

OVERSIGHT

REGULATORY UPDATE

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The Waiting is Nearly Over

I mentioned in our last edition that the EU legislative programme affecting the post-trading sphere was delayed. Now the summer break is over, the Brussels machinery is getting into gear again. Discussions in the EU Council on EMIR have resumed, and we will see draft proposals on MiFID II and CSD Legislation in the next couple of months. At the euro-zone level, it will not have escaped our readers that it has been a summer of turmoil, as the earlier financial crisis and global economic slowdown have transmogrified into a fully-blown sovereign debt crisis. Financial markets remain volatile, and the financial system fragile.

The summer pause did not, however, signify legislative inactivity: the speed and intensity of the regulatory whirlwind is not diminishing. The G-20 commitment of having in place, by the end of 2012, all the principal regulatory planks still holds good. So, we continue to focus in this issue on the latest measures impacting on clients. We feature prominently the EU-embodiment of Basel III – the Capital Requirements Directive IV. There are some aspects here that specifically relate to clearing and settlement risk. The Financial Stability Board also produced a consultation on “Effective resolution for systemically important financial institutions”, while CPSS-IOSCO has come out with a “Report on OTC derivatives data reporting and aggregation requirements”. These two sets of requirements will mainly impact on large banks, but there are some potential spill over effects for market infrastructures as well.

SIX Securities Services was not idle during the summer months either. We kept in touch with the Brussels agenda, and discussed the revised CPSS-IOSCO Principles for market Infrastructures with overseers and regulators. This has enabled us to refine our understanding of the underlying regulatory concerns, the expected requirements, and how the Principles might be rolled out for our two main businesses, SIX SIS and SIX x-clear. The results, I have to say, have left me broadly less concerned than I was at the start of the process. To complete the summer picture, our Group Board has also been busy, reviewing some strategic options in the post-trading space, which are also related to some extent to the regulatory environment and the continued “internationalisation” of our business. These I hope to share these with you in more detail in the coming months.

It will be a fascinating autumn for all of us.

Thomas Zeeb
Chief Executive Officer
SIX Securities Services

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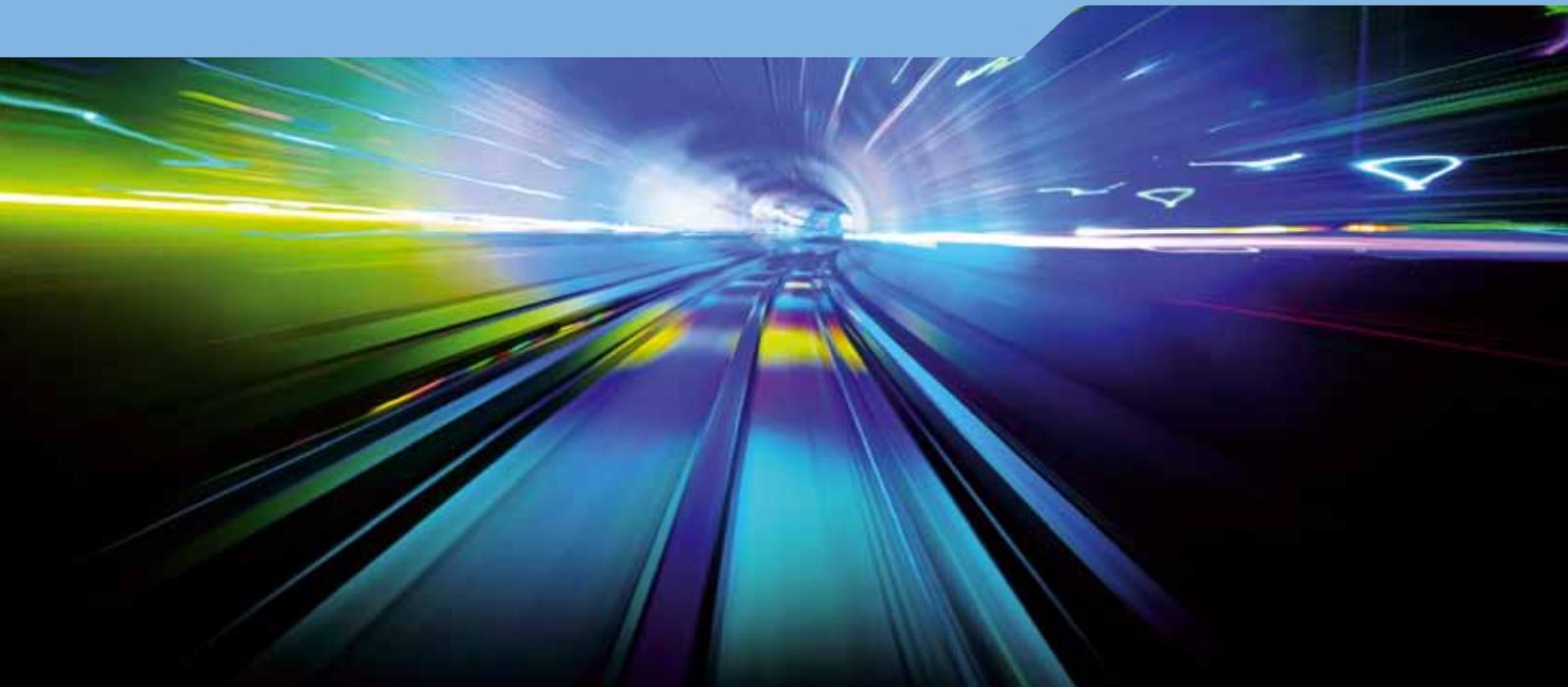


