are higher than 110% of the updated available collateral in accordance with Chapter X, unless the amount of the intraday margins to be paid to the CCP is not material on the basis of predefined amount defined by the CCP and agreed by the competent authority, and to the extent that trades previously allocated to clients are margined separately from trades that are not allocated during the day.

We are currently examining whether this is a plausible option for our clients.

The Commission's recommendations relating to the **EMIR Review** launched last year are still awaited. Oversight understands that the Commission's report should issue by the summer break.

The EU **Clearing obligation** entered into force on 21 June. This means that certain classes of OTC derivatives, mainly interest rate and currency swaps, and CDSs must be centrally-cleared through a CCP, and these will be phased in over a period of three years, depending on size of business. On 10 June, the Commission adopted a further Implementing Act confirming the additional inclusion of OTC contracts in Norwegian Krone, the Polish Zloty and the Swedish Krona.

c) Central Securities Depositories Regulation (CSDR)

Since the last edition of Oversight, the Commission's processing of the relevant RTSs (on CSD Requirements, CSD Capital and Settlement Discipline) has been delayed due to the MiFID RTS taking precedence. Oversight now understands that the necessary Commission validation of these voluminous texts is unlikely to occur before the summer break, slipping into September at the earliest. Our understanding also is that the other EU institutions will be given three months (rather than the usual one or two) for their examination

and approval. As a consequence of this, it is likely that the start of the **application period** for EU and non-EU CSDs will slip (further) to the end of Q4 at the earliest, and may even fall into Q1 2017.

On the outstanding RTSs, ESMA issued on 31 May for consultation a further Guidance paper on participant default rules. The consultation runs to the end of June, and early discussion among CSDs suggest that some of the ESMA proposals appear to contradict existing primacy of EU Law, including aspects of the Settlement Finality Directive, and recovery and resolution arrangements. The final pieces of the CSDR Package jigsaw (yet to see the light of day) concern additional ESMA Guidance to be given to National Competent Authorities ("NCAs"), and so will not concern CSDs directly.

d) MiFID II/MiFIR

While the EU institutions and ESMA are on the point of agreeing to an extension of the implementation timetable for MiFID II by an additional year to January 2018, clear differences have emerged in the approaches taken by ESMA and the Commission in three (out of 26) of the accompanying Regulatory Technical Standards. The Commission's comment on these RTS were delivered to ESMA on 20 April and ESMA replied to them on 2 May. These differences in the relevant RTSs include:

- Phase-in regime for the transparency of non-equity instruments, where ESMA disputes a measured asset-by-asset approach (with yearly reviews);
- position limits for commodity derivatives: where ESMA accepts some changes notably to thresholds and OTC coverage, and;
- setting out criteria to establish when an activity is considered to be ancillary to the main business.

23 other MiFID RTSs are currently being processed by the other EU institutions, with the expectation that they will have been approved by the Ecofin Council on 17 June.



e) The EU Regulation on the Transparency of Securities Financing Transactions (TSFTR)

The publication (on 11 March) of ESMA's DP and draft RTS came too late for the last Edition of Oversight. The consultation itself closed on 22 April. The DP sets out proposals for implementing the reporting framework under the TSFTR, including tables of the fields with the proposed data to be reported, and the registration requirements for those trade repositories (TRs) which want to accept reports on SFTs. In line with the TSFTR requirement to build on pre-existing infrastructures, operational processes and formats which have been introduced with regard to reporting derivative contracts to trade repositories, ESMA has developed its proposals by building on its experience with EMIR and other EU-wide reporting regimes in order to align reporting standards to the greatest extent possible. ESMA will use the responses to its DP to develop detailed rules on which it will publish a follow-up consultation in the second half of 2016, as it works towards fulfilment of the requirement that it must send its draft rules for approval to the Commission by 13 January 2017.

f) Shareholder Rights Directive (SRD)

The European Parliament finally adopted its report in June, and the dossier has returned to the Council, which is looking at the EP's amendments and moving towards a position whereby it can recommend agreement. The most contentious aspect continues to be the threshold for the disclosure of shareholdings (and therefore shareholder identification), with notably the EP and European Issuers arguing that there should be no threshold, whereas Member States tend to favour one. In addition, the Council is more disposed to see this as a tax transparency issue in terms of company information, also known as "country-by-country reporting". To this end, on 12 April, the Commission published a proposal on tax transparency rules for the largest companies operating in the EU.

g) Financial Transactions Tax (FTT)

One meeting of the Working Party on Tax Questions has been held during the Netherlands Presidency during the first half of 2016, enabling discussion among all Member States on selected issues that were already covered by the exchange of views at December 2015 ECOFIN, namely:

- a) application of "issuance" and "residence" principles and the territorial scope for the FTT;
- b) exemption from FTT of market making activities; and
- c) scope of transactions in derivatives contracts to be subject to the FTT.

