European Commission
DG Internal Market and Services, Unit MARKT/G2

Info-letter on post-trading

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The main aim of the possible legislation on legal certainty of securities holding and dispositions is to bring the law of the 27 Member States into line with actual practice. In the last decades, securities and the methods of holding and transferring them have undergone important changes. As a result, lawyers struggle with a disconnect between law and reality since securities laws in some Member States continue to apply the fiction that securities are pieces of paper "deposited" in vaults, when the vast majority of investors' interests exist in dematerialised form as book-entries recorded in accounts.

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Progress on Fiscal Compliance Procedures

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The Tax barriers Business Advisory Group -T-BAG has identified some areas, related to withholding tax procedures, were urgent problems still remain and require further action. The present procedures are indeed costly, time consuming and bureaucratic for both investors, intermediaries and tax authorities. In order to provide suggestions on how to solve the actual problems, the T-BAG Group is now preparing concrete proposals for solutions.

The Expert Group on Market Infrastructures (EGMI)

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The post-trade landscape in Europe is evolving rapidly. While the quest for more efficiency is still a crucial driver of change in that field, aspects of safety and resilience of market infrastructures have become ever more important. The Commission services intend to continue and intensify their contacts with stakeholders and experts in this domain. In light of the above, the Commission services have created a new Expert Group on Market Infrastructures (EGMI).

Transposition of Directive 2009/44/EC in Member States

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The Commission provided by end March 2011 a letter of formal notice, Mise en demeure 258(ex 226) of Non Communication, to all Member States that not informed of fully transposing of the Directive 2009/44/EC on protection of settlement systems and financial collateral arrangements. If Member States still have not provided this information within two months of the date of the mise en demeure, the Commission will, as usual, go ahead to those with a reasoned opinion "avis motive".

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Stakeholders in the post trade processing do work together! The Broad Stakeholder Group for market practices is the example

The implementation of Market Standards for Corporate Actions and General Meetings has been given a new impetus with the set up of an all-inclusive industry body, the Broad Stakeholder Group. The Group has been instrumental in enhancing the cooperation and communication between all parties in the value chain that have different interests.

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Safety, Soundness and Efficiency of post-trading is critical!

One of the key lessons from the financial crisis has been that market infrastructures play a key role in the safety of the financial sector. Central Counterparties, Central Securities Depositories, and Trade Repositories must be safe and sound. The same robust rules and supervision must apply to them across the EU. The safety, soundness and efficiency of post-trading is critical!

Key Challenges on Post-Trading

Emil PAULIS

Dear Reader,

This is already our 3rd edition of the Info Letter on Post-Trading prepared by the Financial Markets Infrastructure Unit in DG MARKT.

We have created the G2 Newsletter in order to meet a growing number of demands for information, both internally, from within the European institutions, and externally, from stakeholders and Member States. Indeed, one of the consequences of the financial crisis is that people are much more focused on safety and efficiency issues related to infrastructures operating in the post-trading field then in the past. Our aim is to give you a snap-shot of the latest developments.

Three existing legislative instruments already concern the post-trade environment: the Settlement Finality and Financial Collateral Directives and the Commission Withholding Tax Recommendation. Each has contributed to a more stable and efficient post-trading environment.

However, we are convinced that we must progress further. Our vision is the removal of all barriers linked to post-trading. In the Internal Market, it must be as easy to buy, own and sell foreign shares as domestic ones. To achieve this, we still have some key challenges ahead. Our current pipe-line includes legislative measures such as the European Market Infrastructure Regulation ("EMIR"), the Securities Law Directive, Central Securities Depositories ("CSD") regulation and policy measures on Close-out netting. Some of these legislative initiatives are more advanced then others. Within the coming months, our two expert working groups of stakeholders, known as 'EGMI' and 'T-BAG', will identify whether there are issues that require further action. All these measures are necessary steps to promote a policy that increases stability in the financial system, enhances legal certainty and brings more efficiency. A policy that covers the whole spectrum of the value chain. We are fully determined to this agenda. We believe that we are well on track, but, we need your contribution in the form of critical and constructive comments to make the success!

Emil Paulis
Director, DG MARKT,
Financial Services Policy & Financial Markets

Our work remains unflagging

Patrick PEARSON

The European Commission's commitment to a Single Market in post-trading remains unflagging. Some say that it is even difficult to keep up these days with the energy that the Commission is devoting to this area. This, third, issue of the DG MARKT, G2 Info-letter is designed to provide a clear picture of our key strands of work.

"With over 340 million securities transactions with a value of some Euro 850 Trillion settled by EU securities settlement systems in 2009, nobody can deny the need for safe and efficient infrastructure in Europe without access barriers."

Safety, cross-border access and competition

It has not escaped the attention of many in the market that the adoption of the Commission's proposal of September 2010 to regulate over the counter –OTC-derivatives also covered important issues relating to market structure itself. As the proposal winds its way through the institutional process in Brussels, many are looking its practical impacts. The proposed requirements for Central Counterparties – CCP's - include access and interoperability rules, and governance requirements. The requirements for trade repositories also reflect the need for open infrastructure. Besides the safety of our system, cross-border access and competition must also remain at the centre of our efforts.

Successful cooperation with other jurisdictions

At the same time, we continue to work together with our regulatory counterparts in other jurisdictions in the G-20 group of nations that are working on similar projects. We continue to devote time and attention to a coherent and converged approach within the Financial Stability Board. The Commission co-chaired, together with the US SEC and Federal Reserve Bank of New York, work that led to the adoption of the FSB Report on Implementing OTC Derivatives Market Reforms on 10 October. This work, which was subsequently endorsed by the G-20 meeting in Seoul, remains a guide towards internationally converging regulations and practices.

Public consultation will inspire our work on CSD's

In addition to CCPs and Trade Repositories, work has continued apace in the Commission on Central Securities Depositories – CSDs . With over 340 million securities transactions with a value of some Euro 850 Trillion settled by EU securities settlement systems in 2009, nobody can deny the need for safe and efficient infrastructure in Europe without access barriers. This work may also include measures to increase settlement discipline in our markets, and harmonised settlement periods could be part of this project. A public consultation will be in its final phase when this Newsletter is published. We expect a rich source of suggestions to inspire our work in this field.

