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White Paper 2016

A Roadmap for Integrated, Safe and Efficient Post-Trade Services in Europe – an integral part of the European Capital Markets Union (CMU)

1. Executive Summary

Our vision is for a single, integrated, low-risk and low-cost post-trading system in Europe with post-trade infrastructure service providers that compete in a harmonised operational, legal and regulatory environment offering innovative and low cost services to all users on a non-discriminatory basis. As a result of a competitive environment that is based on harmonisation and standardisation, we expect continued consolidation among financial market infrastructures (FMIs). To achieve the vision of low-risk and low-cost post trading in Europe, the best medium should be used including new technology (e.g. blockchain).

The White Paper 2016 updates the AFME Post Trade White Paper of 12 August 2011 taking into account achievements of the past five years as well as unresolved and new issues.

We believe that the European Commission's Capital Markets Union project provides for an excellent opportunity towards making our vision reality by means of dismantling remaining Giovannini Barrier as well as new impediments to a safe and efficient European post trade.

The European Post Trade Forum, EPTF, set up by the European Commission in early 2016 to support it in the CMU project, provides the basis for a successful and targeted cooperation between public authorities – in particular the European Commission and the European Central Bank – and the private sector. This is not meant to change responsibilities and accountabilities but rather to fruitfully combine authority and capabilities toward a common objective.

Replacing a highly fragmented structure with a single, integrated post-trading system will significantly improve the liquidity and resilience of European securities markets and render them competitive globally.

Although focusing on clearing, settlement and asset servicing in cash securities markets, this paper should be considered within the broader context, which includes the issuance and trading of securities as well as repurchase agreements¹ (repos), securities lending² and collateral management.

The list of **required action**, resulting from an assessment of the current state against the targeted future state as a benchmark and put in context with T2S and current regulatory initiatives of the European Commission includes the need to harmonise operational processes, changes at market infrastructure level and regulatory requirements.

¹ <http://www.icmagroup.org/About-ICMA/ICMA-Councils/European-Repo-Council.aspx>

² <http://www.isla.co.uk/>

In our view, **the highest priorities** are:

- **Tax: The effective Implementation of Simplified Withholding Tax Relief Procedures**, proposed by the European Commission, using the OECD Implementation Package.
- **Settlement: The systemic alignment of non-T2S markets with T2S and the elimination of national specificities in T2S markets**, e.g. registration processes, that stand in the way of level playing field competition among CSDs.
- **Asset Servicing: The comprehensive implementation of the Market Standards for Corporate Actions Processing and for General Meetings** in all markets.
- **Legal: Securities Law Reform** that reduces / eliminates operationally relevant legal uncertainties, including an insolvency framework that comprises financial markets intermediaries, enforceable close-out netting and internationally harmonised conflict of law rules.
- **Reporting: Alignment and harmonisation of regulatory reporting requirements** at European and national levels.
- **Collateral management: Highest operational efficiency and collateral mobility** achieved through harmonisation and standardisation of operational processes, e.g. harmonisation of FMIs' cut-off times.
- **Access rights: Removal of legal and regulatory obstacles** that prevent end investors from being able to access the services they need, and prevent intermediaries from providing those services.
- **Asset segregation: Consistent and coherent regulation** that is characterised by a balance between safety and efficiency.

We believe that an **institutionalised and influential monitoring body** including relevant public and private constituents is critical to the success of achieving the objective of a single, integrated, low risk and low cost post trading system in a comprehensive and timely manner. We therefore propose the European Post Trade Forum, EPTF, to assume this role in the context of and possibly beyond the CMU project.

2. Introduction

Europe needs a clear vision for its post-trading landscape and a coherent strategy for delivering this goal. Representing the main users of European post-trading services and leveraging our proven ability to deliver real risk and cost reduction to that industry, the Post Trade Division of AFME³ sets out in this paper its roadmap for delivering, **a single, integrated, low risk and low cost post-trading system in Europe.**

³ The Post Trade Division of the Association for Financial Markets in Europe (AFME), is the successor organisation of the European Securities Services Forum (ESSF) and LIBA (London Investment Banking Association). Its members are the major banking firms active in international securities markets. Representing its members as towards market infrastructure organisations and public authorities, AFME's Post Trade Division acts as an agent for change providing and supporting solutions for securities clearing, settlement and custody that reduce risks and costs to market participants.