From the Council note dated 3 June, it was recorded that no agreement could be reached on these issues, with at least one participating Member State either reserving its position or not agreeing to the proposed solution. This caused the official from Austria chairing the discussions to offer to stand down, given the lack of progress and the fact that Member States have been discussing the issue since 2011. The state of play on the dossier was sent to the 17 June Ecofin, which decided that work would continue under the Slovak Presidency, but emphasizing that the solutions must be acceptable to all remaining nine participating Member States. So this dossier continues to be dragged out.

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 20 7550 5442. Previous editions of Oversight and other regulatory information about us are also available at: www.six-securities-services.com



CCP Regulation & OTC Derivatives Clearing

Work to finalise the global and European regulatory frameworks continues in the G-20, the FSB, the CPMI-IOSCO and at the level of the European Commission, ESRB and ESMA; ESMA publishes CCP stress-test results; much commentary from public officials on CCP aspects.

Although there has been perhaps less in the way of legislative initiatives, the current regulatory focus on CCPs has continued in the quarter under review. Some highlights include:

On 29 April, ESMA published the results of its **stress-testing** of 17 EU CCPs. The results of the test showed that the overall EU CCP “system” can in general be assessed as resilient to the stress scenarios used to model extreme but plausible market developments. ESMA’s stress test solely focused on the **counterparty credit risk** which CCPs would face as a result of multiple clearing member (CM) defaults and simultaneous market price shocks. Being the first EU-wide stress test exercise for CCPs, ESMA decided to focus on the counterparty credit risk aspects of CCPs and leave additional risk dimensions for future exercises. In addition, ESMA also issued recommendations on how to improve CCPs’ internal methodologies.

ESMA tested CCPs resources using combinations of CM default and market stress scenarios. The results

show that CCPs’ resources were sufficient to cover losses resulting from the default of the two largest EU-wide CM groups combined with historical and hypothetical market stress scenarios. However, under more severe stress scenarios, CCPs faced small amounts of total (i.e. across all CCPs) residual uncovered losses. This was especially the case for scenarios assuming the default of the top-2 CMs per CCP due to assumed CM defaults across CCPs. That is a scenario where a CM defaulting in one CCP would also be considered to be in default in all CCPs, in which it is a member, leading to more than 25 CM defaulting EU-wide.

Although EU CCPs overall seem well equipped to face severe scenarios, ESMA has included recommendations addressed to the NCAs of CCPs. These cover:

- **The assessment of the creditworthiness of CMs:** a significant part of CCPs collateral are pooled resources of non-defaulting CMs. In extreme cases, these CM could face significant losses which in



turn could trigger the default of further CMs and additional losses at CCP level. Therefore, ESMA recommends that CCPs incorporate in their creditworthiness assessment of CMs, the potential exposures these may face due to their membership in other CCPs. Such analysis is essential in order to identify sources of increased exposure; and

- **Methodologies for price shocks:** in the course of data analysis provided by CCPs, ESMA has also identified that in a number of cases the stress price shocks applied by CCPs for some of their cleared products as part of their own stress testing framework are not as conservative as the minimum shocks defined for this exercise or do not replicate the most extreme historic price changes observed. To achieve the on-going resilience of CCPs, ESMA recommends NCAs to ensure that CCPs revise their price shocks used in their stress test methodologies where gaps have been identified in the course of the exercise.

On 26 May ESMA submitted to the Commission its report and draft RTS on **indirect clearing arrangements** relating to exchange traded derivatives (“ETD”). In addition, in developing these RTS, ESMA was able to initiate the review of the RTS on indirect clearing arrangements under EMIR for OTC derivatives. The package of the two RTS in this report was the subject of a consultation published in November 2015, and has now been sent to the Commission for endorsement. The RTS notably aim to clarify the duties of indirect clearing members, choice of account structure, default management and risk management procedures, and the treatment of long chains.