Progress on Securities Law Directive

The need to progress on the harmonisation of securities law in Europe received renewed impetus after we decided to launch a second public consultation at the end of last year. The ECOFIN Council's call on the Commission in 2008, to proceed with a legislative proposal has led to a lengthy, but necessary process of reflection and consultation that we hope will end in solutions to address the important barriers to cross-border trade that were identified by the Legal Certainty Group in 2008.

Informative analysis by OXERA

The results of the OXERA study also provide valuable information to the market as to the state of the sector and the development of costs and efficiencies. The input from the market in realising this report should not be underestimated. We believe that it proves an informative analysis of the post-trade sector.

Policy measures on Close-Out Netting

The financial crisis has also led us to identify new areas of attention. We are looking at the lack of harmonisation in the field of close-out netting. This is closely linked to the Commission's overall policy on crisis management measures for financial institutions. Policy measures could emerge towards this summer.

EGMI and T-BAG explores further actions

Many of the Barriers that were identified in the milestone 'Giovannini Reports' at the beginning of this century are therefore clearly being addressed. But what next? Our two expert working groups, known as 'EGMI' and 'T-BAG', are conducting important work. We are interested to hear from them if there are issues that require future action. With our extensive policy programme that I have just outlined, are there overlaps? Or lacunae? Are we missing something that requires our attention? We will look to widen the platform for debate before we decide on the future policy in post-trading.

Info-Letter on Post-Trading – A way of successful dialogue

This issue of the Info-Letter on Post-Trading contains contributions from colleagues in the Commission's Financial Markets Infrastructure team who are working on these topics. We hope that readers will find these contributions informative and will contact us directly if they need any further information on our important work. ■

Contact: *Patrick PEARSON, tel. +32.2.295.57.58, e-mail: Patrick.Pearson@ec.europa.eu*

Regulation Proposal on OTC Derivatives, Central Counterparties and Trade Repositories

Nicolas GAUTHIER

The European Commission recently made a proposal for a Regulation on OTC Derivatives, Central Counterparties and Trade Repositories. The objective of this Regulation is to implement some of the objectives spelt out by the G20 leaders in September 2009.

The G20 stressed that "*All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end 2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements.*"

Whilst issues relating to OTC derivatives on-exchange trading and prudential treatment will be addressed in the revisions of the Markets in Financial Instruments Directive (MiFID) and the Capital requirements Directive (CRD IV) respectively, the G20 proposal's objectives are to increase transparency in the OTC derivatives market, reduce counterparty credit risk and enhance risks mitigation practices in bilaterally cleared contracts:

To increase transparency, the proposal requires that

i) detailed information on OTC derivative contracts entered into by EU financial and non-financial firms are reported to trade repositories and made accessible to supervisory authorities, and that

ii) trade repositories publish aggregate positions by class of derivatives accessible to all market participants.

To reduce counterparty credit risk, the proposal introduces

(i) mandatory central counterparty clearing for contracts that are eligible to clearing (i.e. with a sufficient level of standardization and liquidity),

(ii) stringent prudential, organizational and conduct of business requirements for central counterparties which are crucial to mitigate the additional concentration of risks on them which will be generated by mandatory clearing.

To enhance risks mitigation practices in bilaterally cleared contracts, the proposal requires the use of electronic means for the timely confirmation of the terms of OTC derivatives contracts, as well as the performance of regular portfolio reconciliation and exchanges of collateral.

The proposal applies to financial firms who use OTC derivatives but also to non-financial firms that have large positions in OTC derivatives. However, non-financial firms (such as manufacturers) who use OTC derivatives exclusively to mitigate risk arising from their core business activities (when they derivatives contracts to protect against exchange rate variations, for example) will be exempt from the CCP clearing requirement.

Since September 2010, the Regulation proposal has been negotiated with the European Parliament and the Council. The Regulation is planned to be adopted by end 2011, in order to meet the G20 deadline in 2012 and leave sufficient time for the development of implementing legislation by the European Securities Markets Authority, in cooperation with the European Banking Authority and the European System of Central banks where relevant. ■

Contact: Nicolas GAUTHIER, tel. +32.2.295.29.73, e-mail: Nicolas.Gauthier@ec.europa.eu

Coordinated approach on global OTC Derivatives

Mari BACA

Significant work is underway globally on comprehensive reform to address the regulatory concerns coming out of the recent financial crisis. One significant area of focus is the over-the-counter – OTC- derivatives market. Through legislative and other measures, authorities are implementing the commitments that G-20 leaders agreed to in 2009 on OTC derivatives. The objectives of these commitments are to reduce risk and increase transparency in the OTC derivatives market, and thereby contribute to a strengthening of the international financial system.

Mari Baca is on secondment to the European Commission from the Federal Reserve Bank of New York, where she is a senior policy analyst in the Bank Supervision Department[1].

As authorities proceed with reform, they are coordinating globally to ensure consistency in their respective approaches. International consistency in regulatory frameworks is essential to regulate what is a global market. It is also essential to prevent the creation of loopholes and to minimize opportunities for regulatory arbitrage. Global regulatory coordination is occurring on many different levels, in a variety of forums.

Regulators are also working closely together across the Atlantic. The convergence we are witnessing in the legislative provisions of the European Union and the United States on OTC derivatives reflects efforts on both sides of the Atlantic toward a common goal: the implementation of the G-20 commitments on OTC derivatives. Equally importantly, it reflects close cooperation between the authorities through regular outreach and consultation. In the European Union, the G-20 commitments are being implemented through the European Market Infrastructure Regulation ("EMIR"). In the United States, they are being implemented through the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). (Title VII of the Dodd-Frank Act pertains to regulation of the OTC derivatives market.) There will be further elaboration of legislative provisions in both jurisdictions, through the development and adoption of technical standards in the European Union and rulemaking in the United States.

EMIR and the Dodd-Frank Act include similar provisions on central clearing, transparency, and risk management. Summarized below are the requirements under the Dodd-Frank Act.

a) Mandatory clearing

OTC derivatives transactions that are mandated for central clearing must be cleared through central counterparties. The Dodd-Frank Act lays out a framework for the determination of the clearing obligation: US authorities determine, on the basis of reviews that are self-initiated and that result from submissions by CCPs, which products should be cleared. This approach is similar to the top-down and bottom-up approaches proposed under EMIR for the determination of the clearing obligation.

