

A Roadmap for Integrated, Safe and Efficient Post Trade Services in Europe

An essential part of successful and
sustainable European Capital Markets

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1 Executive Summary

In our White Paper 2018 “A Roadmap for Integrated, Safe and Efficient Post Trade Services in Europe” we set out our vision of a future post trade system within the broader context of successful and sustainable European Capital Markets.

This new version follows some major recent developments, such as the publication in August 2017 of the Report of the European Post trade Forum, and the publication on 8 March 2018 of European Commission Action Plans on Fintech and on Sustainable Finance.

Our vision is for

- a truly integrated, harmonised, low risk and low cost post trading system in Europe
- post trade infrastructures and service providers that compete in a harmonised and standardised operational, legal and regulatory environment, offering innovative and low cost services to all users on a non-discriminatory basis.

To achieve the vision of low risk and low cost post trading in Europe:

- the barriers determined by the European Post Trade Forum (EPTF Barriers) in 2017 should be swiftly dismantled in the context of the European Commission’s Capital Markets Union project (CMU)
- simultaneously, a longer-term strategy, based on detailed analyses, to achieve the targeted future state of the post trading landscape should be developed, including responsibilities and timelines and implemented accordingly
- the opportunities created by new technology (e.g. Distributed Ledger Technology, Artificial Intelligence, cloud-based services etc.) should be leveraged
- a close and institutionalised cooperation between the public and the private sector should be continued, including an intensified dialogue with European and national public authorities in a bespoke and targeted manner
- post trade reform should be pursued across all European markets, including non-EU capital markets.

Creating an integrated low risk and low cost post trading system is a necessary pre-condition for building larger and more diverse European capital markets.

Capital markets deliver better outcomes to end users (issuers and investors) both to the degree to which they are larger, and more integrated, and to the degree to which they allow for a diversity of market participants, business models, and eco-systems to exist and thrive.

Delivering these benefits requires a very high degree of standardisation and interoperability at the level of post trade capital market infrastructure.

The TARGET2-Securities (T2S) system delivers a high degree of standardisation and interoperability for some elements of the post trade process. It is thus an important building block for the vision set out in this paper.

Larger and more diverse markets in the EU will deliver benefits to market users; pan-European and global markets can deliver even greater benefits.

International coordination and cooperation – both in the areas of regulation and supervision – are therefore indispensable to avoid discrimination and to provide the highest benefits to users of European capital markets both in the financing and investment space.

The vision of this paper applies to Europe as a whole (including non-EU capital markets), and, where possible, to global capital markets.

We believe that there is a critical need to make significant progress in European Post Trade Reform. In particular, we urge public authorities to ensure that national law and regulation are compatible with a highly standardised and integrated pan-European post trade process.

2 Introduction

The White Paper 2018 is based on the AFME Post Trade White Papers of 12 August 2011 and of 8 July 2016. It takes into account a changed environment, in particular the EPTF Report of August 2017, the AFME response to EC consultation on post trade in a Capital Market Union of 15 November 2017, Brexit, and the publication on 8 March 2018 of the European Commission Action's Plans on Fintech and Sustainable Finance.

A truly 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.

3 Context

In a Communication published in September 2017, the European Commission included the following explanation:

The Single Market in financial services promotes jobs, growth and investment in all EU Member States, by channelling savings more effectively to their most productive uses. If markets are truly integrated, savers and investors can obtain higher returns, while consumers and businesses can obtain better financing conditions - based on a more complete and competitive offering of financial instruments. In particular, financial integration can leverage even further the success of the Investment Plan for Europe in filling the EU's investment gap, while also facilitating the transition to a low-carbon, more resource-efficient economy.

We strongly support this analysis.

We further believe that the lack of integration in the European post trade system has the effect of fragmenting markets, and of preventing Europe achieving many of the benefits of more integrated markets.