Elsewhere there has been extensive commentary by public officials on various aspects of CCP resilience, including inter-operability arrangements, stress-testing and the legal framework for CCP default management. Here are the most salient examples.

In May, a paper from two researchers from the Federal Reserve Bank of Chicago suggested that the drive towards **interoperability for derivatives CCPs** raised insurmountable problems for margin requirements. Unlike equity trades – which settle in two days – the continuing open interest in derivatives trades is a much bigger problem, they argued. Open contracts will need to be revalued at least daily and counterparties must post initial and variation margin, as well as concentration margin – also known as “super margin” – if the open interest between the two CCPs goes above a certain level.

CCPs determine their margin requirements based on a set liquidation period – also known as the margin period of risk. If a position was too large to close out within that period, the CCP would demand a concentration margin. For example, if there was a relatively small trade between two end-users that each cleared with different CCPs, the level of open interest between the two CCPs would increase. If this was enough to push the total open interest over the limit, the CCPs would demand a concentration margin from the two end-users.

The situation worsens if one of these end-users decided to exit its position by selling it to a third party that cleared with the other CCP, say the researchers. Now, both counterparties to the trade would face a single CCP, which has a higher open interest with the second CCP. That means that one of the parties would have to pay an additional concentration margin, but there is no equitable way to handle the issue. Solutions include limiting the size of inter-CCP exposures, or not posting concentration margin, but both have downsides, notably that the latter goes against the spirit of the margining recommendations in the PFMIs. So, if CCPs become their rivals’ largest members, the researchers believe that two or three CCPs would typically dominate each CCP, pushing other non-CCP clearing members to the sidelines.



On 11 May, in a speech to a Futures and Options World conference in London, David Bailey, the Director of the Bank of England's Financial Market Infrastructure Directorate said that the CCPs for financial derivatives should be **stress tested** on a global basis to prevent them becoming "too big to fail". Mr Bailey said the proportion of derivatives being centrally cleared will increase significantly in June when mandatory clearing begins for some interest rate swaps in the European Union. He continued: "We need to plan for the extreme or even the implausible event. Simply put, we need to ensure that CCPs are not 'too big to fail'." Regulators have already strengthened rules so that a CCP must have enough resources to withstand its two biggest members defaulting, known as "cover two". But given their growing size and interlinkages, more needs to be done to address risks from the increasing systemic importance of CCPs, Mr Bailey said.

He continued to say that British and German authorities have taken "initial steps" in a joint default management exercise across two major CCPs – thought to be the London Stock Exchange Group's LCH.Clearnet and Deutsche Boerse's Eurex Clearing. The two exchanges have announced plans to merge and savings for customers by linking the clearing houses have been put forward as a major selling point for the deal. Mr Bailey said such regional testing is not enough. "In our view, it is important that work is progressed at the international level to provide consistency," Mr Bailey noted. LCH.Clearnet, for example, has ties with U.S. markets. But thorny questions still needed answering, such as when should regulators intervene in a failing CCP, and what resources should be called on to avoid taxpayers bailing out a CCP.

In their May paper on the legal framework for **CCP default management**, two Bank of England researchers find that central clearing offers numerous benefits to financial stability including multilateral netting of

cleared exposures and the centralisation of default management. These benefits explain the pivotal role of CCPs in the post-crisis derivatives market reforms. However they lead to a key financial stability question: will CCPs be able to manage a large member default effectively? There are various aspects to this question, and the researchers concentrate on one of the least studied: the legal certainty of CCP default management practices. This aspect is important because the prospect of legal challenge to a CCP could be destabilizing, and the legal framework within which CCPs operate is a complex and, in some areas, newly constructed one.

The researchers evaluate the diverse legal rules governing CCP default management by investigating the extent to which they provide adequate legal certainty. The paper discusses the processes of clearing and collateral posting in detail, establishing the nature of the rights which CCPs rely upon when managing defaulting members. They then consider the relationship between CCP default management processes and insolvency law, as defaulting members are sometimes (but not always) insolvent. This leads to an evaluation of the legal issues arising along a typical default timeline of default declaration; returning to a matched book; and use of the defaulter's collateral.

Their findings are that English and EU law provide legal certainty for many aspects of CCPs' default management processes, but some challenges remain. One set arise through the piecemeal nature of the legislative framework, while others turn on the importance of CCPs' contractual drafting being as robust as possible. The paper concludes with recommendations on both legislative and drafting issues.



