

12 August 2011

## White Paper

# A Roadmap for Integrated, Safe and Efficient Post-Trade Services in Europe – an integral part of the European single market vision

### 1. Executive Summary

**Our vision is for a single, integrated, low-risk and low cost post-trading system in Europe with a small number of 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.**

We are concerned that the process of harmonisation as defined in the Giovannini Reports has been slow and incomplete, and that the regulatory initiatives currently underway, though welcome, may deliver piecemeal reform.

To make our vision reality, we believe that the successful and targeted cooperation between public authorities – in particular the European Commission and the European Central Bank – and the private sector should be continued and revitalised. This is not meant to change responsibilities and accountabilities but rather to fruitfully combine authority and capabilities toward a common objective.

Estimated aggregate excess costs of post-trading of between EUR 2 and 5 billion p.a.<sup>1</sup> emphasise the importance of achieving efficient post-trade services in Europe. Moreover, replacing a highly fragmented structure with a single, integrated post-trading system will significantly improve the liquidity and resilience of European securities markets.

**The unfinished work of the Giovannini process needs to be completed without further delay.** This paper therefore aims at describing functionalities and characteristics of post-trading for cash securities that appear achievable in a 3 to 5 year time horizon. Although focusing on clearing, settlement and asset servicing this paper should be considered within the broader context, which

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<sup>1</sup> Commission draft working document on post-trading activities of 23 May 2006 and annexes. Private sector studies have shown similar results.

includes the issuance and trading of securities as well as repurchase agreements<sup>2</sup> (repos), securities lending<sup>3</sup> and collateral management.

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

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

- **Clearing: The availability of interoperable CCP clearing services** in all markets for adequately liquid cash securities, enabled by non-discriminatory access of CCPs to trading venues / trading feeds and to CSDs.
- **Settlement: The harmonisation of settlement processes** including pre-settlement functionalities (confirmation, allocation, affirmation, matching, including pre-settlement date matching) that will allow smooth cross-CSD settlement in Europe, including T2S.
- **Asset Servicing: The comprehensive implementation of the Market Standards for Corporate Actions Processing** in all markets.
- **Legal: The Securities Law Reform** that is compliant with the Geneva Securities Convention and that incorporates all recommendations of the Legal Certainty Group.
- **Tax: The implementation of Simplified Withholding Tax Relief Procedures**, proposed by the European Commission, using the OECD Implementation Package.

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.

## 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

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<sup>2</sup> <http://www.icmagroup.org/About-ICMA/ICMA-Councils/European-Repo-Council.aspx>

<sup>3</sup> <http://www.isla.co.uk/>

reduction to that industry, the Post Trade Division of AFME<sup>4</sup> sets out in this paper its roadmap for delivering, **a single, integrated, low risk and low cost post-trading system in Europe.**

We believe this vision is entirely consistent with the European Commission's objective of creating an integrated securities market and in particular, *'smooth, safe and sound post-trading arrangements in the EU'* (EC Communication on Clearing and Settlement Communication COM(2004)312). Indeed, we fully acknowledge and support the steps taken by the Commission and other public authorities such as the European Central Bank to address the barriers that stand in the way of integrated and efficient European post-trading, including: the analysis of the Giovannini Group, the work of the CESAME / CESAME2 Groups / EGMI, the Legal Certainty Group, the Fiscal Compliance Group, the Code of Conduct on Clearing and Settlement and the Target2-Securities project as well as current regulatory initiatives in the areas of central counterparty clearing (EMIR), securities laws (SLD), CSD regulation and close-out netting.

Nevertheless, significant obstacles remain to the 'domestication' of cross-border clearing and settlement in Europe, including material differences in the processing, legal, fiscal and regulatory regimes that apply to post-trade services.

Therefore these remaining obstacles and deficiencies must be removed as a matter of urgency. The recent financial crisis has underscored the importance of developing a more resilient financial system to minimise systemic risk. Although the clearing and settlement components of the financial system have proved generally robust, we believe that a move from the current fragmented structure towards a more effective single European market in post-trading services, with the elimination of all material restrictions and barriers, will make a significant contribution to a safer financial system. Building on the achievements to date, we believe that removing the remaining restrictions and barriers will not only favour further increases in competition and efficiency but also improve the liquidity of European financial markets and thereby enhance the shock-absorption capacity of the system, and contribute to financial stability.

