

Regulatory Update

More of the same.

The eurozone crisis is still very much with us and the zeal of regulators shows no sign of abating. I mentioned in the last edition that there is a bit more clarity about the potential impact of the various regulatory initiatives, and that we are now moving somewhat more from the assessment to the implementation phase.

In this edition, we explain that we now have the final revised Principles for Financial Market Infrastructures produced by CPSS-IOSCO. EMIR is also in a more or less final shape. What this means is that we can start looking at the requirements and taking a view on how they are likely to affect our current organisation and processes, and of course how they will impact you, our partners, clients and customers.

As simple as this may sound, it is deceptive. For a number of reasons. First, the reality is that we will have to marry together two sets of requirements: one from the EU and one from a global regulatory entity, as well as, of course, the Swiss implementation of each, or both.

In addition, no one has any great insights into how all of these initiatives will, collectively, impact an integrated infrastructure like SIX. But, notwithstanding these uncertainties, we are making progress in creating clarity out of this flood of regulation.

I will have more to say about this in our next edition, as we put into place a project framework that will enable us to comprehensively assess the regulatory effects across all SIX Securities Services businesses and, ultimately, how these will affect you.

Thomas Zeeb
CEO
SIX Securities Services

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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

If you would like to learn more about topics covered in this edition, please contact: Alex Merriman, Head of Market Policy (alexander.merriman@six-group.com) or at +41 58 399 4583.



The EU Legislative Programme on Market Infrastructures

Negotiations on the CSD Regulation have begun slowly, while the next phase on EMIR, ESMA's Technical Standards is awaited.

General Outlook

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 MiFIDII/MiFIR	20 October 2011	End - 2013 ?	2015
Clearing	EMIR	15 September 2010	Q1 2012	End - 2012
Settlement	RCSD	7 March 2012	Mid - 2013 ?	Mid - 2015
Underpinning Law	Securities Law Directive (SLD)	Q4 2012	End - 2015 ?	2017 / 18?

Regulation on Central Securities Depositories (RCSD)

Only three Council Working Group discussions have taken place since the European Commission issued the proposal on 7 March, and the Danish Presidency is now preparing to hand over the dossier to Cyprus. The initial discussions have not tackled the sensitive area of the legal separation of CSDs' banking-type services, and instead have concentrated on definitions, core services, and the proposal to enable issuers to issue into the CSD of their choice.

The Cypriots are very keen to progress discussions in the Council and to tackle the major technical issues; they are aiming for a Council 'general approach' (agreement) by the end of their Presidency. However, progress will depend to a large extent on the headway the Presidency makes on other key financial services dossiers, such as MiFID II, MAR, CRR and the recently issued crisis management framework for banks.

Parallel work is also beginning in the European Parliament, with the *Rapporteur*, Dr Kay Swinburne about to embark on drafting her report for the EP's ECON Committee. The draft is promised by mid-July, with a vote in ECON in October, and a possible Plenary vote in December. In comments made to a conference in London in mid-May, Dr Swinburne notably highlighted issues on settlement discipline (and fails) and third country aspects. The Council and EP could conceivably enter into a Trilogue early in 2013, with the Regulation being finalised by the middle of the year. As with EMIR, ESMA will then also be required to work on a number of Technical Standards clarifying various aspects.

SIX Securities Services continues to closely follow developments, particularly via our European trade association, ECSDA. The main controversial issue continues to be the proposed legal separation



RCSD: The main issue remains the legal reparation of banking-type services.

of banking-type services, with positions becoming entrenched, notably as supported by banking associations, and opposed by the CSD community.

European Market Infrastructure Regulation (EMIR)

While something of a final EMIR text now exists following the agreement reached between the Council and the European Parliament on 29 March, it is still not definitive, as it awaits publication in the Official Journal. This is expected imminently.

However, some areas still need to be clarified, for instance, margining, the weighting of exposures (capital charges) to default funds and to uncleared OTC transactions, and intra-group exposure. ESMA is clarifying the proposed treatment of some of these issues in its next consultation on EMIR Technical Standards, which it issued at the end of June. ESMA will also hold a hearing in the middle of July. The consultation lasts until August, so interested market participants will not have long over the summer months to respond.

This is unfortunate, but is necessitated by ESMA's deadline of having to submit the draft Technical Standards to the European Commission by the end of September, so that the EU can meet the year-end G-20 deadline for legislation ensuring that OTC derivatives are traded, centrally cleared and reported. It is expected, however, that some aspects of the EU framework will not be in place by this deadline.

Internally, SIX x-clear Ltd has begun the process of comparing the impact of EMIR (and the revised CPSS-IOSCO Principles for Financial Market Infrastructures) on current processes, with a view to ensuring that it is

compliant with the revised requirements by the middle of 2013 when it has to submit its application to ESMA for re-authorisation. One particular IT adaptation that will be required is in ensuring that the facilities are in place to offer clearing members a choice of 'global omnibus' or segregated client accounts.

Revision of the Market in the Financial Instruments Directive (MiFID II/MiFIR)

Discussions have continued in the Council and the European Parliament, with prominence paid to previously identified issues such as a new category of trading venue, the OTF, the degree of supervisory requirements imposed on high frequency traders, including an obligation to make continuous markets if algo-trading; and notably the Third Country (TC) aspects. In addition, repeating the debate that was had with EMIR, an attempt is being made to remove clauses ensuring that trading venues offer a choice of, and access to, clearing venues. The Cypriot Presidency intends that MiFID will be the key financial services dossier that it will negotiate during its Presidency, with the purpose of agreeing the Council position by the end of the year.