EU Institutional Developments

The Commission's review of the impact of EU financial services legislation and CMU progress report; Update on the European Post-trade Forum's work; ESMA publishes its Risk Dashboard, 2015 Annual Report and consults on DLT; Commission moves to ratify EU financial services acts under the EEA Agreement.

a) Commission Consultation on the EU regulatory framework for financial services

With preliminary conclusions noted in the last Edition, the Commission moved to publish both a summary of responses to its "Call for Evidence" and its first CMU progress report.

On 25 April, the European Commission published its first **CMU progress report**, in which it takes stock of the progress made in the first six months since the adoption of the CMU Action Plan. The report includes sections on steps taken since adoption of the CMU Action Plan, key initiatives planned by end 2016 and preparation of other CMU actions in 2017 and 2018. It indicates that first measures are already having an impact on the ground. New rules have just entered into force to support investment by insurers and reinsurers in **infrastructure projects**. The Commission's legislative proposal to restart **securitisation** markets in Europe was agreed in record time by Member States in December 2015; and a proposal was also presented to simplify **prospectus** requirements and reduce burdens for companies issuing shares and bonds – the Commission hopes that these proposals will be agreed swiftly by the co-legislators.

The Commission also carried out a cumulative assessment of the financial services legislation – **the Call for Evidence** – to check that its legislative framework is working to support growth across the EU. This work is not finished and the Commission has launched a public consultation on **business restructuring and insolvency** in order to tackle some of the longer-term issues that

are holding back jobs and growth in the EU. The have supplemented this with further actions to promote **personal pensions**; and through a report on the development of **crowdfunding markets** in the EU. The Commission has also proposed measures to stimulate European venture capital markets, including a revision of the **venture capital** legislation and work on a venture capital "fund of funds", launching in the process on 2 June a public consultation to gather views on how the passporting rules for the cross-border distribution of investment funds can be improved. Oversight does not believe these have any particular resonance for FMIs.

In terms of the industry responses, concerns were expressed as to the (cumulative and single) effects of measures such as EMIR and the CRR (with further comments about the disproportionality of UCITS, Solvency II, MiFID and AIFMD). The majority of examples related to single pieces of legislation, but respondents also provided a significant number of examples relating to a combination of pieces of legislation. Respondents provided examples of where the rules are perceived to be inconsistent, overlapping or duplicative (e.g. reporting and disclosure requirements, definitions). Limited specific information was provided as regards the compliance costs or the wider market impacts of these inconsistencies or overlaps. Similarly, feedback on the market impacts of the different rules (e.g. their impact on **funding** or market liquidity or other unintended consequences) was largely qualitative or based on external studies. This may reflect the difficulty of assessing the impact of rules that are very recent (or not yet implemented or adopted). It may also reflect the



difficulties inherent in isolating the impact of EU rules from other factors (e.g. monetary policy, national policy changes, macroeconomic developments) that may also play a significant role.

A number of market participants argued that specific pieces of legislation and the cumulative impact of certain EU rules have had a detrimental impact on **market liquidity**, particularly in corporate bond markets. Other respondents questioned whether regulation was responsible for the decline in market liquidity, arguing that other factors play a greater role, and that the evidence of an adverse impact of regulation is unclear. Some public sector respondents cautioned that part of the impact of regulation was intended and reminded of the risks of excessive liquidity before the financial crisis. As a consequence of this, the Commission announced on 16 June that it was setting up an **Experts Group** to discuss market liquidity and called for expression of participation interest.

In parallel with the CMU status report, the Commission also published a new edition of the European **Financial Stability and Integration Review (EFSIR)**, which this year focusses on the CMU and identifies some promising developments in European capital markets. The EFSIR builds on the economic analysis that had supported the publication of the CMU Action Plan. Publication of the EFSIR comes alongside a one day joint conference of the Commission and the ECB, *Completing European financial integration: What next?* The ECB's published contribution towards this is the 2016 edition of its report on *Financial Integration in Europe*, which indicates that the financial re-integration trend has moderated, but that an ambitious CMU will boost the benefits of integration.