In *Section 3* of this paper, we set out the targeted future state for post-trading for cash securities in Europe covering objectives and requirements in reasonable detail for primary and secondary markets as well as for asset servicing.

Section 4 assesses the current state against the targeted future state as benchmark by taking into account achievements of the past five years as well as unresolved and new issues.

Section 5 identifies the action required to make the desired future state reality. The action plan is prioritized and indicates primary responsibilities.

3. Targeted future state of the post-trading landscape in Europe

Our vision is for a single, integrated, low risk and low cost post-trading system in Europe with post-trade infrastructures that compete in a harmonised operational, legal and regulatory environment offering innovative and low cost services to all users on a non-discriminatory basis.

To make this vision reality, we believe that the post trade landscape has to meet the objectives and fulfill the operational requirements and characteristics outlined hereafter:

3.1. Primary market

3.1.1. Objectives (of all constituents, i.e. issuers, investors, intermediaries, infrastructures, regulators, though with different priorities)

3.1.2.

- Issuers have unhindered access to a large and broad investor pool
- Process to issue securities is broadly consistent with cost to do so kept as low as possible.
- Level playing field on the cost of trading in secondary markets (e.g. removal of stamp tax).
- Operational issuing processes are safe and efficient.
- High liquidity in the primary market is provided through efficient clearing and settlement.

3.1.3. Operational requirements and characteristics

- Primary market transactions are settled in true DvP⁴.
- Each issuance
 - has a single fungible ISIN
 - is issued in one Issuer CSD⁵
 - is issued in dematerialized or immobilized form
- Issuance of international securities (Eurobonds) is compliant with the ISMAG Recommendations⁶.

⁴ A securities settlement mechanism that links a securities transfer and a funds transfer in such a way as to ensure that delivery occurs if and only if the corresponding payment occurs.

⁵ Applicable for domestic securities; international securities, i.e. Eurobonds, are usually issued in Euroclear and Cleastream but benefit from the Bridge

⁶ www.euroclear.com/ISMAG,
www.clearstream.com/ci/dispatch/en/kir/ci_nav/1_settlement/027_initiatives/010_ismag/012_recommendation_s

3.2. Secondary market

3.2.1. Objectives (of all constituents, i.e. issuers, investors, intermediaries, infrastructures, regulators, though with different priorities)

- Post trade processes provide for
 - a low-risk, safe environment
 - high operational efficiency
 - low cost
 - sound markets
 - absence of discrimination

3.2.2. Operational requirements and characteristics of clearing and settlement and related functionalities

The functionalities outlined in this section refer to the segregated post trade business model, i.e. different service providers for trading, clearing, settlement and custody services. In an integrated business model, typically offered by universal banks to institutional and private investors, some of these functionalities may either be unnecessary or automatically performed; e.g. not all markets call for CCP clearing of all exchange traded instruments (e.g. warrants, fixed income) hence the 'locked-in confirmation' from an exchange may be directly routed to a settlement venue and thus also be considered pre-settlement date matched.

- **Entire chain of functionalities: communication**
 - The communication of all service providers in the transaction chain is in electronic, formatted and standardized form based on ISO 15022 / 20022 to achieve STP, i.e. avoiding the necessity of manual intervention unless required for risk management or other purposes. This communication model is a priori mandatory for new entrants whilst existing infrastructures offer a migration plan toward this communication model.
- **Notice of execution:**
 - Trade data are available to the counterparties of the trade and CCPs immediately after execution of trade in a non-discriminatory manner.
- **Trade reporting, Transaction reporting:**
 - All trade-based reporting is harmonised (including timelines of reporting) at least at pan-European level.
- **Trade confirmation (Block level):**
 - Trade confirmation by the counterparties of the trade takes place at T+0.
- **Allocation:**
 - The allocation process takes place at T+0.
- **Affirmation:**
 - Affirmation by the buy side takes place at T+0.
- **Give-Up Process**
 - Give-up processes between investor, executing broker and prime broker according to confirmation, allocation and affirmation timeframes above are standardised.
- **Clearing:**
 - CCP clearing is available in all markets for adequately liquid cash securities.
 - CCP clearing operational processes are transparent, including timing of novation / open offer, irrevocability and acceptance of