There is a long history of European public policy initiatives that try to tackle the barriers that prevent the creation of a more integrated post trade system. Some of the most notable initiatives were the two Giovannini reports of 2001 and 2003, the entry into force in 2011 of EMIR (European Market Infrastructure Regulation), the entry into force in 2014 of the CSD Regulation (CSDR), and the launch in 2015 of the TARGET2-Securities (T2S) settlement platform.

These initiatives have brought benefits towards the creation of an efficient pan-European post trade system. With respect to securities clearing, settlement and custody, improvements have, however, been incremental and segmented, national, post trade processes continue to exist.

The European Commission's Action Plans on Fintech and on Sustainable Finance that were published on 8 March 2018 are of particular importance for the vision set out in this White Paper. Fintech developments create the possibility for new and improved post trade processes. The sustainable finance agenda is critically dependent on efficient and effective capital markets that can channel savings into long-term and sustainable investment projects; it is thus highly dependent on the post trade vision set out in this Paper.

¹ <https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/>

² <http://www.isla.co.uk/>

4 Targeted future state of the post trading landscape in Europe

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

We believe that such a system is necessary to support a vision of a Capital Markets Union that combines integrated pan-European markets, together with a diversity of market participants, business models and capital market eco-systems across all European countries.

Capital markets work best when they have a variety of participants with different investment profiles, time horizons, and objectives. Existing national capital market eco-systems, with in many cases distinct national business models, provide valuable services to their national capital market participants. But in order to avoid fragmentation, and to harvest the benefits of larger and more diverse markets, it is necessary to integrate those national eco-systems into pan-European capital markets.

The fundamental challenge is to ensure all the elements of the future CMU landscape are interoperable, can communicate with each other, and can function, so that all European savers and investors can achieve the benefits of a single market.

We believe that the necessary communication, and inter-operability between all parties in the landscape can only be achieved if there is a very high degree of uniformity in messaging formats and post trade processes.

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

4.1 Characteristics of our vision for primary markets

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

- Issuers have unhindered cross-border access to a large and broad investor pool
- Process to issue securities is consistent across jurisdictions and platforms, with cost to do so kept as low as possible.
- Operational issuance processes are safe and efficient.
- High liquidity in the primary market is provided through efficient clearing and settlement.

Operational requirements and characteristics

- Primary market transactions are settled in true DvP³.
- Each issuance
 - has a single ISIN throughout Europe
 - is issued in one Issuer CSD, or in two or more fully interoperable CSDs
 - is issued in dematerialised or immobilised form
 - is issued in Central Bank Money or Commercial Bank Money, depending on issuer and user preferences
- Issuance of international securities (Eurobonds) is compliant with the ISMAG Recommendations⁴

³ 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.

⁴ <https://www.euroclear.com/en.html>

<http://www.clearstream.com/clearstream-en/strategy-and-initiatives/market-harmonisation/ismag>

4.2 Characteristics of our vision for secondary markets

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

Operational requirements and characteristics of clearing and settlement and related functionalities

The functionalities outlined in this section are generic and apply in particular if there are 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 internalised or automatically performed.

- **Entire chain of functionalities: communication**
 - The communication of all service providers in the transaction chain is in electronic, formatted and standardised form based on ISO 15022/20022 to achieve straight-through processing (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, where possible.
- **Affirmation:**
 - Affirmation by the buy side takes place at T+0, where possible.
- **Give-Up Process**
 - Give-up processes between investor, executing broker and prime broker according to confirmation, allocation and affirmation timeframes above are standardised and take place at T+0.
- **Clearing:**
 - CCP clearing is available in all markets for adequately liquid cash securities (even where not mandatory).
 - 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 are 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 Clearing Member, if required) to all eligible market participants for purposes of risk reduction and efficiency (netting).
 - CCP-cleared transactions are netted using a trade date netting model.
- **Settlement and settlement related services**
 - Settlement and settlement related services are provided in accordance with T2S rules, including ESSF/ECSDA Matching Standards, particularly in regard of early matching, or aligned thereto for non-T2S markets.
 - All national specificities are eliminated.
 - The CSDR mechanism for late settlement penalties is implemented in a unified manner across all European CSDs.
 - Buy-in rights and obligations are placed at the level of the trading parties and harmonised across all market participants, including CCPs.
 - For account structures, at every level in the custody chain there is a clear distinction between the proprietary assets of the account provider, proprietary assets of the account holder, and assets of clients of the account holder. Beyond this degree of segregation, the principle of choice as set out in CSDR Article 38 applies, so that account holders have the ability to hold client assets in an omnibus account or in an account with assets of just one client; the legal and fiscal regimes in each country should recognise these account structures and should ensure that client assets are not at risk of being treated as proprietary assets.
 - Settlement takes place in Central Bank Money or Commercial Bank Money, depending on issuer and user preferences.
 - **Resource management (securities):**
 - In all markets securities lending 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 are available.
 - Users have the possibility to settle in Central Bank Money, where possible, with auto collateralisation of borrowing needs.