This last report highlights a series of policy actions that support the financial re-integration trend. In addition to the ECB's expansionary monetary policy, the **Special Resolution Fund** became operational this year; and ECB Banking Supervision is addressing remaining cross-country heterogeneities in the regulatory framework. Looking ahead, the ECB emphasises that the CMU and all the other steps proposed in last year's Five Presidents' Report need to be pursued with

determination in this context. The ECB's report makes a strong case for strengthening Europe's more bank-oriented financial system by better developing and integrating capital markets, notably in the equity space. The analysis explains how this can improve the system's resilience, enhance cross-country risk-sharing and improve the financing options of firms and households.

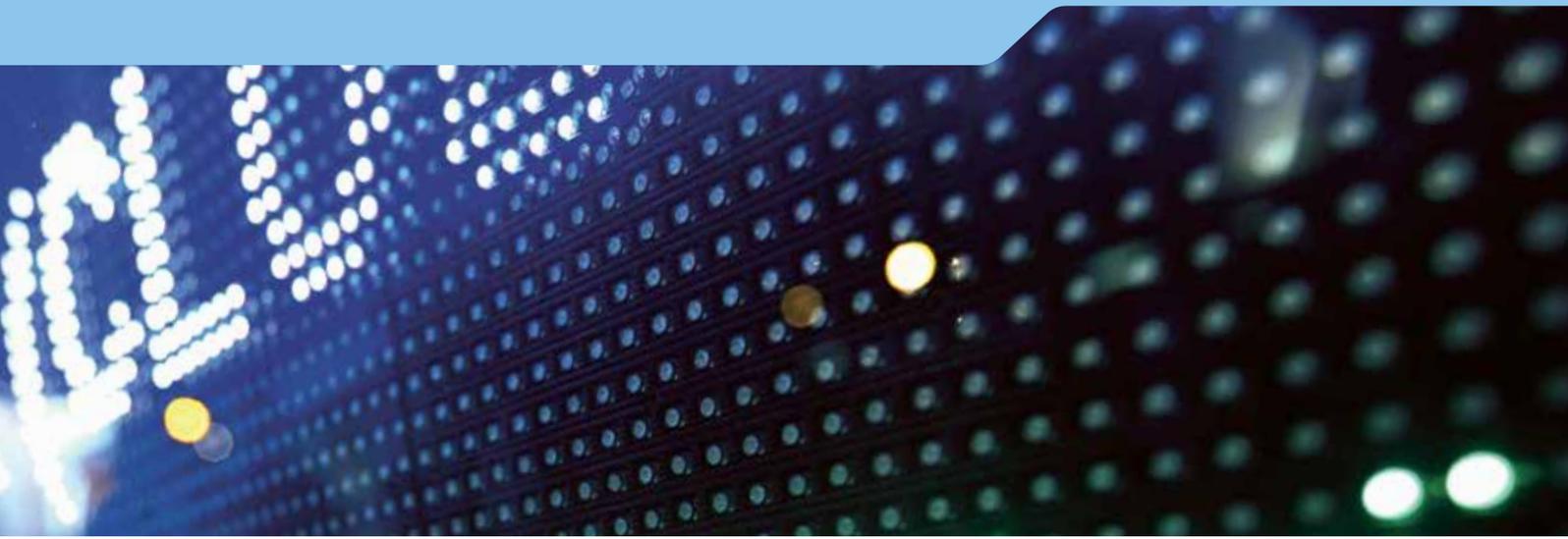
b) The Commission's European Post-trade Forum (EPTF)

The first stage of this work (mapping existing regulatory requirements and issues) is drawing to a close. Recent issues discussed in the first of the sub-groups include account segregation, shareholder rights and collateral. It is intended that the EPTF Board should adopt the first stage reports in mid-July. The next stage will involve members of the Forum and its sub-groups (which involve substantial representation from EU CCPs and CSDs) producing recommendations and follow-up action. We understand that the report should issue with recommendations in early 2017.

c) ESMA publishes its Risk Dashboard

ESMA published on 10 May its Risk Dashboard for the First Quarter of 2016, which shows that the overall risks to securities markets in Q1 2016 remained unchanged at high levels, with market and credit risks being very high. This was reflected in major price swings in global equity markets, especially affecting financial institutions at the beginning of Q1 2016, and high volatilities across market segments. Corporate bond spreads increased substantially, especially for lower rated bonds, before moderating at the end of Q1 2016.