Oversight

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The EU Legislative Programme on Market Infrastructures

Across the board, the timetable for the EU programme has slipped

(i) General Outlook

Further delays to the programme are now occurring as summarised in the table below:

(ii) Specific Measures

Following the finalisation of the European Parliament's position in July, discussions on **EMIR** resumed among Member States in the Council in the first week in September. The Polish Presidency has set an ambition target of achieving political agreement by the Ecofin Council meeting of 4 October. As described in June, a **MiFID II** proposal is expected in October, while the timetables for issuance of the **LCSD** and the **SLD** have slipped, to October/November and Q1 2012, respectively.

(iii) Commission Post-trading Conference on 24 October in Brussels

The Commission has published details on its website of its "Conference on European post trading landscape: the road ahead". The programme includes the discussion of issues relating to safety, efficiency, as well as governance and competition. As mentioned previously, the report of the Commission's expert group, EGMI, is likely to form the backdrop of the event.

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 +41 58 399 4583

Segment of the Value Chain	Measure	Proposed (Published)	Adopted (Finalised)
Trading	Review of Market in Financial Instruments Directive (MiFID)	October 2011	End – 2013?
Clearing	European Market Infrastructure Regulation (EMIR)	September 2010	Between Q4 2011 and Q2 2012?
Settlement	Legislation on Central Securities Depositories (LCSD)	October/November 2011	Mid - 2013?
Underpinning Law	Securities Law Directive (SLD)	Q1 2012	End - 2015?



TARGET2-Securities

Discussions continue as key project milestones arise

A T2S information session, hosted by SIX SIS and attended by nearly 100 market participants, was held in Zürich on 12 July. ECB representatives covered key aspects of the project, including pricing, user connectivity, harmonisation, and a concluding panel discussion focussed on the benefits for non-euro markets of participating in T2S. Intensive negotiations on the Framework Agreement (FA) between T2S and CSDs continue; as a result, the timetable has once again slipped. We are now expecting the ECB Governing Council to approve the offer to participating CSDs in October, with CSD signature expected in December, or even as late as January 2012.

The next T2S Advisory Group meeting is scheduled at the end of September, while a Conference "Securities Settlement in 2020: T2S and beyond" hosted by the ECB takes place in Frankfurt on 4-5 October.

As we went to press, the Head of the T2S Project Team announced a further delay of "some months", with a new start date in 2015. We will analyze the consequences of this decision in our next edition.



Other Legislative and Regulatory Initiatives Impacting on Market Infrastructures and the Value Chain

This quarter's focus falls on "CRD IV" together with further initiatives on resolution, OTC derivatives and an update on the CPSS-IOSCO Principles

(i) EU transposition of Basel III – Capital Requirements Directive IV

On 20 July, the European Commission published its proposals for the EU implementation of Basel III, otherwise known as CRD IV. The proposals will apply to all credit institutions and investment firms of the EU, and to those from third countries, including Switzerland, wishing to do business in the EU. SIX Securities Services has mainly focussed on those aspects relating to clearing and settlement risk, namely:

- a) Own Funds Requirements for Exposures to a Central Counterparty (Articles 294-300 on Pages 150-159 of Part II of the Regulation) – principally the 2% capital charge;
- b) Own Funds Requirements for Settlement Risk (Articles 368-370 on Pages 55-56 of Part III of the Regulation), against unsettled or failed trades (broadly unchanged); and
- c) Own Funds Requirements for Credit Valuation Adjustment Risk (Articles 371-375 on Pages 57-63 of Part III of the Regulation) – the algorithms for the calculation of CVAs.

The package is complex and long because it is significantly "re-cast". The Commission has taken the opportunity to convert a significant proportion of CRD I - III from a directive to a regulation (and so has to produce a new text rather than just an amending directive). The original CRD sections survive in the "Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending

Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate" [Document COM(2011) 453 final].

This document is accompanied by an Impact Assessment (and a smaller Executive Summary). The Directive contains existing requirements for **authorization and supervision, right of establishment** etc, as well as new aspects such as **governance, counter-cyclical capital buffers and minimising reliance on rating agencies**.