- trades by direct clearing members as well as risk algorithm and associated margin requirements.
- CCP operational processes should be harmonised to the highest possible extent, including trade-date netting, messaging, margining procedures, elimination of restrictions on collateral location, market claims on cash trades and on repos.
- CCP clearing is available (via CM, if required) to buy side for purposes of risk reduction and efficiency (netting).
- **Pre-settlement date matching:**
 - Pre-settlement date matching is mandatory for all transactions at CSD level as soon as possible and by midday of T+1 at the latest.
 - All CSDs are fully compliant with the ESSF/ECSDA Matching Standards, including the implementation of hold and release mechanisms, supported by any necessary legal and regulatory changes.
 - Pre-matching by phone is abolished other than for exceptions / in an emergency.
- **Netting**
 - CCP-cleared transactions are netted using a trade date netting model.
- **Generation / communication of settlement instructions to CSD:**
 - Settlement is on the basis of pre-settlement date matching instructions without the input of any further settlement instructions being required.
- **Resource management (securities):**
 - In all markets securities lending⁷ services are commercially available, where appropriate / required, free of obstacles to efficient functioning.
- **Liquidity management (cash):**
 - In all markets efficient repo services and collateral management processes⁸ are available.
- **Settlement:**
 - All settlements are effected by means of 'True DvP', i.e. Model 1 as defined in the CPSS-IOSCO document of 2006.
 - Settlement processes are fully harmonised and national specificities are eliminated to allow smooth cross-CSD settlement in Europe, including in T2S, in Central Bank Money where available and practicable.
 - Settlement cycles are harmonised at T+2 with possible derogations for securities financing transactions (repo and securities lending) and for certain types of OTC transaction (bilaterally settled transactions).
 - Processes related to settlement discipline (penalties, buy-ins) are fully harmonised.
 - CSD account structure: omnibus accounts and the nominee concept are recognized in all markets.

3.2.3. Operational requirements and characteristics of asset servicing and related functionalities

⁷ <http://www.isla.co.uk/dynamic.aspx?id=62>

⁸ <http://www.icmagroup.org/getdoc/83bc0fea-1c74-4558-edef-43c21a818b17/repo0.aspx>

- All markets are comprehensively compliant with the Market Standards for Corporate Actions Processing and the Market Standards for General Meetings.
- The application of Standards for Transaction Management / CASG Rules (i.e. specific T2S-related transaction management rules) provide for efficient and effective corporate actions on flows, warranting full rights to corporate actions.
- Operationally feasible record dates for cross-border participation in General Meetings are provided in all markets.
- The responsibility for reconciliation at each layer ensures the integrity of the custody chain.

Registration processes are harmonised, non-discriminatory and efficient, meet the needs both of issuers and of investors, and do not create extra risk in the custody chain. Generally, asset-servicing is non-discriminatory (e.g. all investors enjoy equal practical ability to participate in corporate actions irrespective of nationality).

3.3. Collateral management

- Highest operational efficiency and collateral mobility is achieved through harmonisation and standardisation of operational processes, e.g. harmonisation of FMIs' cut-off times.

3.4. Legal environment

- Securities laws in Europe are harmonised to an extent that reduces / eliminates operationally relevant legal uncertainties, including an insolvency framework that comprises financial markets intermediaries, enforceable close-out netting and internationally harmonised conflict of law rules.
- The Europe-wide acceptance and recognition of the nominee concept and omnibus accounts as well as an internationally compatible conflict of laws regime are part of the securities law reform.
- Access rights: legal and regulatory obstacles are removed that prevent end investors from being able to access the services they need, and prevent intermediaries from providing those services.

3.5. Fiscal environment

- Withholding tax at source relief procedures are the rule.
- Highly efficient withholding tax refund procedures apply where relief at source procedures are not yet available within the time horizon.
- The use of the OECD Implementation Package provides for international compliance.
- Collection of taxes (e.g. capital gains and transaction taxes) is not linked to the settlement process.
- Transaction taxes, e.g. FTT, UK stamp tax are not levied.