Key risk sources were mostly related to the uncertain EU and global economic outlook, commodities price dynamics and global financial developments. Liquidity risk was at high levels amid sustained investors' uncertainty, potentially leading to portfolio reallocation and related liquidity pressures. Contagion risk was also high, the main drivers including financial market interconnectedness related to the exposure of EU financial and non-financial sectors to EM and the commodities sector, as well as increased interconnectedness of the fund sector with the rest of the financial system.



The report noted that systemic stress increased during the first part of Q1 before easing in March 2016, mainly driven by bond and equity market dynamics.

d) ESMA publishes its 2015 Report

On 16 June, ESMA published its 2015 Report. As well as covering its activities during 2015, and looking ahead, ESMA also looked back to its inception, celebrating its 5th anniversary. ESMA emphasizes the progress it has made in developing a Single Rulebook for Securities Markets and notably the supervisory framework for Credit Rating Agencies, Trade Repositories and CCPs. ESMA notes that MiFID II is, by far, the most significant piece of regulation that it has ever undertaken, also representing the biggest change to European securities trading in a decade. It says that MiFID II will alter the way Europe's secondary markets function by making them more efficient, safe and transparent to invest in. MiFID II will also increase the protection of investors by, for example, improving the governance around the development of financial products and making their selling more transparent and suitable to end-users. The magnitude of MiFID II should not be underestimated.

ESMA goes on to say that the rules it has delivered on MiFID II in 2015, once implemented, will bring the majority of non-equity products into a robust regulatory regime and move a significant part of OTC trading onto regulated platforms. In addition, ESMA says that its Market Abuse Regulation (MAR) standards will strengthen the existing market abuse framework by extending its scope to new markets, platforms and behaviours. ESMA's CSDR rules will also ensure that CSDs are safe, efficient and sound. Taken together with new rules on post-trading (EMIR), market abuse (MAR) and securities depositaries (CSDR), the MiFID II package is at the heart of the post-crisis reforms of financial markets initiated by the G20 in Pittsburgh.

e) ESMA consults on Distributed Ledger Technology

On 2 June, ESMA published a consultative paper on DLT as applied to securities markets. ESMA's paper looks at how the key EU regulations on post trade (including EMIR, the SFD, the CSDR) would be applicable to DLTs and the opportunities and challenges posed by DLT for securities regulators, and whether a specific regulatory response is needed. It looks at a number of aspects including clearing and settlement, safeguarding of assets, collateral management and counterparty risk. A first FMI reaction is that the paper is a methodical and positive one, in the sense that it argues that if DLT activities, such as settlement, have similar attributes to those identified in EU legislation, then parallel regulation should ensue. The consultation closes on 2 September.

f) Incorporation of EU Financial Services Acts under the EEA Agreement

This is an important issue because it concerns the three non-EU EEA countries, and particularly Liechtenstein, where SIX SIS has important clients. Norway is also involved, and Iceland is the third. In short, for all EU acts to take effect in the three countries a joint decision of the Commission and the EEA Joint Committee must move to approving their incorporation under the EEA Agreement. This is a slow and cumbersome process (because of the need to tailor the EU requirements in the individual countries) with the result that a number of EU acts have not yet taken effect in the three countries. Chief among these are EMIR and the Regulations establishing the ESAs and the ESRB. Finally an agreement has been reached between all parties (particularly on the interplay of NCAs with the ESAs), and the Commission is now moving to have the EU endorsement finalized, adopting a Decision on 2 June to process this through the other EU institutions. Oversight understand that a second set of EU legislative acts, including the CSDR, will come forward for incorporation under the EEA Agreement later this year or early in 2017.



Market Infrastructure Initiatives by Other Standard-setters

CPMI-IOSCO Work on CCP resilience; update on T2S; IOSCO policy and risk mitigation priorities; and change in IOSCO leadership.

a) CPMI-IOSCO Work on CCP resilience

This ambitious programme continues to be endorsed by the G-20 (including at its most recent meeting in Hangzhou) and the expected timetable is as follows:

- (I) A first raft of reports covering the implementation of the **PFMIs** in G-20 jurisdictions is slated for August, together with a report on the application of the recovery PFMI add-on from 2012; and
- (II) More specific guidance and consultations on **CCP resilience**, including loss recovery; margining standards; and stress-testing, by the end of the year.