The **Regulation** called "Regulation on prudential requirements for credit institutions and investment firms" [Document no COM(2011) 452 final] is divided into three parts (and an Impact Assessment and a smaller Executive Summary), in total five documents, with the following main features:

- a) Part I: Explanatory memo, Recitals, Scope, definitions, application, **Own Funds** (Tier 1 and 2), minimum capital requirements, measurement of Credit Risk (Standardised Approach, External ratings and IRB);
- b) Part II: ELD, PD, LGD, Credit Risk, Credit Risk Protection, Credit Counterparty Risk, Securitisation, **Netting, Own Funds requirements for Exposures to a Central Counterparty**); and
- c) Part III: OpRisk, Market Risk, **Settlement Risk, CVA**, Larges Exposures, Liquidity Risk, Stable Funding Ratio, Leverage Ratio, Disclosure, Transitional etc arrangements.

The first discussions in Council on the package are expected at the end of September. We will bring any changing clearing and settlement aspects to your attention in future issues.

(ii) Financial Stability Board (FSB) Consultation on Effective resolution of systemically important banks

The G-20 framework was issued on 19 July, with a response deadline of 2 September, accompanied by a parallel consultation paper from the Basel Committee on Banking Supervision (BCBS). These papers cover a number of additional prudential requirements for large globally systemically important banks ("G-SIFIs"), including additional capital requirements, more intensive supervision, and recovery and resolution plans "RRPs" (which will be made compulsory for all G-SIFIs). At present, these additional requirements are largely targeted at G-SIFIs only, and will be rolled out in the period up to the end of 2012. For a bank, this means, for instance, transferring its obligations such as public deposits in an orderly way to a new or successor institution.

Our view is that this framework for banks does not translate very easily to the infrastructure world. A CCP relies on its default "waterfall", which successively uses the defaulting participant's initial and variation margin, its contribution to the default fund, then that of surviving participants' margin and default fund contributions, then its own funds; in a CSD (settlement) context, participants' cash and securities positions should broadly cancel out, with no residual liability. Our understanding is that a sub-group of the CPSS-IOSCO working group that produced the Revised Principles for Financial Market Infrastructures in March, is now working on RRP for infrastructures (notably for CCPs). It is expected that their proposals will issue for consultation some time early in the New Year. We will be contributing comments to the FSB paper via the response of our CSD association, ECSDA.

(iii) CPSS-IOSCO Report on OTC derivatives data reporting and aggregation requirements

The Committee on Payment and Settlement Systems and the Technical Committee of IOSCO released for comment on 24 August a report on the OTC derivatives data that should be collected, stored and disseminated by trade repositories (TRs). The consultation runs until 23 September, and the authorities expect to implement the finalised requirements by the end of this year. The report addresses Recommendation 19 in the October 2010 report of the FSB, "Implementing OTC Derivatives Market Reforms", which called on the

CPSS and IOSCO to consult with the authorities and the OTC Derivatives Regulators Forum in developing:

- a) minimum data reporting requirements and standardised formats, and
- b) the methodology and mechanism for data aggregation on a global basis.

The proposed requirements and data formats will apply to both market participants reporting to TRs and to TRs reporting to the public and to regulators. The report also covers the mechanisms and tools that the authorities will need to aggregate OTC derivatives data. It advocates a system of standard **legal entity identifiers** (LEIs) as an essential tool for aggregation of such data. It further recommends that TRs actively participate in the LEI's development and use the system once it becomes available. As the implementation of a universal LEI will require international cooperation, it is noted that further international consultation would be beneficial. Therein lies SIX Group's chief interest in the proposals, in two particular respects: first, as participants in the numbering agency, ANNA, in the issuance of the new LEI codes; and second, because the basis of the code may involve changes from an instrument-based data model to a company-based model. We are beginning the process of consulting with the market.

(iv) Revised CPSS-IOSCO Principles for Market Infrastructures

SIX Securities Services has attended a number of meetings in London, Frankfurt and Zurich during the summer discussing with key G-20 infrastructure overseers and regulators the main outstanding issues. These discussions encompassed aspects such as timetable (finalisation of the Principles is now not expected until mid-2012), scope, roll-out, and more technical issues such as governance, risk management, account segregation, continued use of commercial bank money, credit collateralisation and monitoring of tiered participants. On most of these issues, we have come away with a better appreciation of the authorities' requirements and concerns, and have received a greater degree of comfort on, notably, the extent of monitoring that will be required for tiered participants (clients below the level of direct participants). We expect that, in a domestic context, the Swiss National Bank will roll out our assessment against the revised Principles during the course of 2013, with any changes to risk management and other requirements in the existing Principles being agreed in an implementation plan.

For further information on any of these issues, please contact: Alex Merriman, Head of Market Policy: Alexander.Merriman@six-group.com or +41 58 399 4583.