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 Meetings⁵.
- The application of Standards for Transaction Management/CASG Rules⁶ (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, i.e. record dates are fixed so that all record date holders have the real possibility to cast their vote at a meeting.
- The responsibility for reconciliation at each layer ensures the integrity of the custody chain.
- Given the shareholder identification process that will be implemented as a result of the amended Shareholder Rights Directive (SRD2), registration processes will be abolished.
- Asset-servicing is non-discriminatory (e.g. all investors enjoy equal practical ability to participate in corporate actions irrespective of nationality, and of residence).

⁵ <https://www.afme.eu/globalassets/downloads/briefing-notes/2017/afme-cajwg-standards-revised-version-2012-updated-2015.pdf>
<https://www.ebf.eu/home/european-industry-standards/>

⁶ <http://www.ecb.europa.eu/paym/t2s/governance/ag/html/subcorpact/index.en.html>

- Any CSD that supports the settlement and custody of a secondary listing of a security is required to ensure that it can support any corporate action, market claim or tax reclaim on the same basis as the issuer CSD of that security.
- All information to be carried by custody-related messages should be capable of being contained in formatted fields. There should be no requirement to use free text in custody messages.
- ISO 15022 and 20022 are global messaging standards, and thus can contain a large number of options. Within the EU, business processes should be identical (and in line with the market standards), so that messaging related to those business processes should be standardised, and without the use of additional options.

4.3 Characteristics of our vision for collateral management

- Highest operational efficiency and collateral mobility is achieved through harmonisation and standardisation of operational processes in accordance with the ongoing work of the ECB Collateral Management Harmonisation Task-Force⁷ that include
 - the harmonisation of FMIs' cut-off times
 - the use of harmonised messaging formats for collateral management instructions
 - harmonised corporate action and taxation processes for collateral management activity
 - the wider use of standard market tools.
- All restrictions on locations where collateral can be held should be eliminated.
- Collateral management services are largely provided by intermediaries, as intermediaries can give collateral givers and collateral takers access to a broader range of securities, so in particular restrictions on holding collateral with intermediaries should be eliminated.
- In essence, there is a level playing field for the provision of collateral management services across providers.

4.4 Characteristics of our vision for the 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 (even when acting as indirect participants of a settlement system), enforceable close-out netting and internationally harmonised conflict of law rules.
- The Europe-wide acceptance and recognition of the nominee concept (i.e. assets that are held on behalf of clients are not proprietary assets of an intermediary) and omnibus accounts, as well as an internationally compatible conflict of laws regime for both securities and claims, are part of the securities law reform.
- On access rights, there is a removal of all legal and regulatory obstacles at all levels of the post trading system that currently prevent end investors from being able to access the services they need as well as intermediaries from providing those services.

4.5 Characteristics of our vision for the fiscal environment

- The measures set out in the European Commission's Code of Conduct on Withholding Tax are implemented in a harmonised manner across all EU member states by end 2018 as a first step.
- The withholding tax system for securities income clearly distinguishes in all countries between tax policy and tax process. Tax policy (tax rates, determination of which categories of activity are taxable, and determination of which categories of investor are liable for the tax) are a matter for individual countries. The operational tax process, including deadline for refund, is harmonised across all countries.
- Withholding tax at source relief procedures are the rule. Where relief at source procedures are not yet available, highly efficient withholding tax refund procedures are available (quick refunds

⁷ <https://www.ecb.europa.eu/paym/initiatives/shared/docs/d1a36-ami-seco-2018-03-20-item-04.1-cmh-tf-reporting.pdf>

or other procedures that allow refunds to be processed within maximum six months after income payment date).