The Dodd-Frank Act also lays out requirements for central counterparties, including standards on risk management, governance, and reporting. These are analogous to the prudential, organizational, and conduct of business requirements set out under EMIR.

b) Transparency

Under the Dodd-Frank Act, all OTC derivatives transactions, cleared and uncleared, must be reported to a trade repository. Trade repositories will be subject to data collection and maintenance, governance, and public reporting standards, as well as requirements for regulatory access to data.

EMIR also proposes the reporting of trades to trade repositories, as well as comparable standards for trade repositories on organization, safeguarding and recording, transparency and data availability.

c) Risk management

Risks associated with trades that are not centrally cleared must also be managed. The Dodd-Frank Act includes provisions on risk management measures for OTC derivatives transactions that are bilaterally transacted, including capital and margin requirements, and post-trade processing requirements. EMIR also proposes measures to reduce counterparty credit and operational risks for bilaterally cleared trades.

The European Union and United States are working towards the deadline of end-2012 set by the G20 Leaders. The Dodd-Frank Act was signed into law last July, and rulemaking is currently underway, with most rulemaking under Title VII required to be completed within 360 days of enactment (by July 15, 2011). Work is also progressing in the European Union. EMIR is currently being negotiated in the Council and Parliament, and once EMIR is adopted, technical standards will be developed. Regulators on both sides of the Atlantic will continue to be in close cooperation with each other as further work is undertaken in the coming months. ■

[1] *The purpose of her secondment is to facilitate EU-US coordination on regulatory efforts towards derivatives reform. Since 2005, the Federal Reserve Bank of New York, together with global supervisors, has been working with major market participants to improve the infrastructure and risk management practices in the OTC derivatives markets.*

OTC derivatives international work-streams

Perrine HERRENSCHMIDT

The European Commission is actively involved in a number of forums aiming at reducing risks in the OTC derivatives market. This article explains the context of the work in these forums.

The OTC Derivatives Working Group

The European Commission is co-chairing the OTC Derivatives Working Group with the CPSS and IOSCO. The group was set up at the initiative of the Financial Stability Board (FSB) in April 2010 to make recommendations on the implementation of the G-20 commitments concerning standardisation, central clearing, exchange or electronic platform trading and reporting of OTC derivatives transactions to trade repositories. In October 2010 it published a report with 21 recommendations, which address practical issues that authorities may encounter in implementing the G-20 commitments. It has also tasked the OTC Derivatives Regulatory Forum, OTC Derivatives Supervisory Group, IOSCO Taskforce on OTC Derivatives Regulation, and CPSS/IOCO Group on markets infrastructures with taking forward certain recommendations. The OTC Derivatives Working Group is now monitoring progressing made in the various jurisdictions and by the various forum in implementing the recommendations of its report.

The OTC Derivatives Regulators Forum

Since January 2009, international regulators, including the European Commission, have been meeting periodically to exchange views and share information on developments related to CCPs for OTC credit derivatives. Based on the success of this cooperation, the OTC Derivatives Regulators Forum has been formed to provide regulators with a means to cooperate, exchange views and share information related to OTC derivatives CCPs and trade repositories.

OTC Derivatives Supervisory Group

The European Commission is an observer in the OTC Derivatives Supervisory Group, which works with the largest market participants to deliver improvements to the global OTC derivatives markets. Since 2005, this effort has resulted in a series of regular commitments from the industry to reduce risk and improve operational resilience in these markets.

International Organization of Securities Commissions (IOSCO) Taskforce on OTC Derivatives Regulation

The European Commission is an observer in the taskforce on OTC derivatives regulation was set up in October 2010 to coordinate securities and futures regulators' efforts to work together in the development of supervisory and oversight structures related to OTC derivatives markets.

CPSS-IOSCO Review of Standards for Financial Market Infrastructures

Finally the Commission attends to the Steering Group of the CPSS-IOSCO Review of Standards for Financial Market Infrastructures. The Group is working towards producing standards harmonizing and, where appropriate, strengthening the existing international standards and recommendations for payment systems that are systemically important, central securities depositories, securities settlement systems, and CCPs. The revised standards also incorporate guidance for OTC derivatives CCPs and trade repositories. ■

Contact: Perrine HERRENSCHMIDT, tel. +32.2.296.23.09, e-mail: Perrine.Herrenschmidt@ec.europa.eu

Trade Repositories and Access to Data: an International Issue

Muriel JAKUBOWICZ

Trade repositories are expected to play a key role for improving transparency of financial markets, by enabling regulators to gain access to information about the OTC markets and disclosing aggregate information to the public. International coordination is critical to ensure information is shared between regulators irrespective of the location of the trade repository.

In line with the G20 recommendations, new financial regulations proposed in Europe and in the US in the aftermath of the financial crisis include an obligation to report all OTC derivatives contracts into trade repositories.

Trade repositories are thus expected to play a key role for improving transparency of financial markets, by enabling regulators to gain access to information about who traded what with whom in OTC markets, and disclosing aggregate information to the public.

Given the global nature of OTC derivatives contracts and to avoid data fragmentation, a widespread view among market participants is that the most efficient solution would be to have one single global trade repository per each asset class of derivatives contracts, so a total of five global repositories (credit, equity, interest rate, exchange rate and commodities). The solution of global repositories is indeed appealing since it provides a single comprehensive source of information on OTC trades and could thus ensure maximum transparency. However, although global in terms of information registered, each trade repository is located and regulated in a single country. This situation poses challenges to ensure that third-country regulators have access to all relevant trade repositories' data.

A number of initiatives have been announced by the industry with a few key players currently occupying the OTC data reporting landscape in the EU[1] and the USA[2]. These existing trade repositories cover today three asset classes of derivatives contracts, i.e. (credit, equity and interest rate). Repositories are in the process of being established for commodity and foreign exchange derivatives.

Canada, Japan, Singapore and Hong Kong are also currently enacting relevant laws to enable the creation of local trade repositories. As a result, the ultimate number of trade repositories globally, the asset classes they will cover and their locations are not yet known.

