

Don't hold your breath

When planning our editions of Oversight, we had hoped to give you a fairly positive mid-term report on the progress of regulatory measures in this issue. We thought that we would have much to report on the EU post-trading programme as it makes its way through the legislative cycle, for instance finalisation of EMIR. Instead, for a variety of reasons, EMIR is nowhere near finished and the emergence of further EU post-trading initiatives has been postponed until after the summer break (at least our Head of Market Policy is happy about this!).

One of our first items in this edition summarises where we are with all these initiatives. None of which helps either us or you when planning for the future: the uncertainty does not diminish. While this is frustrating, there is, of course, one silver lining to this delay. We know that regulators are taking more time over getting their proposals right: there have been extensive discussions with regulatory authorities, and the industry too has been involved. Via our membership of the European CSD Association, we have been able to see first hand how the draft CSD Legislation has been evolving and indeed to be part of the effort to advise the Commission and contribute to what we hope will be a well crafted proposal. Our membership of EACH has likewise meant a co-ordinated approach with other CCPs to EMIR.

We are similarly in intensive (external and internal) discussions over the revised CPSS-IOSCO Principles for market infrastructures, which passed the half way point of the consultation period recently. Our first-order assessment is that we are in good shape to meet a great deal of the revised framework. We won't know just how much it will affect us until the proposals are finalised and we have a better idea about how our national regulators, FINMA and the SNB, intend to apply these new standards to our business.

As I said, uncertainty still lingers, and we continue to monitor and influence the process wherever possible to ensure that we maintain a safe, robust and competitive basis for our clients to develop their business models.

Thomas Zeeb
Chief Executive Officer
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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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The EU legislative programme on market infrastructures

The finalisation of EMIR, and the production of further MI initiatives is subject to delay

(i) General Outlook

It is worth recapping that delays to the programme are now occurring as summarised in the table below.

(ii) Review of MiFID

A legislative proposal (an Amending Directive, although there are also concerns that the Commission might produce a Regulation) is now delayed until September or October. Differences of opinion between a number of parties have surfaced publicly and been the subject of, at times, quite heated debate. For instance between the Commission, on the one hand, and the proponents of certain execution venues such as broker or crossing

networks, on the other, over plans to force them to register as MTFs, which is also echoed in the positions taken by FESE and the broker dealer representatives; and between the Commission and some member states for instance over the introduction of the new OTF category and moves to mandate greater pre- and post-trade transparency.

(iii) European Market Infrastructure Regulation (EMIR)

We noted in the last issue that the finalisation of EMIR was likely to be delayed beyond the end of the current Hungarian Presidency of the EU (at the end of June),

Segment of the Value Chain	Measure	Proposed (Published)	Adopted (Finalised)
Trading	Review of Market in Financial Instruments Directive (MiFID)	September/October 2011	End – 2013?
Clearing	European Market Infrastructure Regulation (EMIR)	September 2010	Q1/2012?
Settlement	Legislation on Central Securities Depositories (LCSD)	October 2011	End - 2013?
Underpinning Law	Securities Law Directive (SLD)	Q1 2012	End - 2015?

and this is now certain. There have been a number of obstacles to progress: (i) slow progress in the Council discussions between member States notably over the OTC derivatives part of the proposal and the powers conferred on ESMA; (ii) the adoption of the European Parliament's (EP) report on EMIR which is directly at variance with the Commission text in a number of areas, notably the extent of interoperability; and (iii) protracted discussions between the Commission and the US authorities in ensuring consistency between EMIR and the relevant provisions in the Dodd-Frank Act. This last difference is serious, and we know from discussions with many of our clients with global presences, that the last thing firms want is to be faced with at least partial implementation in one jurisdiction, with a subsequent (and different) implementation in another. This amounts to duplicate sets of compliance standards and added cost.

The Council, Commission and EP texts will still need to be reconciled, after the EP Plenary votes on its committee's report and the Ecofin Council agrees on its general approach, both likely in July. A further complication is that the EP is stipulating that the proposal will have to go to a second reading, rather than negotiating a common position among all the EU institutions (at the current first reading stage).

