

Regulatory Update

Well, another year is over.

And it has proved a difficult one, not least in terms of the regulatory workload. Looking back over the year as whole, I am somewhat surprised that more has not fallen into place. In April, the CPSS-IOSCO Principles for Financial Market Infrastructures were finalised. In August, the text of EMIR took legal effect and, very soon we will learn whether the under-pinning Technical Standards are endorsed by the European Commission.

Elsewhere, progress has not been so swift. The EU Regulation on CSDs has moved slowly in negotiation. The European Parliament is also taking its time finalising the shape of its report, now expected in the New Year. While the technical discussions on T2S continue.

So, we have a lot of unfinished business for 2013.

While the Principles are final, their implementation in Switzerland and elsewhere is still pending. We have begun the process of benchmarking ourselves against some of the new Principles, and will discuss the results with the Swiss National Bank in the New Year, and also be subject to a revised CPSS-IOSCO Assessment Methodology and Disclosure Framework. Taking this into account, 2013 will also see discussions and a consultation on the modernisation of Swiss financial markets law including new requirements governing market infrastructure. Finally, FMIs will, just like systemically important banks, eventually be subject to resolution and recovery plans. The CPSS-IOSCO Framework might well be finalised, although work in the EU is further behind.

So, the glass appears half empty, rather than half full. But this doesn't stop me from wishing you an excellent festive period and end of year.

Thomas Zeeb
CEO
SIX Securities Services

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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.



EU Initiatives affecting the value chain

Negotiations on the CSD Regulation continue in a slow vein, MiFID discussions are not concluded, and draft EMIR Technical Standards are submitted to the Commission for endorsement. Global regulators agree on transitional arrangements for the cross-border regulation of OTC derivatives.

EU Legislative Programme affecting Market Infrastructures

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	Q1 2013 ?	2015
Clearing	EMIR	15 September 2010	July 2012	Q1 2013
Settlement	RCSD	7 March 2012	Mid - 2013 ?	Mid - 2015
Underpinning Law	Securities Law Directive (SLD)	End Q1 2013	End - 2015 ?	2017 / 18?

Central Securities Depositories Regulation (CSDR)

Progress remained slow under the Cyprus Presidency, with the last Council Working Group meeting taking place on 26 October. The dossier has now been handed over to the Irish (formally on 1 January). However, contacts with the Irish Presidency also indicate a lack of enthusiasm for this dossier. The Irish will prioritise banking legislation during the first half of next year, finishing up on CRD IV, bank crisis management and Banking Union (see last issue). It may mean that even discussion of MiFID takes a back seat. Meanwhile, nearly 700 amendments were tabled to Kay Swinburne's report in the European Parliament. These will be considered (and significantly reduced) during the ECON's committee vote in mid-December. There is delay here too, as the EP Plenary vote is not expected to take place until May. ESMA, which will be expected to produce a couple of dozen Technical Standards under the CSDR, has begun the process of information gathering by addressing a comprehensive questionnaire to EU CSDs.

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

The main development since EMIR took legal effect on 16 August, is the submission to the European Commission by ESMA and EBA, of a number of draft Technical Standards ("TS") on 27 September. It is now expected that these TS will be endorsed by the European Commission at a meeting of its College of Commissioners before the end of the year. How quickly the TS (which are also Regulations) become final is dependent on the extent to which the Commission has not amended them, and the degree to which the EP and Council decide to object to the texts (this is possible, e.g. in relation to supervisory colleges). This means that the final process will not be concluded until the end of Q1 (on a best case basis) or Q3 2013 (on a worst case basis). The entry into force of certain TS will then trigger the

requirement for SIX x-clear to submit an application to ESMA for re-authorisation during the course of 2013.

The final introduction of EMIR will not, however, mean that the full framework to deal with the trading, clearing and reporting of OTC derivatives will be fully in place at the EU level by the end of this year. As previously mentioned, the standard setters still have to put in place capital charges for the clearing of non-centrally cleared OTC derivatives, as well as final reporting arrangements, exemptions, lists of standardised contracts and dealing with regulatory arbitrage and extra-territoriality of domestic regimes. To this end, a number of global supervisory authorities including those in the EU, USA and Switzerland met on 28 November to agree transitional arrangements. These include prior notification of exemptions, entering into co-operation agreements and exchanging information, and particularly mutual recognition of firms and infrastructures, substituted compliance and registration categories.

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

While the European Parliament adopted its position on the text in November, an absence of agreement in the Council Working Group discussions meant that a General Position could not be produced in time for the last ECOFIN of the Cyprus Presidency on 4 December. The EP notably confirmed its position in relation to more stringent requirements on high frequency trading, and in circumscribing the trading of OTFs to non-equities only. The latter in, particular, is opposed in the Council. Attention will now switch to the Irish Presidency in 2013, which is less than enthusiastic about progressing the dossier. The expectation is that agreement in Council and the start of the Trilogue with the EP will not take place until well into the first half of next year.

Securities Law Directive/Legislation

A further discussion between the Member States and the Commission took place in November. This covered aspects such as collateral chains and re-hypothecation of collateral. Our understanding is that the Commission is still intending to come forward with a proposal in Q1 2013, but more towards the end of that period. In addition, the form of the legal instrument is also being deliberated again, with the potential for a Regulation rather than a Directive.