The Commission Services are working closely with the US regulators to find a solution that guarantees mutual unfettered access by all relevant regulators on both sides of the Atlantic to data held by their respective trade repositories. If more trade repositories are created in other jurisdictions, the Commission Services will engage in a dialogue with the appropriate regulators globally, with a view to ensuring a mutual and global access to the relevant data. ■

[1] *TriOptima in Stockholm, operated by Icap, Regis-TR in Luxembourg operated jointly by Deutche Boerse and Bolsas y Mercados Espanoles and the Equity Derivatives Reporting Repository operated by DTCC in London.*
[2] *The Warehouse Trust Company LLC operated by DTCC TR located in New York.*

Contact: *Muriel JAKUBOWICZ, tel. +32.2.295.81.54, e-mail: Muriel.Jakubowicz@ec.europa.eu*

Updated Oxera report on trading and post-trading prices, costs and volumes

Felicia STANESCU

The Commission has recently published a report by Oxera, which adds updated data on trading and post-trading prices, costs and volumes. The report provides useful analysis and valuable insight into the evolution and structure of prices and costs along the trading and post-trading value chain. The report is based on data provided by intermediaries (fund managers, brokers and custodian banks) and infrastructure providers (trading venues, CCPs and CSDs) from 18 financial centers in Europe[1].

The findings of the report for the efficiency and integration of the European trading and post trading markets are rather mixed:

Trading and post-trading costs have overall decreased per transaction…

Costs per transaction have declined considerably between 2006 and 2009, for instance for equities on book-trading costs decreased on average by 60%, CCP clearing costs by 73% and CSD clearing and settlement costs by 25% (no systematic trend for CSD account provision costs).

…but have increased per value of transaction in many financial markets

Costs per value of transaction have gone up in many markets. This may reflect a trend in the brokerage sector of smaller transactions; indeed, the average transaction size between 2006 and 2009 has fallen by between 22% and 80% in each financial centre.

Markets are becoming more integrated and cross-border activity is increasing…

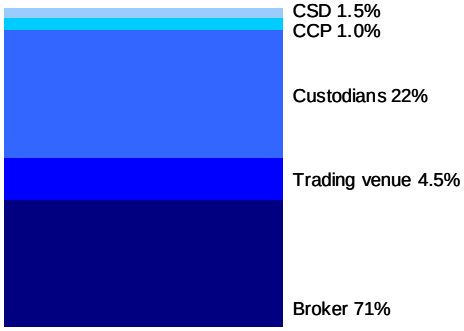
An increasing proportion of members on trading platforms, CCPs and, to a lesser extent, CSDs originate from outside the domicile of the infrastructures. For instance, between 2006 and 2009 the cross-border proportion of members has increased from 35% to 39% for trading platforms, from 30% to 37% for CCPs and from 2% to 3% for CSDs.

…but the gap between cross-border and domestic costs is not declining across the value chain

Relative costs of cross-border clearing and settlement costs of CSDs have declined compared to domestic costs, from 4.1 times on average in 2006 to 2.6 times in 2009. However, at other parts of the value chain the gap has widened; for instance, custodians' settlement fees charged to brokers were on average 4.2 times more expensive for cross-border vs. domestic settlement in 2009 compared to 2.3 times in 2006. The persisting gap between cross-border and domestic costs can be attributed to a number of factors, including increased complexity of cross-border settlement as well as lower economies of scale (due to lower volumes) for cross-border transactions.

The cost of market infrastructures remains a small part of the overall trading and post trading value chain

This is illustrated in the figure below showing the breakdown of costs faced by funds in holding and transacting (excluding any fund management costs)[2]. ■



[1] *These are classified in major financial centres (France, Germany, Italy, Spain, Switzerland and the UK), secondary financial centres (Belgium, Luxembourg, the Netherlands, Norway, Poland and Sweden) and other financial centres (Austria, Czech Republic, Denmark, Greece, Ireland and Portugal).*

[2] *For a fund with an average turnover of 1.3 per annum. The percentages do not add up to 100 due to rounding. Brokers' costs may include the costs of other services, bundled with trade execution, such as research.*

Contact: *Felicia STANESCU, tel. +32.2.298.30.65, e-mail: Felicia.Stanescu@ec.europa.eu*

Harmonisation of CSD legislation

Marcel-Eric TERRET

The recent financial crisis, which now results in a further regulation of trading venues and of CCPs (Central Counterparties), might also lead to a strengthening, or at least a harmonisation, of the EU CSD (Central Securities Depositories) legislations.

The 30+ national and international CSDs (Central Securities Depositories) recognised in Europe are essential market infrastructures which have emerged during the thirties in order to account for the safety of the issuance of securities at a time where the trust in the securities system was wavering. The recent financial crisis, which results now in a further regulation of trading venues and of CCPs (Central Counterparties), might also lead to a strengthening, or at least a harmonization of the CSD legislations of the Member States.

The CSDs serve three core functions:

1. the "**notary function**" that starts at the issuance of securities and ends when they are reimbursed
2. the "**settlement function**" through which securities are paid and delivered every time they change hands following a trade on organised or even OTC venues, and
3. the "**central safekeeping**" function, which may also form part of this triptych.

The "notary function"

The "notary function" of CSDs lies somewhat in between corporate law and financial law and the European legislator must avoid encroaching upon corporate law which remains in the hands of Members States. It has however to regulate the notary function in order to ensure that there are no more securities circulating with their settlement participants than there were actually issued and entered in book-entry form. In this respect the regulation of the notary function completes the draft securities law directive (SLD) which will impose account providers a "no credit without debit rule" when they pass on securities down the holding chain till the final investor or its agent. Such an integrity rule will be all the more necessary that the services of the European Commission envisage imposing dematerialization to most securities, with the adverse effect that they will be easier to replicate through an error of book entry or through fraud.

The "settlement function"

The "settlement function" is as important, since the Securities Settlement Systems (SSS) operated by the CSDs have a systemically important nature (although different from the CCPs which have differentiated themselves during the last decades from SSS by ensuring a prior netting of the commitments to pay and deliver). Any settlement failure that is due to the bankruptcy of a participant or simply because of the lack of cash or of securities (short sellers is one of the numerous causes of this) can result in huge delays that may trigger subsequent failures and contaminate other CSDs.