3.6. Market Infrastructure

- **Central counterparty clearing:**
 - Interoperable CCPs ensure high efficiency through competition.
 - The CCP market structure is largely determined by user demand.
 - CCPs have non-discriminatory access to trading venues and CSDs.
- **Settlement:**

- Smooth cross-CSD settlement in Europe including at T2S provides for true Investor CSD competition and both avoids further fragmentation and promotes further consolidation.
- Barriers to entry and non-harmonised practices are eliminated.
- Non-T2S markets are systemically aligned to T2S.
- **ETF infrastructure:**
 - ETF transactions are processed by means of an integrated, highly automated clearing and settlement infrastructure.
- **Trade Repositories:**
 - Trade Repositories are required for derivatives, not for cash securities.
- **Reporting:**
 - Regulatory reporting requirements are aligned and harmonised at European and national levels.

4. Current state, achievements of the past five years

The operational requirements described in our vision for the primary market (3.1.) are largely met and coincide with the reality in major European markets. Operational processes for ETFs in the primary and secondary market divert significantly from the model processes described in desired future state. However, an industry working group is currently developing standards / best market practices for ETF processing in the primary and secondary market.

In the secondary market the following achievements have closed diagnosed gaps when compared to the targeted outcome :

- Communication based on ISO 15022 / 20022
- Availability of CCPs for cash securities markets, required functionalities and, subsequent to final implementation of EMIR, interoperability.
- Pre-settlement date matching / settlement instructions.
- Availability of securities lending and repo services.
- Harmonisation of settlement processes for T2S markets subsequent to finalized migration to the T2S system.
- Harmonisation of settlement cycles at T+2.
- Advanced state of implementation of the two sets of market standards for corporate actions and general meetings.

To close existing gaps when compared to the targeted outcome, we list in the next chapter the required actions and their priorities as well as proposed responsibilities.

5. Required Action

In addition to the required action at pan-European level below, AFME proposes that policy makers at European and at national levels take action to resolve the following **national issues:**

- Securities registration process in Spain
- Inadequate record dates for general meetings in France and UK
- ETF related legal issues in Germany

HIGHEST PRIORITIES

Action

TAX:

Implementation of Simplified **Withholding Tax Relief procedures** Recommendation COM (2009) 7924), using the OECD Implementation Package

SETTLEMENT:

Harmonisation of **settlement processes and, systems** including pre-settlement functionalities (confirmation, allocation, affirmation, matching) where that will allow smooth cross-CSD settlement required across Europe aligned to T2S **and the elimination of national specificities in T2S markets**, e.g. registration processes, that stand in the way of level playing field competition among CSDs

ASSET SERVICING:

Comprehensive implementation of the Market Standards for **Corporate Actions** Processing Groups, and for **General Meetings**

LEGAL:

Harmonisation of securities laws through **Securities Law Reform** that reduces / eliminates operationally relevant legal uncertainties, including an insolvency framework that comprises financial markets intermediaries enforceable close-out netting and internationally harmonised conflict of law rules.

REPORTING:

Alignment and harmonisation of regulatory reporting requirements at European and national levels.

COLLATERAL MANAGEMENT:

Highest operational efficiency and collateral achieved through harmonisation and standardisation of operational processes, e.g. harmonisation of FMIs' cut-off times.

ACCESS RIGHTS:

Removal of legal and regulatory obstacles that prevent end investors from being able to access the services they need, and

Responsibility

European Commission
Member States

T2S, ECSDA, EFAMA
AFME, public sector at national level

National / European
Market Implementation public sector at national level where required

European Commission
Members States

European Commission
Members States

Financial market mobility infrastructures

European Commission
Member States

prevent intermediaries from providing those services.

HIGH PRIORITIES

Action

Responsibility

CLEARING:

Transparent operational CCP process including timing of novation, revocability, acceptance of trades by direct clearing members, risk algorithm and associated margin requirements.

EACH

CCP operational processes should be harmonised to the highest possible extent, including trade-date netting, messaging, margining procedures, elimination of restrictions on collateral location, market claims on cash trades and on repos.

EACH

CSD ACCOUNT STRUCTURE:

Omnibus accounts and the nominee concept are recognized in all markets.

European Commission
Members States, where applicable

ETF PROCESSING:

Harmonisation of operational processes for ETFs Elimination of defined legal obstacles.

Securities industry
Members States, where applicable

ASSET SERVICING:

Operationally feasible record dates for cross-border participation in General Meetings.

Members States, where applicable

Harmonisation of processes that ensure that entitlements from corporate actions on stock, including voting rights, become effective at the point of settlement.

Issuers, T2S, ECSDA, national regulators