EMIR: Some areas still need to be clarified.

Market Infrastructure Initiatives by the European Central Bank (ECB)

A number of CSDs have signed up to the T2S project, including SIX Securities Services.

Target 2 Securities (T2S)

On 15 May, nine European CSDs signed the Framework Agreement with the ECB. The CSDs are from Belgium, Denmark, Greece, Germany, Italy, Luxembourg (2), Romania and Spain. These CSDs are said to represent about two thirds of the total euro-denominated settlement flow. With the next phase of the project underway, the ECB has also altered the governance structure for the project, creating a new T2S Board and tweaking the roles of the CSD Working Group and the Advisory Group. The SIX Group Board meeting on 18 June unanimously agreed to signing the T2S Framework Agreement.



T2S: A critical date is the conclusion of a Framework Agreement by participating CSDs with the ECB.

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

This Quarter's focus falls on the appearance of the revised CPSS-IOSCO Principles, the Commission's proposal on a crisis management framework for financial institutions and an update on the work on Shadow Banking.

Revised CPSS-IOSCO Principles for Financial Market Infrastructure (PFMI)

Very much as expected, these were issued on 16 April. The Principles themselves are now final, and the intention is that they should be reflected by national authorities in domestic rules by the end of this year. The Swiss National Bank for SIC (SIX Payment Services), SIX SIS Ltd and SIX x-clear Ltd (SIX Securities Services) will notably be looking at how the Principles will affect their Control Objectives.

Thereafter, the PFMI will be rolled out for the relevant parts of the SIX Group during the course of 2013.

While the PFMI are addressed to all types of clearing, payment and settlement institutions (and trade

repositories), there is an inevitable slant towards safeguarding the position of CCPs. This is part of a more general objective by the G-20, and regulators and overseers as a whole, to place FMIs back at the centre of risk management for the financial system. In particular, there is an emphasis on recasting Governance (Principle 2), managing credit and liquidity risks (Principles 4 and 6), as well as limiting the consequences of default (Principle 13), and having adequate financial resources and appropriate recovery and wind-down plans (Principle 15). A final objective for FMIs is to ensure that their participants adequately safeguard their clients' business, notably in appropriate account segregation (Principle 14) and intelligence about the drivers of clearing and settlement flows (Tiered Participation – Principle 19).

The Principles were accompanied by two consultations, which closed on 15 June, covering:

- A revised Assessment Methodology for the implementation of the Principles; and
- A Disclosure Framework.

The first of these is to guide authorities in the application of the Principles, while the second will be a publicly available document describing how each infrastructure intends to meet the individual Principles. A key question is how these elements interact, together with the requirement for the infrastructure to undertake a self-assessment, which then forms the basis of the authorities' work. A particular objective will be to avoid duplication of effort in all these exercises, together with aligning this work with other outstanding disclosure frameworks, such as AGC questionnaires. We responded via ECSDA.

CPSS-IOSCO also intends to make a further release, in mid-July, on the key attributes of recovery and resolution plans for FMI.

European Commission Proposal on a recovery and resolution framework for financial institutions

The Commission formally adopted its proposal on 6 June. As part of its work in creating a sounder and stronger financial system, the Commission is proposing a new bank (and investment firm) resolution regime, which is crucial for ensuring the long term stability of the financial system and for minimising the potential impact of possible future financial crises for the taxpayer and for economic growth. The aim is to avoid having banks

bailed out with public money. The key elements of the proposal are:

- The framework will be based first on preventing and reducing the risk of failure. A key element will be early intervention. The powers of the supervisory authorities will be expanded to enable them to intervene at an early stage before problems in a bank become critical and its financial situation deteriorates irreparably.
- The proposal will ensure that national authorities and the European Banking Authority (EBA) have the appropriate coordination tools to ensure they can respond appropriately. This is particularly important in the context of cross-border banking groups.
- The framework will provide credible resolution tools for when a bank is no longer viable and when allowing it to go bankrupt would be disruptive for essential financial services and overall stability.
- These tools will include 'bail-in' measures (the power to convert or write down the debt of failing banks). In order to be effective, sufficient funds should be available to finance resolution, for example to issue guarantees or provide short term loans to help a newly set up bridge bank to operate. Such funds would only serve to ensure the continuity of critical functions and not to bail out troubled institutions.

Separately the EBA has launched a consultation, closing on 15 June, on a template for banks' recovery plans.

Shadow Banking

At a conference organised by the European Commission in April, the major work streams were confirmed to be in tune with those from the Financial Stability Board. These include the links between banks and shadow banking, the role played by securitisation and Money Market Funds, as well as financing through securities lending and repo. In this last respect, it was confirmed that the authorities were looking more at the role played by intermediaries, rather than infrastructures. In terms of concrete proposals, it is only the first of these that is likely to yield any immediate concrete results, with potential proposals on tightening up capital and other requirements where banks interact with the shadow banking sector.

If you would like to find out more on any of these topics, please contact: Alex Merriman, Head of Market Policy (Alexander.Merriman@six-group.com or +41 58 399 4583). Previous editions of Oversight and other regulatory information related to us are also available at: www.six-securities-services.com.