The result of all this is more uncertainty over when we will see a composite agreed text. This could even stretch into the Danish presidency in the first half of 2012. This would make it hard for both the Commission and ESMA (which has to produce an extensive set of accompanying Technical Standards) to ensure that the EU meets in a timely fashion its G-20 commitment of introducing the requirements by end-2012.

(iv) Future EU Legislation on CSDs (LCSD)

Following the closure of the consultation in March, the European Commission has been digesting the results and following up the comments with a series of further meetings with the regulatory authorities of the Member States and other interested parties, particularly the CSD community. The tenor of the comments has been generally consistent in welcoming the introduction for CSDs, as for other market infrastructures, of a comprehensive authorisation and supervision regime and a common set of definitions and risk management standards. There has been less heterogeneity in views over other aspects of harmonisation, such as mandating a T+2 settlement cycle, and how far the EU should go in mandating a common settlement failure and penalties regime.

But by far the major difference between the CSD community, on the one hand, and certain associations

of users (together with authorities in Finland, France, Portugal and Spain) has been over the extent to which 'banking-type' services should be ring-fenced, perhaps in a separate legal entity. These services typically occur at the level of the investor CSD or ICSD (including SIS), but by no means concern all CSDs in Europe. So a major facet of the discussion between ECSDA and the Commission has revolved around this point. The Commission will accompany its legislative proposal with an Impact Assessment, both of which will need to be taken through an internal inter-service (departmental) consultation.

A proposal is now expected sometime during October.

(v) Securities Law Directive

The Commission feedback statement on the consultation revealed that there were considerable divergences of views over how to tackle the identified problems in harmonising the various areas of legislation. These included the use of the term of the ultimate account holder and how this impacted on the identification of shareholders, the extent of a priority of interests rule, and the law governing conflicts.

A legislative proposal is not now expected until Q1 2012.

(vi) EU Expert Group on Market Infrastructures (EGMI)

This Commission post-trading advisory group, which carried on the work of CESAME and the Code of Conduct Monitoring Group held its last meeting on 22 June. It is widely expected that EGMI will then be wound up, having produced a report on the post-trading landscape and the post-trading 'to do's', which will be presented and discussed at a Commission conference on 24 October (postponed from 31 May). A major potential pitfall is that the EGMI report might then be accepted as a licence to initiate a further legislative programme.

ECSDA has written to the Commission to suggest that this ought to be postponed given both the incomplete nature of existing Commission initiatives, and other transformational infrastructural developments in process such as T2S. These will make it extraordinarily hard to assess the post-trading market in a steady state in the next few years, without taking stock first of how some of the finalised infrastructure legislation has impacted (in other words not much before 2014 or 2015).

If you would like to find out more on EU market infrastructure legislation, please contact: Alex Merriman, Head of Market Policy (Alexander.Merriman@six-group.com or 058 399 4583)



Target 2 Securities

A number of concrete steps have been taken as the project momentum is maintained

The Framework Agreement between CSDs and the Eurosystem is being finalised and will be sent to the ECB Governing Council in July for approval. An offer will then be made to CSDs, who will have until November 2011 to approve it and return it to the ECB. It is expected that the individual Framework Agreements will be subject to ongoing bilateral discussions with the ECB in this period. SIX SIS is strongly involved in these negotiations. Second, the User Detailed Functional Specifications (UDFS 1.0) produced by the ECB have been put out to consultation. As far as the Swiss market is concerned, SIX Securities Services has continued to hold a series of client facing meetings, including with the Foreign Banks' Association

and the Liechtenstein Bankers' Association, to explain the options still available to the market. A decision by the SNB on whether to put the CHF into T2S is expected by Q4 this year (six months later than originally planned).

Finally, an information session by the ECB Project Team will be held on T2S in Zürich on 12 July. Six Securities Services is hosting and contributing to this dialogue and we look forward to welcoming any interested parties to the event.

Please contact your relationship manager for more information.