In *Section 3* of this paper, we set out the desired 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.

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<sup>4</sup> 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.

*Section 4* assesses the current state against the desired future state as benchmark.

*Section 5* identifies the action required to make the desired future state reality within a 3 to 5 year time horizon. The action plan is prioritized with timelines and allocated responsibilities.

Concrete proposals covering a sizeable part of the action list have either been developed or endorsed by AFME.

### **3. Desired 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 a small number of 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)

- Issuers have unhindered access to a large size investor pool
- Operational issuing processes are safe and efficient
- High liquidity in the primary market is provided through efficient clearing and settlement
- Transparency on allocation to investors is provided to investors for issuers, regulators and the market

##### **3.1.2. Operational requirements and characteristics**

- Primary market transactions are settled in true DvP<sup>5</sup>
- Each issuance
  - has a single fungible ISIN
  - is issued in one Issuer CSD<sup>6</sup>
  - is issued in dematerialized or immobilized form
- Issuance of international securities (Eurobonds) is compliant with the ISMAG Recommendations<sup>7</sup>

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<sup>5</sup> 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.

<sup>6</sup> Applicable for domestic securities; international securities, i.e. Eurobonds, are usually issued in Euroclear and Cleastream but benefit from the Bridge

## 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.

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<sup>7</sup> [www.euroclear.com/ISMAG](http://www.euroclear.com/ISMAG),  
[www.clearstream.com/ci/dispatch/en/kir/ci\\_nav/1\\_settlement/027\\_initiatives/010\\_ismag/012\\_recommendations](http://www.clearstream.com/ci/dispatch/en/kir/ci_nav/1_settlement/027_initiatives/010_ismag/012_recommendations)

- **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 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 lending<sup>8</sup> 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 processes<sup>9</sup> 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).
  - 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

- 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.
- Generally, asset-servicing is non-discriminatory (e.g. all investors enjoy equal practical ability to participate in corporate actions irrespective of nationality).

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<sup>8</sup> <http://www.isla.co.uk/dynamic.aspx?id=62>

<sup>9</sup> <http://www.icmagroup.org/getdoc/83bc0fea-1c74-4558-ade4-43c21a818b17/repo0.aspx>

### 3.3. Legal environment

- Securities laws in Europe are harmonised through a comprehensive securities law reform (SLD) that incorporates all recommendations of the Legal Certainty Group and is compliant with the Geneva Securities Convention (Unidroit).
- 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.
- Targeted company law reform provides for uniform shareholder definition and registration as well as non-discriminatory corporate actions.
- Netting regulation eliminates legal uncertainties regarding the enforceability of netting agreements.

### 3.4. 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. UK stamp tax are no longer levied.
- Extraterritorial fiscal requirements, e.g. FATCA are no longer imposed.

### 3.5. Market Infrastructure

- **Central counterparty clearing:**
  - A small number of 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.
  - T2S is the pan-European settlement platform for all European markets including non-Euro zone markets.



- **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.

## 4. Gap analysis

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.

The reality in all other areas, however, differs in most cases and to a varying degree from the outlined desired future state. To close these gaps we list in the next chapter the required actions, prioritized.

## 5. Required Action

This Action Plan, the deadlines and rationale for sequencing of actions as well as the proposed responsibilities are put in **context** with the time plan and harmonisation agenda of **TARGET2-Securities** as well as with current **regulatory initiatives of the European Commission** (EMIR, CSD legislation, SLD).

