EUROPEAN PARLIAMENTARY FINANCIAL SERVICES FORUM

EPFSF Briefing
"Post-trade legislation: What will change after EMIR and CSDR, and what remains to be done?"

Introduction

The last two years have brought unprecedented regulatory changes to the European post-trade sector, not all of which have been fully implemented yet. For the first time post-trade issues are in the spot light of high level policy debates, which can clearly be seen as an acknowledgement of the crucial importance of the services that financial market infrastructures (FMIs, including trading venues on the level of trade and CCPs, CSDs and trade repositories in the post-trade space) provide for the stability and safety of financial markets.

While on the trading level, the MiFID review is in its final stages towards adoption, also in the post-trade space a lot has already been achieved. The two main building blocks of the new European framework of post-trade legislation have either already entered into force (EMIR and related technical standards) or are close to being finalised (CSD Regulation).

Post-trade issues nevertheless remain high on the political agenda, as a number of important questions are still open and will need to be addressed by policy makers in the coming months.

EMIR implementation

On 16 August 2012, after nearly two years of intense legislative debates in Council and Parliament, the EU Regulation on OTC Derivatives, Central Counterparties (CCPs) and Trade Repositories also referred to as "EMIR" - European Market Infrastructure Regulation - entered into force.

EMIR follows up on the G20 commitments made in Pittsburgh in September 2009[1]. Its objective is to increase the stability of the financial system by bringing more safety and transparency to the OTC derivatives market. To achieve this, EMIR introduces among others a clearing obligation for 'eligible' OTC derivatives, measures to reduce counterparty credit risk and operational risk for bilaterally cleared OTC derivatives, a reporting obligation for OTC derivative contracts (both cleared and non-cleared), as well as common rules for CCPs and for trade repositories. A set of 9 complementary regulatory and implementing technical standards were subsequently developed by the European Supervisory Authorities (ESAs) to complement the obligations of the level 1 text and entered into force in March 2013. Draft standards on the cross-border application of EMIR (Art 4(4) and 11(14)) should be delivered by ESMA to the Commission in Q3 2013.

Remaining EMIR discussions centre on a number of important questions of implementation, such as the issue of mutual recognition. Moreover, trade repositories and CCPs are currently in the process of applying for registration and authorisation under EMIR and only after this will EMIR's reporting and central clearing obligations come into effect. A further issue to be addressed relates to initial margins for non-cleared derivatives. The ESAs that are likely to consult in 2013 on the implementation of the relevant applicable rules will have to consider carefully the potential impact of such rules on the relevant markets.

[1] (…) *Improving over-the-counter derivatives markets:* 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. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse. (…)

CSDR

In March 2012 the Commission published a second important piece of the new EU legislative framework for the post-trade sector: its proposal for a Regulation on improving securities settlement in the European Union and on central securities depositories (CSDs). The CSD Regulation (CSDR) aims at improving the safety and efficiency of securities settlement in the EU by harmonising post-trade processes in Europe and should help to make cross-border securities transactions less complex, less risky and less costly.
Some of the main features of the Regulation include the obligation to record all transferable securities in book entry form at the CSD as well as the harmonisation of settlement cycles (at 2 business days after trade date) and of settlement discipline measures across the EU. CSDs would also benefit from an EU wide "passport" which would allow to remove some of the existing barriers of access and to open up the sector for increased competition.

After more than a year of legislative discussions, the initial Commission proposal has been modified by Council and Parliament and both institutions are about to enter trialogue negotiations with the Commission to agree on the final text of the law. It is expected that these negotiations can be concluded under Lithuanian Presidency so that the law could be adopted in its final form by the end of 2013.

Although on most issues the current positions of Parliament and Council have already converged considerably, some contentious issues and gaps between the texts remain to be solved. In particular, policy makers will need to decide whether and how to include provisions dealing with possible conflicts of law and, linked to this question, discuss the provisions that grant issuers the right to issue into any CSD across the EU. Gaps also remain on the provisions on settlement discipline, the authorisation procedure for CSD links and the terms and conditions for providing banking services.

A timely entry into force of the CSDR will be important, especially given the interdependencies with other projects such as the Eurosystem's TARGET2 securities.

Securities Law Legislation (SLL)

While the work on EMIR and CSDR is already well advanced, this is much less the case for two further crucial pieces of post-trade legislation on which a proposal is still pending. Most importantly, the Commission has been working for several years already in cooperation with experts from Member States on legislation to harmonise Securities Law across the EU and plans to come up with a legislative proposal on the issue after the summer break.