A directive of 1998, the Settlement Finality Directive (SFD) has already provided for a legal safe harbour by exempting the orders processed in the settlement systems (as well as in the CCPs) from the claws of the insolvency judge following the bankruptcy of a participant. However, this directive, which has rendered huge service during the financial crisis (many custodian banks have sheltered their assets in these SSS) is not sufficient. In particular, operational and supervision rules are not regulated and thus the smooth interconnection of CSDs as well as the cooperation in case of problems is not ensured. Operational and supervision problems will potentially increase as from the start of T2S, an IT platform operated by the central banks of the ESCB to which most CSDs will be connected in order to accelerate their settlement.

Therefore, it is necessary that supervisors and CSD operationals cooperate across the borders for the management of CSDs as well as for their good order settlement in case of crisis.

The "central safekeeping function"

The "central safekeeping" function works as a linchpin between the two previous functions. Both the "notary" and the "settlement" functions require in practice the recourse to "securities accounts" for the initial creation of the securities and for their settlement between participants to the SSS. However, these securities accounts are not exactly of the same nature as the securities accounts opened by ordinary intermediaries (and which will be soon governed by the Security Law Directive - see Article on the SLD). These securities accounts are closely linked to an important mission of CSDs, which is to ensure through their position at the top of the holding chain that no more securities are settled than securities were actually issued. As a consequence, the central safekeeping function is functionally meant to ensure the performance of this basic mission of "reconciliation".

Subject to these conditions addressing the safe performance of their core functions, it is the intention of the Commission services to consider the provision of other "ancillary" functions, including registrar services to their issuers and credit to their settlement participants as well as the provision of classic "securities accounts" in an open and safe manner. ■

Contact: Marcel-Eric TERRET, tel. +32.2.299.65.74, e-mail: Marcel-Eric.Terret@ec.europa.eu

Securities Law Directive (SLD)

Olga TYTON

The main aim of the possible legislation on legal certainty of securities holding and dispositions (so called "Securities Law Directive", or short "SLD") is to bring the law of the 27 Member States into line with actual practice. In the last decades, securities and the methods of holding and transferring them have undergone important changes, paper certificates became "intangible" book-entry securities which are transferred through credit and debits in accounts held by intermediaries. As a result, lawyers struggle with a disconnect between law and reality since securities laws in some Member States continue to apply the fiction that securities are pieces of paper "deposited" in vaults, when the vast majority of investors' interests exist in dematerialised form as book-entries recorded in accounts.

Possible legislation would be built on the assumption that book-entries to an account should have constitutive effect as regards acquisition and disposition of securities. It would attempt to codify what investors get when their securities exist as credits to account and, equally importantly, it would search to determine the duties of account providers. The SLD would also aim at achieving a wide range of policy goals, from reducing administrative burdens and facilitating cross border transactions to fostering investor protection and achieving systemic integrity.

In order to promote global compatibility, the SLD would build on the common language and key concepts developed by the Unidroit Convention on substantive rules regarding intermediated securities adopted on 9th October 2009 in Geneva by a Diplomatic Conference which comprised of representatives of the EU and 19 Member States. It is highly important to reach a situation where a harmonised legal framework on book-entry securities within the EU is capable of interconnecting with other important markets outside the EU.

The Commission Services have already conducted two full public consultations on this important part of the package of legal reforms. In response to the second public consultation held between 5.11.2010 and 21.01.2011, the Commission received 108 contributions from intermediaries (35), trade and post-trade infrastructures (13), issuers and professional investors (30), other professions (15) and public authorities (15)[1]. The initiative was welcomed by almost all respondents and many constructive comments have been submitted on the published set of principles. ■

[1] *The contributions received and an extended summary are published on the Commission website: http://ec.europa.eu/internal_market/consultations/2010/securities_en.htm*

Contact: *Olga TYTON, tel. +32.2.295.75.02, e-mail: Olga.Tyton@ec.europa.eu*

Recognition of close-out netting agreements

Rogier WEZENBEEK

In view of legal certainty and financial stability, DG MARKT has embarked upon a discussion with Member States and stakeholders to explore whether the protection of close-out netting provisions should be extended. There is also, ongoing discussions on special resolution measures to rescue systemically important financial institutions. DG MARKT is actually working on both issues in parallel.

Close-out netting is a crucial risk mitigation technique relevant for a large proportion of derivatives, repurchase contracts ("repos") and stock lending agreements. Upon the default of one of the two counterparties, all future claims and contractual relations between them are brought forward (become due), calculated and then set off. What finally remains for actual payment is a small fraction of the initial gross positions and claims between the two parties.

For example[1], global OTC derivatives positions amounted to $583tn at end-June 2010.This total gave rise to 'gross market values' (the cost of replacing all open contracts at current market prices) - a measure of counterparty risk - of $25tn. However, gross credit exposures after enforceable netting arrangements, amounted to only $3.6tn, a reduction of some 85% of the related gross market values.

Since close-out netting thus reduces parties' bilateral exposures significantly, credit risk and transaction costs (e.g. cost of credit lines and margin collateral) are much lower. Similarly banks' capital requirements against credit risk are substantially lower than they would be against their gross exposures (by around $500bn in mid-2009 on one estimate) and they are less constrained by large exposure ceilings.

For the system to work, it is crucial that counterparties know on beforehand that close-out netting provisions, often part of so-called master agreements, are recognized and enforceable under national insolvency laws. However, this is not always the case. Despite some harmonisation measures, such as the Financial Collateral Directive (2002/47/EC), there still is a great diversity amongst close-out netting regimes within the EU.

In view of legal certainty and financial stability, DG MARKT has embarked upon a discussion with Member States and stakeholders to explore whether the protection of close-out netting provisions should be extended (between whom and what transactions).

At the same time there is a debate going on about special resolution measures to rescue systemically important financial institutions. In this context, the European Commission suggested in October 2010[2] that there should be provision for a temporary stay on rights to close-out netting where the authorities transfer relevant contracts as a part of a resolution measure and that further consideration should be given to the exercise of close-out rights in connection with early intervention measures.