Commission consultation on a recovery and resolution framework for non-banks

The European Commission initiated, in September, a consultation which closes on 28 December. Following on from its work in developing a recovery and resolution framework for banks, which is currently being discussed in the Council, the Commission is consulting on the features of RRP that might be applicable to CCPs, CSDs, insurance companies and trade repositories. Compared with the CPSS-IOSCO consultation (see September issue of Oversight), the Commission's

thinking seems in rather a less advanced state. A key consideration is whether there are aspects (particularly in relation to resolution tools) that are common to what is a very disparate selection of institutions. The thrust of the response from SIX SIS's trade association, ECSDA has been to stress the uniqueness of CSDs, and particularly that any requirement for resolution would probably arise out of a major operational breakdown, since the risk profile of a CSD is very limited. We understand that should the Commission be in a position to bring forward a legislative initiative, this has to take place by the summer of 2013. This is by no means certain given the current (fact-finding) state of the dossier.

If you would like to find out more on EU market infrastructure legislation or on any other topic, please contact: Alex Merriman, Head of Market Policy (Alexander.Merriman@six-group.com or 058 399 4583). Previous editions of Oversight and other regulatory information about us are also available at: www.six-securities-services.com.

Market infrastructure initiatives by the European Central Bank (ECB)

The three migration waves for the T2S project have been agreed, while a decision on SIS's connectivity solution is still awaited. The ECB's involvement in the oversight of LCH.Clearnet and Ice Clear are confirmed. The CCBM 2 Project is abandoned.



Target 2 Securities (T2S)

Following extensive discussion in the Advisory Group and elsewhere, an agreement was reached in November on the composition of the three CSD migration waves, respectively in June 2015, July 2016 and November 2016. The first migration wave which includes SIX SIS was confirmed, and the other major decision related to sequencing of both Euroclear's and Clearstream's participation, since migration by both at the same time would unbalance roughly proportionate

securities pools. As result it has been determined that the Euroclear Group (except Finland) will migrate in the second wave and Clearstream in the final wave. On 21 November, the Governing Council also approved a revised T2S User Requirements Document.

Following, the decision by SIX SIS to sign the framework agreement in June, discussions have continued at the SIX Board level about the modalities of how SIX SIS will connect to T2S. There are still two basic options on the table; one involving the construction of a new entity - a CSD in the eurozone; the other via a direct connection from SIX SIS's operations centre in Olten. There are pro's and con's of both approaches, and the Board has continued to consider business case aspects such as cost, regulatory framework, ownership and potential partnership. From a strictly regulatory perspective, the option of building a CSD in the eurozone appeals the most, not least because of the future implementation of the CSDR and the continued need for SIX SIS to offer cross-border services into the EU market. The Board is expected to take a final decision in February.

ECB Oversight of Infrastructures

The ECB announced that, on 15 November, its Governing Council approved two arrangements for the cooperative oversight of two UK CCPs with significant cross-border risk implications. These are ICE Clear Europe's over-the-counter (OTC) credit default swap clearing service (CDS) and LCH.Clearnet Ltd's OTC interest rate swap clearing service (SwapClear). The ECB noted that these arrangements were in line with the requirements of the CPSS-IOSCO Principles, as these relate to the comprehensive regulation, supervision and oversight of FMIs and the systemic importance of an FMI in the respective jurisdictions, and in monitoring their safety and efficiency, and the FMI's comprehensive risk profile and that of its

participants. In the case of the CDS and SwapClear, those authorities deemed eligible for participation in cooperative oversight – including the ECB representing the Eurosystem as the central bank of issue of the euro – were invited by the United Kingdom's Financial Services Authority, as the current supervisor, to conclude this arrangement.

CCBM 2

In deciding to postpone the introduction of a uniform minimum size threshold for the acceptance of credit claims as collateral, the ECB Governing Council confirmed in November its earlier decision to abandon the development of the pan-European collateral management system, dubbed CCBM 2, in its existing form.

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

The Financial Stability Board has continued its examination of shadow banking. In Switzerland, steps are taken to start the process of considering changes to modernise further aspects of financial market regulation, including infrastructures.

FSB work on shadow banking: securities lending and borrowing and repo

As part of the progress report released by the Financial Stability Board on 18 November, the work stream (WS5) on securities lending and borrowing and repo issued a further consultative paper. This requests comments until 14 January 2013. As well as asking a number of questions, WS5 makes several policy proposals and recommendations. These cover the areas of transparency, reporting, risk management (including haircuts, re-investment and re-hypothecation) and minimum standards of collateral valuation. It also notably supports the use of CCPs in clearing SLB and repo. The FSB is expected to bring forward its final Recommendations by September 2013.

The FSB work is also being shadowed by the European Commission, which has also launched its own consultation on shadow banking. Recent pronouncements by the Commission suggest that they will take formal legislative action (by the summer of 2013) in the areas of tightening up capital requirements for securitisation, on the regulation and supervision of Money Market Funds, and SLB/repo.

Modernisation of Swiss Financial Markets Law

Following the decision of the Federal Council at the end of August to confirm the FDF/SIF mandate to continue its work, the next steps have become clearer. These notably involve a public consultation in

the Spring of 2013, together with the establishment of a working group structure which consider notably (i) the Swiss implementation of the G-20 commitments to trade, clear and report OTC derivatives; and (ii) the overhaul of the Swiss requirements as they relate to FMIs. SIX will be represented on both these groups, together with a representative on an overarching Steering Committee. The working groups are expected to report by September, with a proposal for revised legal framework issuing by the end of the year.

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CPSS-IOSCO Assessment Methodology and Disclosure Framework

Just as we went to press, CPSS-IOSCO published, on 14 December, the final version of their AM and DF, which complement the Principles for Financial Market Infrastructures finalized in April. At first sight, we are pleased to see that these bodies have taken into account our comments, and those of other CSDs, at the consultation stage that more commonality needed to be introduced between the two frameworks, and that duplication was mitigated.