- All countries strictly apply the record date principle to determine tax benefits. Market claims are considered as indemnities rather than as taxable dividends.
- Any European end investor is able to use one single standardised form and one single set of documentation requirements for all tax processing purposes across all EU member states.
- The use of the OECD Implementation Package provides for international compliance.
- As with withholding tax systems, transaction tax systems all countries clearly distinguish between tax policy and tax process. Operational tax processes are aligned across all markets.
- Specifically, national requirements for tax processing and reporting, both for transaction taxes and for capital gains taxes, are not linked to the settlement process at the issuer CSD, or at any other CSD.

4.6 Characteristics of our vision for the market Infrastructure

- **Central counterparty clearing:**
 - CCPs are interoperable and genuinely compete amongst each other. The regulatory framework on CCP governance and appropriate European supervision ensure that the competition among CCPs does not compromise appropriate risk management and result in a race to the bottom on margin levels and Guarantee Fund contributions.
 - 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. Local market specificities have been removed.
 - 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 and securities finance transactions, but not for cash securities.
- **Reporting:**
 - Regulatory reporting requirements are aligned and harmonised at European and national levels.

5 New technology / New market structures

Many of the barriers identified by the EPTF have their origin in specifically national post trade processes that were built on current technologies, and on and around the limitations of those technologies.

New technologies, such as distributed ledger technologies, artificial intelligence, and cloud-based services, by their ability to improve the collection, management and distribution of information, create the possibility to deliver new post trade processes that are much more efficient and effective than the old processes, that are not restricted by national borders, and that can be implemented on a pan-European basis.

The use of new technologies may be associated with the risk of fragmentation, as different actors implement different technological solutions to deal with the same underlying problems. Such problems may be forestalled by a high degree of standardisation in the definition of core data fields and in message protocols, and may be solved by other technological solutions, including those derived from artificial intelligence.

As the existence and possibilities of new technologies may have specific impacts on current regulation, AFME stands ready to support regulators by making respective expertise and experience available.

As set out in a January 2018 AFME paper, we believe that there is scope for new utilities⁸ to provide new services on a pan-European basis.

Areas in which there may be scope for the provision of utility services include regulatory reporting, shareholder transparency, and operational tax processing.

6 Pan-European and global aspects

Many financial markets in Europe are deeply embedded in global financial markets, and Europe is the location for significant global financial market infrastructures.

Accordingly, we believe that the process of building integrated European capital markets cannot ignore the global dimension.

Integrated European capital markets that are open to the world and that use global standards will be more efficient and effective in delivering benefits to end users; they will also be increasingly attractive as a location for global financial market activity.

To achieve such outcomes, there will be a need for international regulatory and supervisory coordination and cooperation.

7 Way forward

We believe that there is a critical need to make significant progress in European Post Trade Reform.

Despite major efforts from the European public authorities and the private sector over the past 20 years, successful initiatives have been limited.

We urge European and national authorities to prioritise post trade reforms as they are important pre-conditions for a successful Capital Markets Union, and for the implementation of the sustainable finance agenda.

In particular, we urge national authorities to take steps to ensure that national law and regulation are compatible with a highly standardised and integrated pan-European post trade process.

⁸ <https://www.afme.eu/globalassets/downloads/publications/afme-tao-industry-utilities.pdf>

We believe that close and institutionalised dialogue and cooperation between the public and private sectors, both at the European and national levels, can help deliver the vision set out in this paper.

AFME stands ready to engage in such an intensified dialogue with European and national public authorities, in order to allow issuers and investors to derive the full benefits from integrated pan-European capital markets, and from a diversity of business models and eco-systems across all European countries.

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