DG MARKT is looking at both issues in parallel. Whereas the preparation of a crisis management package is primarily dealt with by the newly created Financial Stability Unit, Unit G2 is in charge of a possible initiative to strengthen the protection of close-out netting provisions. ■

[1] *See BIS data (16 November 2010) at http://www.bis.org/publ/otc_hy1011.htm*

[2] *See Communication on 'An EU Framework for Crisis Management in the Financial Sector' http://ec.europa.eu/internal_market/bank/docs/crisis- management/framework/com2010_579_en.pdf (page10)*

Contact: *Rogier WEZENBEEK, tel. +32.2.296.56.81, e-mail: Rogier.Wezenbeek@ec.europa.eu*

Progress on Fiscal Compliance Procedures

Tomas THORSÉN

The Tax Barriers Business Advisory Group - T-BAG - has identified some areas, related to withholding tax procedures, were urgent problems still remain and require further action. The present procedures are indeed costly, time consuming and bureaucratic procedures for both investors, intermediaries and national tax authorities. In order to provide suggestions on how to solve the actual problems linked to withholding tax procedures, the T-BAG Group is now identifying and preparing concrete proposals for solutions.

"One problematic area is the lack of standardised documentation. More than 54 different documents are, for instance, necessary today to claim tax relief in the EU. This results in indeed costly, time consuming and bureaucratic procedures for both investors, intermediaries and tax authorities."

By the end of 2009, the Commission adopted a Recommendation on withholding tax relief procedures that outlines how EU Member States could make it easier for investors resident in one Member State to claim entitlements to relief from withholding tax on securities income (mainly dividends and interest) received from another Member State. The Recommendation also suggests measures to eliminate tax barriers for the securities investment activities of financial institutions. This is important because a study by the Commission services shows that at present the costs related to the present reclaim procedures are estimated to a value of € 1.09 billion annually whereas the amount of foregone tax relief is estimated at € 5.47 billion annually.

The Recommendation – the first one in the tax area since approximately nine years – was an important step forward in trying to solve fiscal barriers in the post-trading environment.

The Recommendation is based on the (2006-2007) reports of the EU Clearing and Settlement Fiscal Compliance Experts' Group (FISCO) to address Giovannini barriers 11 and 12 on withholding- and transaction tax procedures.

In order to structure the future work, the Commission has created an expert group on fiscal compliance procedures related to post-trading. The new group – the Tax barriers Business Advisory Group -T-BAG - had its first meeting in 2010. The aim of the T-BAG Group is to:

1. Examine and update the current state of withholding tax relief and/or refund procedures in EU Member States with respect to double tax conventions and domestic law.

2. Suggest workable solutions to implement the principles outlined in the Commission Recommendation on Withholding Tax Relief Procedures (COM (2009) 7924 final), that might be acceptable to Member States' tax authorities. This task will consider parallel OECD work in this area and would involve a two-step approach as follows:

- short-term measures aimed at improving withholding tax relief procedures (e.g. widespread use of Taxpayer Identification Numbers; standardised claim forms; standardised residence certificate having an harmonised validity period; use of electronic systems; etc.); and
- long-term, more ambitious and comprehensive solutions based on a simplified relief at source system.

3. Identify and suggest solutions to address any possible other (remaining) tax barriers affecting the post-trading environment.

The 23 Members of the Group are high level Experts, mainly from private bodies and the academic society. The Commission is providing a Chair and Secretariat of the Group.

The T-BAG Group has identified some areas, related to withholding tax procedures were urgent problems still remain and require further action. One such problematic area is the lack of standardised documentation. More than 54 different paper documents are for instance necessary today to claim tax relief in the EU. This results in indeed costly, time consuming and bureaucratic procedures for both investors, intermediaries and tax authorities. In order to provide suggestions on how to solve the actual problems, the T-BAG Group is now concretely working on how to standardise the present documentation. This work includes both proposals for standardised documentation for making refund claims and electronic filing and documentation to prove the investors' entitlement to tax relief. The work also includes comprehensive solutions based on a relief at source system, improving exchange and the use of Taxpayer Identification Numbers (TINs). A linked issue also dealt with is the liability for financial intermediaries.

At the next T-BAG Meeting, tentatively planned for September 2011, are also documents on the legal basis of tax practices, corresponding OECD work and the FATCA reform in the US planned to be discussed. The T-BAG work is planned to be finalised during 2011. ■

[1] *The Commission's Recommendation (COM (2009) 7924 final), the underlying study on "The Economic Impact of the Commission Recommendation on Withholding Tax Relief Procedures and the FISCO Proposals" and other background documents related to fiscal compliance procedures have been published on the Europa website: http://ec.europa.eu/internal_market/financial-markets/clearing/compliance_en.htm*

Contact: *Tomas THORSÉN, tel. +32.2.299.45.52, e-mail: Tomas.Thorsen@ec.europa.eu*

The Expert Group on Market Infrastructures (EGMI)

Christoph SCHIEBLE

The post-trade landscape in Europe is evolving rapidly. While the quest for more efficiency is still a crucial driver of change in that field, aspects of safety and resilience of market infrastructures have become ever more important. The Commission services intend to continue and intensify their contacts with stakeholders and experts in this domain. In light of the above, the Commission services have created a new Expert Group on Market Infrastructures (EGMI).

A number of private and public initiatives have been adopted over recent years with a view to increasing safety and/or efficiency in cross-border post-trade activities. The Settlement Finality Directive, the Financial Collateral Arrangements Directive, the Markets in Financial Instruments Directive ("MiFID"), the Industry Code of Conduct on Clearing and Settlement (monitored via the "MOG") and the work on the dismantlement of the 15 Giovannini Barriers to an integrated post-trade market in Europe have already impacted the landscape significantly. Another important driver of change is expected to come with the introduction of the European Central Bank's project for an integrated settlement platform in central bank money (Target 2-Securities), and of course following the introduction of the various legislative initiatives which are described in this newsletter.

Against the background of this flurry of initiatives, it will be important not to loose sight of the "bigger picture" and to find answers to the following questions:

- In what direction is the market evolving?
- Is the overall roadmap towards a safer and more efficient post-trade market still on track?
- And what actions will have to be taken by public authorities and private actors in the near future?

To answer to these questions, the Commission services have created a new Expert Group on Market Infrastructures (EGMI).