There is no news on the timing and content of the follow-up to the CPMI-IOSCO consultation on its draft **Guidance on Cyber Resilience** for FMIs. Oversight suggests that this guidance still could be finalized by CPMI-IOSCO by the end of this year. In the meantime, IOSCO published in April a report entitled “IOSCO’s Cyber Risk Coordination Efforts” that provides an overview of some of the different regulatory approaches related to cyber security that IOSCO members have implemented thus far. More recently, the BIS has published the 25 responses received in reply to the consultation mentioned above. A flavour of these, from an FMI perspective, indicates broad agreement to the outlined guidance, but that the guidance should remain principles- based; that the guidance should form part of the PFMIs; that there was a need for more emphasis on the principles of proportionality and criticality; and that a two-hour recommended recovery period cannot always be met.

At the BIS, an insider, Morten Linnemann Bech has replaced Klaus Löber as Head of the CPMI’s **Secretariat**.

b) European Central Bank

In relation to **T2S**, work continues in relation to the third migration wave of CSDs due in September, notably with the instigation of peer-to-peer testing. Other issues, in the context of the Harmonisation

Working Group, concern notably Settlement Discipline. The ECB’s MI consultative group COGESI has also been looking at the scope of the ECB’s consultation on the **future of the Eurosystem financial market infrastructure**, and notably key harmonization activities for collateral management arrangements.

c) Initiatives by IOSCO

Following his appointment as Secretary-General, Paul Andrews has been active promoting IOSCO’s priorities and confirming its future direction of travel. These include:

- (I) Asset Management;
- (II) OTC Derivatives;
- (III) CCP resilience;
- (IV) Market Conduct; and
- (V) emerging risks (including disruptive technologies and cyber resilience).

See below for more detail. As well as the internal and stakeholder management issues detailed in the last Edition of Oversight, Mr Andrews has said that he particularly wants to return IOSCO to its core of issuing standards, principles and recommendations, rather than surveys and stock takes.

On 11 May, IOSCO opened the public sessions of its Annual Conference in Lima focusing on SME financing, investor protection and education, and the opportunities and challenges of new financial technologies (FinTech). This public conference comes at the conclusion of IOSCO’s private meetings in which members discussed responses to the challenges currently facing markets regulators. During the four-day meeting, the IOSCO Board, the Growth and Emerging Markets (GEM) Committee, the four Regional Committees and the Affiliate Members Consultative Committee (AMCC) discussed policy initiatives to strengthen **securities market resilience** and ensure that securities markets continue to be sustainable sources of finance.



In particular, IOSCO members discussed how best to make use of the expertise and knowledge of IOSCO's diverse membership, including measures to further the integration and enhance the participation of GEM Committee members. On **enforcement cooperation**, IOSCO's Presidents Committee approved the text of an Enhanced Multilateral Memorandum of Understanding (MMoU) on cooperation and the exchange of information. This Enhanced MMoU, which is aspirational in nature, provides for the additional powers that IOSCO believes are necessary for its member regulators to ensure their continued effectiveness in deterring cross-border misconduct and fraud in securities markets. It builds on the success of the current MMoU on cooperation and exchange of information, while taking into account technological and regulatory developments since the launch of the original MMoU in 2002. It was resolved that arrangements for implementation of the enhanced MMoU will be developed by the Board with a view to approval by the Presidents Committee by the end of 2016.

On policy work, the IOSCO Board progressed its work on **asset management** by focusing on liquidity risk management and leverage. Additionally, it considered how to address gaps in asset management data collected by securities regulators, and will publish a statement in this regard shortly. In other key policy areas, the IOSCO Board heard updates on work on **CCP resilience and recovery, market conduct** in wholesale markets, and revisions to IOSCO's Objectives and Principles of Securities Regulation and supporting Methodology. On the issue of **infrastructure finance**, the Board agreed to establish a working group comprised of Board members from both advanced and growth and emerging markets that will engage with development banks, institutional investors and other stakeholders to discuss issues relevant to market based finance for infrastructure development. On identifying and addressing **emerging risks**, the Board discussed the issue of **liquidity in securities markets**, with a particular focus on liquidity in corporate bond markets; and will shortly publish a consultation paper on corporate bond market liquidity and take up further

work on corporate bond market transparency. The Board also discussed its work on **cyber resilience** and FinTech, agreeing to consider different mechanisms for securities regulators to share and gather information on cyber risk and cyber security issues that are relevant to securities regulators across its membership; and receiving an update on IOSCO work on the potential impact of **FinTech** and digitalization on securities markets and regulation.

At the Lima meetings, it was also confirmed that Ashley Alder would succeed Greg Medcraft as Chairman of IOSCO's Board.