Changes in the EU institutional landscape

European Securities & Markets Authority (ESMA)

ESMA has finally set up its Stakeholders Group, but with disappointing results for the post-trading industry and major financial institutions in terms of representation

ESMA publicised only on 17 May the composition of its Securities and Markets Stakeholders Group. While it has plenty of appropriate consumer, (end-)user, academic and even SME representatives, the participation from the post-trade and major financial institutions (only one) is disappointing to say the least. The so-called financial market representation is heavily weighted towards

exchanges (LSE, NYSE Euronext, Eurex and FESE are all on board), while only one CSD and no CCP has a seat.

We understand that the selection process was extremely convoluted and tense, but the outcome seems unbalanced as far as ensuring that each segment of the value chain has equal weight.

Other legislative and regulatory initiatives impacting market infrastructures and the value chain

This Quarter's spotlight falls on the CPSS-IOSCO Principles and also provides an update on the AIFMD

(i) Revised CPSS-IOSCO Principles for Market Infrastructures

We have been discussing the Principles, which were released in a consultative report on 10 March, extensively in a number of fora, both internal and external. We have notably been formulating our own position, which will lead SIX Securities Services to respond both in the names of SIX x-clear Ltd, and SIX SIS Ltd, and this has been input into the responses being put together by EACH and ECSDA. We have also benefitted from discussions with members of the CPSS Secretariat, and are attending meetings at the Bank of England on 14 June and the ECB on 11 July.

Some initial comments are already possible:

- (a) Because they are combined in one document, the clarity of the revised Principles as applied to different types of market infrastructure suffers
- (b) A number of the Principles (for instance on risk management) are very CCP-centric (e.g. segregation, tiered participation), and do not sufficiently differentiate the applicable treatment to CSDs
- (c) We believe we meet most of the revised Principles, particularly "Cover 2" requirements in the event of market participant failure, minimum equity coverage (as a multiple of expenses), and business continuity arrangements, including back up site
- (d) We will need to look afresh at the interplay between credit and liquidity risk management
- (e) We take issue with some of the overly-prescriptive proposals notably over inter-dependency risk, and the "drilling down" being required to participants' clients

(ii) IOSCO Papers on Trading of OTC Derivatives, mitigating Systemic Risk

On 18 February IOSCO's Technical Committee released a report as its contribution to the migration of OTC derivative transactions onto organised trading venues, as part of G-20 efforts to narrow the perimeter of business outside the scope of mainstream regulation. As well as being convinced of the benefits of migration through enhanced liquidity and transparency, together with resilience, the Technical Committee proposes a series of regulatory actions, including establishing and

monitoring targets for market initiatives, regulatory incentives (or disincentives) for not through-putting OTC contracts via organised platforms, and establishing regulatory mandates for the meeting of certain standards for OTC derivative products.

As previously noted, regulators' responsibilities are not just being confined to the micro-prudential sphere, but also to macro-prudential aspects as well (i.e. the state of overall risks in the system as a whole). This has been a developing theme in banking in recent years, but is probably much less developed in securities.

ESMA will have to take account of it in its work, as well as advising the European Systemic Risk Board, and now IOSCO, on 25 February, has issued the discussion paper: "Mitigating Systemic Risk – A Role for Securities Regulators". This describes (i) the role of securities regulators with respect to systemic risk: the primary ways in which it can develop in securities markets; (ii) approaches and indicators that securities regulators may use in seeking to identify sources of systemic risk; and (iii) guidance on how securities regulators can act, both to reduce the opportunity for systemic risk to arise and to reduce its impact. IOSCO also proposes updating its principles for securities regulators with two new recommendations in relation to systemic risk:

- a. Principle 6: The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate
- b. Principle 7: The Regulator should have, or contribute to, a process to review the perimeter of regulation regularly

(iii) Alternative Investment Fund Managers Directive

We reported on this extensively in the last issue. The EU Council agreed on 27 May to release a finalised text. This will be published shortly in the EU's Official Journal, and so will come into force. In the mean time, the Directive does exist in a tidied up Council document, which we have made available to the Swiss Bankers' and Liechtenstein Bankers' Associations. If you would like a copy, please contact: Alex Merriman, Head of Market Policy (Alexander.Merriman@six-group.com or 058 399 4583).