The EGMI Group is composed of 30 high-level experts with practical experience in post-trade services and market infrastructures. The members of the group are selected from relevant stakeholders such as market infrastructures, investment firms, custodian banks, asset management firms as well as from the academic community. The Commission services is chairing the group and providing secretarial services. Prof. Alberto Giovannini is assisting the work of the Group as a special adviser.

The Group has already met on four occasions. Members have submitted input on a number of issues, e.g. on CCPs, collateral, insolvency, competition, transparency, business risk, fragmentation/regulatory arbitrage/internalisation, cost/inefficiencies, choice of infrastructures and CSDs. The Group is expected to render a consolidated report to the Commission services in the course of 2011. ■

"Even though progress in creating an integrated post-trading market has been disappointingly slow, the direction of reform has been broadly correct and, in particular, the project to create an integrated and efficient securities market in Europe is understood and shared by an ever larger number of people. These are important and encouraging achievements, which do not preclude, at any moment, an acceleration of the pace of reform."

Alberto Giovannini

Contact: *Christoph SCHIEBLE, tel. +32.2.295.22.68, e-mail: Christoph.Schieble@ec.europa.eu*

Transposition of Directive 2009/44/EC in Member States

The Commission provided by end March 2011 a letter of formal notice, Mise en demeure 258(ex 226) of Non Communication, to all Member States that not informed of fully transposing of the Directive 2009/44/EC on protection of settlement systems and financial collateral arrangements. If Member States still have not provided this information within two months of the date of the mise en demeure, the Commission will, as usual, go ahead to those with a reasoned opinion "avis motive".

In 2009, the Commission issued Directive 2009/44/EC amending the Settlement Finality Directive and the Financial Collateral Arrangements Directive to strengthen the protection of settlement systems and financial collateral arrangements. The main amendments stipulated by this Directive concern:

- A broader scope of the protection provided by both Directives by including credit claims eligible for the collateralisation of central bank credit operations in order to facilitate their use throughout the Community;

- A number of other simplifications and clarifications to facilitate the application of the FCD and SFD. The Directive promotes the proper functioning of settlement systems. Particularly in times of market turmoil, this is indispensable for the stability of the financial markets. The Directive also promotes cross-border business and competitiveness.

The Directive should have been transposed by all Member States by 30 December 2010. However, by mid-March 2011 only eleven Member States informed that they have transposed the Directive, fully or partly, and provided their legal texts to be examined by the Commission.

The Commission provided by end March 2011 a letter of formal notice, Mise en demeure 258(ex 226) of Non Communication, to all Member States that not informed of fully transposing of the Directive. If Member States still have not provided this information within two months of the date of the mise en demeure, the Commission will, as usual, go ahead to those with a reasoned opinion "avis motive".

The Commission informed the Member States about the current state of play as regards the transposition of the Directive at the European Securities Committee (ESC) 16 of March 2011. The Commission then highlighted that all Member States that already have transposed the Directive 2009/44/EC, immediately must inform the Commission of this measure. In case some Member States have difficulties in transposing this Directive into national legislation, the Commission is willing to arrange a separate Meeting on guidance on how to implement this Directive. ■

Contact: *Tomas THORSÉN, tel. +32.2.299.45.52, e-mail: Tomas.Thorsen@ec.europa.eu*

Letter to the Editor:

Stakeholders in the post trade processing do work together!
The Broad Stakeholder Group for market practices is the example

The implementation of Market Standards for Corporate Actions and General Meetings has been given a new impetus with the set up of an all-inclusive industry body, the Broad Stakeholder Group. The Group has been instrumental in enhancing the cooperation and communication between all parties in the value chain that have different interests. By Ruud Sleenhoff, European Banking Federation (EBF)/European Credit Sector Associations (ECSA) BSG Chairman and Christophe Bonte, EBF/ECSAs BSG Secretariat.

It is now ten years ago since the Giovannini Group identified the fifteen barriers to a single European market for clearing and settlement of securities' transactions. Two sets of market practices standards have been developed to dismantle Barrier 3: the Market Standards for Corporate Actions Processing and the Market Standards for General Meetings. The former are in the process of implementation while the latter are currently subject to a thorough gap analysis to assess them against the market practices and the legal and regulatory requirements that currently exist in the different EU and EFTA countries.

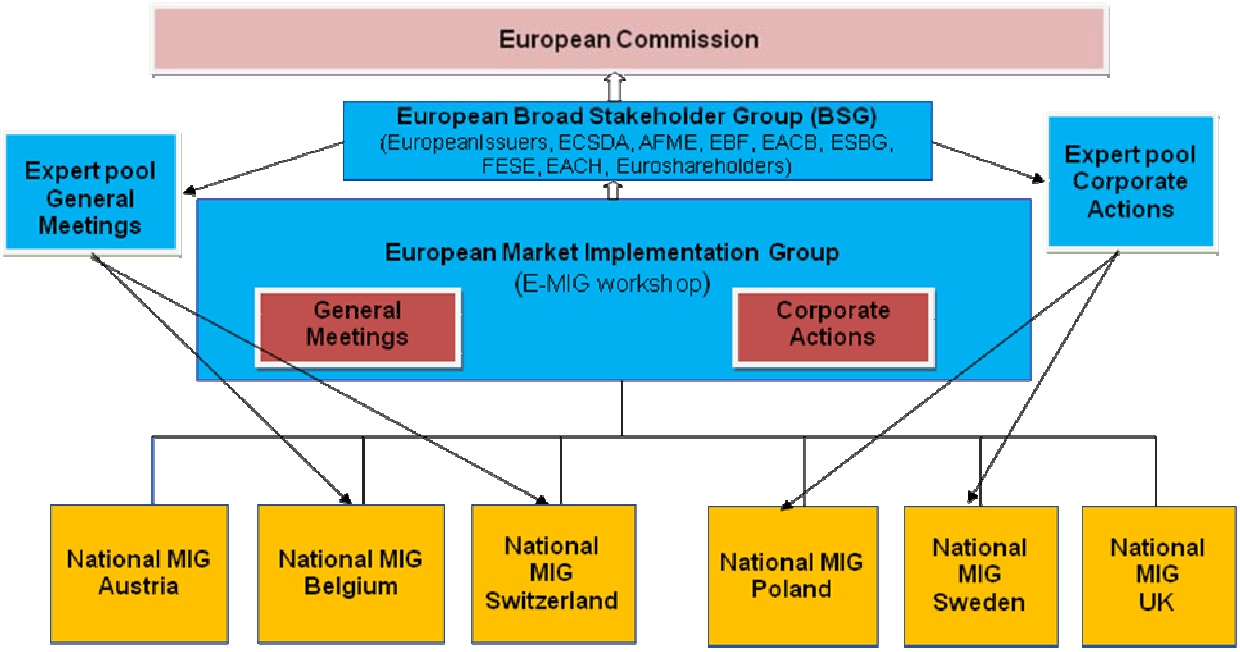
The implementation process of these standards has given birth to a unique experience of organised collaboration between private sector participants: the Broad Stakeholder Group (BSG). Since the dissolution of the CESAME2 Group, the BSG reports directly on behalf of all stakeholders involved to the European Commission's Internal Market services on the implementation progress of the market standards to dismantle Giovannini Barrier 3. In addition to its reporting role, the aim of the BSG is to steer, coordinate and monitor, at European level, the implementation of the standards that takes place at national level. To this end, Market Implementation Groups (MIGs) have been established in most countries. The BSG has been helpful in keeping the momentum towards a comprehensive and timely implementation of the standards by the MIGs. It has also proved to be successful in taking common policy decisions that have clarified technical issues and in seeking coherence with other European integration initiatives like Target2-Securities.