### 5.1. Highest priorities

Action	Deadline	Responsibility
<ul style="list-style-type: none"> <li> <b>All areas:</b>  Removal of barriers to effective competition throughout the transaction chain, eliminating fragmentation and fostering consolidation </li> </ul>	2014	Public sector at national and European level
<ul style="list-style-type: none"> <li> <b>Clearing:</b>  Availability of interoperable <b>CCP services</b> in all markets for adequately liquid cash securities, enabled by non-discriminatory access to trading venues / trading feeds and to CSDs </li> </ul>	2012	EACH, European Commission (EMIR)
<ul style="list-style-type: none"> <li> <b>Settlement:</b>  Harmonisation of <b>settlement processes</b> including pre-settlement functionalities (confirmation, allocation, affirmation, matching) that will allow smooth cross-CSD settlement across Europe (including T2S) </li> </ul>	2013	T2S, ECSDA, EFAMA, AFME, public sector at national level, where required (e.g. France re. hold and release mechanism)

- Asset servicing:**  
Comprehensive implementation of the Market Standards for **Corporate Actions** Processing in all markets

2013

National / European Market Implementation Groups, public sector at national level, where required (e.g. UK re. dematerialization, Germany re. payment date for cash and securities distribution)
- Legal:**  
Harmonisation of securities laws through **Securities Law Reform**, compliant with the Geneva Securities Convention, including all recommendations of the Legal Certainty Group

2015

European Commission, Member States
- Tax:**  
Implementation of Simplified **Withholding Tax Relief Procedures** (Recommendation COM (2009) 7924), using the OECD Implementation Package

2014

Member States

## 5.2. High priorities

- Communications:**  
Electronic, formatted and standardized communication throughout the entire value chain implemented

2014

Private sector: market infrastructure, intermediaries
- Clearing:**  
Availability of CCP clearing to buy side for purposes of risk reduction and efficiency (netting)

2013

EACH , IMA

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|---|---------|---|
| <ul style="list-style-type: none"> <li>• Transparent operational CCP process including timing of novation, irrevocability, acceptance of trades by direct clearing members, risk algorithm and associated margin requirements.</li> </ul> | 2012    | EACH  |
| <ul style="list-style-type: none"> <li>• <b>Trade data:</b><br/>Non-discriminatory availability of trade data to counterparties of trade and CCPs immediately after execution of trade.</li> </ul>  | 2012    | European Commission (MiFID II)                        |
| <ul style="list-style-type: none"> <li>• <b>CSD account structure</b><br/>Omnibus accounts and the nominee concept are recognized in all markets</li> </ul>   | 2013    | European Commission (CSD legislation or SLD)          |
| <ul style="list-style-type: none"> <li>• <b>Settlement:</b><br/>Harmonisation of settlement cycles at T+2</li> </ul>  | 2013    | European Commission (CSD legislation), private sector |
| <ul style="list-style-type: none"> <li>• Harmonisation of fails management including buy-in regimes</li> </ul>  | 2013    | T2S, FESE, ECSDA, AFME                                |
| <ul style="list-style-type: none"> <li>• Harmonisation of operational processes for ETFs</li> </ul>   | 2012/13 | Securities industry, including Issuers and CSDs       |
| <ul style="list-style-type: none"> <li>• Harmonisation of processes that ensure that entitlements from corporate actions on stock, including</li> </ul>   | 2013    | Issuers, T2S, ECSDA, national regulators              |

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voting rights, become effective at the point of settlement.

- **Asset servicing:**  
Comprehensive compliance with Market Standards for General Meetings in all markets 2013 National / European Market Implementation Groups
- Operationally feasible record dates for cross-border participation in General Meetings 2014 European Commission (revised Shareholder Rights Directive)
- **Legal:**  
Netting regulation that eliminates legal uncertainties re. enforceability of netting agreements 2012 European Commission
- **Tax:**  
Provide informed opposition to any new tax collection proposals linked to the settlement process (with particular reference to the FATCA passthru payment proposals 2013 Private sector, market infrastructure)

## 5.3. Lower priorities

- Harmonisation of all trade-based reporting (including timelines of reporting) at least at pan-European level
- Targeted company law reform providing for uniform shareholder definition and registration as well as

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non-discriminatory corporate actions.

- Abolishing existing tax collection (e.g. capital gains taxes) that is linked to settlement process
- Non-discriminatory asset-servicing (e.g. all investors enjoy equal practical ability to participate in corporate actions irrespective of nationality)
- Internationally harmonised conflict of laws regime