IOSCO has updated, on 1 April its **information repository** for central clearing of over-the-counter (OTC) derivatives. The information repository provides regulators and market participants with consolidated information on the clearing requirements of different jurisdictions on a product-by-product level. By providing this information, IOSCO seeks to assist authorities in their rule making and help participants comply with the relevant regulations in the OTC derivatives market. The repository sets out central clearing requirements on a product-by-product level, and any exemptions from them. In particular, IOSCO has also asked market participants for their input on how to improve the information repository and on other areas that should be covered.

d) The Swiss Legal Framework for FMI

There are no new developments since we reported in the last Edition of Oversight. SIX SIS will soon be coming out to its clients, communicating what changes can be expected in the wake of the new requirements.

For further information on any of these issues, please contact:
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A glossary of acronyms

AIFMD	Alternative Investment Fund Management Directive	Governing regulation of hedge funds
BIS	Bank for International Settlements	Global standard setter for major NCBs
BRRD	Directive on the Recovery & Resolution of Banks	EU harmonizing measure for NRA Responsibilities and tools
CFTC	Commodity Futures Trading Commission	US regulator covering regulation of futures & clearing houses
CPMI	Committee for Payments & Market Infrastructures	BIS Committee of central banks' Payment & MI experts
CSDR	Central Securities Depository Regulation	EU measure governing requirements for CSDs
CMU	Capital Markets Union	A Commission plan for regenerating finance for firms
DG FISMA	Directorate-General for Financial Stability, Financial Services & CMU	Commission entity responsible for financial services initiatives
ECON	Economic & Monetary Affairs Committee	of the European Parliament
EEA	European Economic Area	The 28 Member States plus Iceland, Norway & Liechtenstein ('The 3')
EEA Agreement		The mechanism through which EU Laws/Acts become law in 'The 3'
EBA	European Banking Authority	Pan-European banking regulator
ECB	European Central Bank	Requires no explanation
EDs	Equivalence Decisions	Commission confirming compatibility of a Third Country's regime (e.g. CCPs)
EDIS	European Deposit Insurance Scheme	Commission proposal to mutualise bank deposit protection schemes
EIOPA	European Insurance and Occupational Pensions Authority	Pan-European insurance & Pension Fund regulator
EMIR	European Market Infrastructure Regulation	Governing requirements for CCPs, derivatives clearing & trade repositories
ESAs	European Supervisory Authorities	Such as EBA and ESMA
ESMA	European Securities & Markets Authority	Pan-European securities regulator
EU	European Union	The 28 Member States (MS)
FMI s	Financial Market Infrastructures	CCPs, CSDs & Trade Repositories
FSB	Financial Stability Board	Forum of central banks, regulators from major market economies
IOSCO	International Organisation of Securities Commissions	Forum of global securities regulators
MAR	Market Abuse Regulation	Tackling insider trading & market abuse
MiFID/MiFIR	Market in Financial Instruments Directive/Regulation	Rules governing requirements for, and supervision of, investment firms & trading venues
NCA s	National Competent Authorities	MS regulators and supervisors
NCB s	National Central Banks	Central banks of the EU
PFMI s	Principles for Financial Market Infrastructures	Guidance for FMI's management of business and risks
RRP s	Recovery & Resolution Plans	Plans by which firms will mitigate threat of failure and authorities will alleviate systemic contagion
SRB	Single Resolution Board	Euro-area banking resolution authority
SRD	Shareholder Rights Directive	EU measure prioritizing rights of shareholders to company information
SRM	Single Resolution Mechanism	Euro-area framework for resolving failing banks and mutualizing funds
SSM	Single Supervisory Mechanism	The banking supervision framework for the euro-area
TC	Third Country (like Switzerland)	Non-member of the EU/EEA
TLAC	Total Loss Absorption Capacity	Total availability of capital resources above regular capital adequacy
TSFTR	Regulation on transparency of SFTs	Commission Regulation on reporting of Securities Financing Transactions and re-use of collateral
TTIP	Trans-Atlantic Trade & Investment Partnership	Framework for EU – US liberalization of trade & investment (in negotiation)
T2S	Target 2 Securities	Single euro settlement platform project by the ECB
UCITS	Units of Collective Investment In Transferable Securities (Directive)	Products known as Unit Trusts in UK or SICAVs in France or Belgium

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