The importance of this industry-led body rests with its all-inclusive membership: all parties in the value chain are represented, with a good mix of senior officers from relevant European trade associations and practitioners from the issuers, the market infrastructures for trading, clearing, settlement and safekeeping of securities, the financial intermediaries and the end-investors. The market standards' implementation is supported by a semi-annual European MIG (E-MIG) workshop, which gathers representatives and experts from all European markets and allows peer review over implementation status to occur (next workshop is in early May). The BSG can also request the two Joint Working Groups which elaborated the respective Standards to provide technical expertise to the MIGs if necessary (see graph). The BSG is currently chaired by the European Banking Federation on behalf of the European Credit Sector Associations.

Though the world may have changed since the financial crisis and the focus has been much more on improving safety and stability, agreed market standards can still offer efficient, valuable and innovative solutions to address complex operational back office activities. As such, they can be useful tools to translate high-level principles enshrined in EU legislation into practical implementation. Based on best market practices, market standards can be easily adapted and thus also offer long-term solutions. In this respect, the existing market standards should not lose public authorities' interest because of their positive impact on the safety and soundness of the financial system. Furthermore, the efficiency element in the standards could also help to reduce risk because it will diminish complexity.

The new structure dedicated to the organisation of the implementation of the Market Standards for Corporate Actions and for General Meetings functions. The BSG is maturing, and is now responsible for the whole set of Standards to dismantle Giovannini Barrier 3. The BSG is expanding to include investor representation. It has also succeeded in improving cooperation and communication between issuers, infrastructures and banks and will continue seeking to foster a continuing dialogue between these players to discuss issues of common interest related to the standards and to ensure there is a shared understanding of the objectives and priorities.

However, the industry cannot act in isolation. It also needs the support of public authorities at both national and European level to address conflicting local laws and regulations that could possibly prohibit a uniform implementation of the market standards. ■



Ruud Sleenhoff, EBF/ECSAs, BSG Chairman | Christophe Bonte, EBF/ECSAs, BSG Secretariat

Nadia Calviño: - Safety, Soundness and Efficiency of post-trading is critical!

Nadia CALVIÑO

One of the key lessons from the financial crisis has been that market infrastructures play a key role in the safety of the financial sector. Central Counterparties, Central Securities Depositories, and Trade Repositories must be safe and sound. The same robust rules and supervision must apply to them across the EU. The safety, soundness and efficiency of post-trading is critical!

(Keynote Address by Nadia Calviño, Deputy Director DG MARKT Internal Market and Services, at AFME 2nd Annual European Operations Conference, 16 Nov 2010.)

Need for a liquid pan-European market with lower costs

Nadia Calviño underlined the need for an efficient and smoothly operating post-trade sector in Europe. We need a more liquid pan-European market with lower costs. Today, the cost of domestic clearing is twice the cost of clearing in the US. Cross-border trading remains expensive, sometimes prohibitively so. Cross-border clearing and settlement can still be up to 6 times more expensive than those of domestic settlements. As a basic single market rule, cross-border clearing and settlement should cost no more than domestic clearing and settlement. We are achieving this for payments. We should make this also as our goal for post-trading. So, safety and soundness of the system are not an alternative for efficiency. The two go hand in hand. A safe but inefficient market will reduce liquidity. While an efficient but unsafe market will increase premiums on risk. Our policy addresses both. ■

"As a basic single market rule, cross-border clearing and settlement should cost no more than domestic clearing and settlement."

Anne-Catherine GALLANT
Assistant to the Head of unit

Katarzyna CZAJKOWSKA
Assitant to the administrators

The G2 Info-letter

The purpose of the Info-letter is to inform about, and to highlight, actual topics related to the EU and post-trading, in particular on the work carried out by Unit Markt/G2. It provides up-dated information and describes the current state-of-play on issues related to post-trading and financial infrastructure.

The Info-letter is available in both electronic and printed paper form. It is distributed 1 - 2 times a year, inter alia, to Commission services, Council, Parliament, Member States, stakeholders, industry, press and interested citizens.

You can subscribe/unsubscribe to the mailing list by sending an e-mail to: ***MARKT-G2-NEWSLETTER@ec.europa.eu***

Photo of G2 colleagues (from left): *Christoph Schieble, Tomas Thorsén, Anne-Marie van Rooij, Louisiana de Smet, Marcel-Eric Terret, Chris Redmond, Perrine Herrenschmidt, Nicolas Gauthier, Anita Wieja-Caruba, Muriel Jakubowicz, Patrich Pearson, Anne-Catherine Gallant, Katarzyna Czajkowska, Felicia Stanescu, Rogier Wezenbeek and Olga Tyton.*

Contact: *Tomas THORSÉN, tel. +32.2.299.45.52, e-mail: Tomas.Thorsen@ec.europa.eu*