The future Securities Law Legislation (SLL) is considered to be the backbone of any legislative framework for the post-trade sector. It could help to reduce existing legal barriers to the safe and efficient functioning of the Single Market by increasing the transparency and legal certainty on cross-border securities holding and dispositions. It would also be a necessary complement to the other pieces of post-trade legislation by clarifying situations of conflict between different national laws.

Although the final form and scope of the law remain to be decided, the Commission seems to intend to use the SLL to clarify "who owns what" in a cross-border context by harmonising substantial aspects of securities law and also addressing some activities that are considered to be part of shadow banking. Some stakeholders stress the benefits of more transparency but warn against an overly ambitious approach for the SLL given the complexity of the task and the need for a comprehensive assessment of the benefits and disadvantages of all the current regimes in Europe. Others note that any EU law proposal needs to be in line with global standards (Geneva Securities Convention); and should increase the degree of legal certainty across all aspects of securities law (e.g. CSD, collateral, general securities).

Recovery and Resolution for non-banks

A second important complement to EMIR and CSDR will be to define an appropriate recovery and resolution regime for FMIs that effectively addresses potential situations of severe financial stress. While discussions on Recovery and Resolution Plans (RRPs) for banks approach their final stage, policy makers are now turning their attention to FMIs given their central and systemic role for the financial system. After the Commission's public consultation, the Parliament will be the first to address the issue in an own-initiative report (to be published in June and adopted in November). The report is expected to set the tone for following legislative debates on a first proposal by the Commission which is planned for September 2013.

A well-designed recovery and resolution regime for CCPs and other FMIs will help to harmonise certain aspects of national laws and to facilitate the recovery and resolution of FMIs in a cross-border context. A functioning framework will be important to guarantee the safety and orderly functioning of the financial market and to avoid a negative systemic impact in case an FMI gets into a situation of severe financial stress.

The framework for FMIs will thereby have to be clearly distinct from the one for banks. Specific provisions need to be designed that take into account the unique role of FMIs in the financial system and the fact that FMIs are often not easily substitutable. For instance, while in the case of banks the main objective is to ensure that bank failures across the EU are managed in a way that avoids financial instability and minimises costs for taxpayers, the overriding principle for FMI's has to be to guarantee a continuous and uninterrupted provision of systemic functions even in times of severe stress either via the restoration of the FMI to going concern status or via the effective transfer of positions, property, rights and liabilities of the FMI to other appropriate parties depending on the circumstances behind the FMI's failure. Moreover, should resolution be unavoidable, it is imperative that resolution arrangements are transparent, predictable and consistent with recovery arrangements in place at FMIs.

Most stakeholders moreover agree that a clear distinction between the different types of financial infrastructures, i.e. CCPs and CSDs, is necessary given their different characteristics and risk profiles. As regards CCPs, 'Clearing Members' (CMs) should be subject to a limited liability to prevent systemic risk (via certainty and transparent arrangements). Additionally, authorities should always respect the CCP recovery rules and see resolution (where NB netting and collateral arrangements need to be recognised) as a last resort.

It will be important to ensure that EU legislation on FMI recovery and resolution builds up on and is fully consistent with international work streams on the topic, in particular with upcoming guidance by CPSS-IOSCO, the global forum of securities supervisors, on FMI recovery and the "Key Attributes" on resolution by the Financial Stability Board (FSB).

Conclusion

The ongoing major regulatory changes together with other large-scale projects such as the Eurosystem's TARGET2-Securities will transform the European post-trade sector.

Besides solving the important remaining questions outlined above with regard to ongoing work on the new post-trade legislative framework, a crucial task for policy makers over the next years will thus also be to closely monitor the market impact of the new laws and to identify remaining gaps. Given the scale of the reforms and the significance of market infrastructures for the safe and efficient functioning of the financial market, it will be fundamental that regulators and policy makers are consistent with global standards and react quickly to any unintended and harmful consequences of the new rules, reviewing and modifying adopted legislation wherever this proves necessary.

On top of these legislative reforms, the European Commission, the ECB, ESMA and some representatives of the private sector have also established the European Post Trade Group (EPTG) to foster a targeted cooperation between public authorities and the private sector on post-trade issues.[2]

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[2] http://ec.europa.eu/internal_market/financial-markets/clearing/eptg/index_en.htm

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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