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The greater the challenge, the more important your partner.

With the increasing velocity of change, the difference between who succeeds – and who merely survives – will be defined by clear thinking, quick decisions and rapid reflexes. This is where SIX Securities Services comes in.

As one of Europe’s few truly international post-trade service providers, we have learned to adapt to rapidly changing landscapes, carve out our own innovative path and deliver industry-recognised performance. The result is satisfied customers who enjoy having us to help steer them to success. Solutions for the future. Now.
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Welcome to Radar

When most people start talking about chaos theory, butterflies and hurricanes are rarely far behind. Such ideas are not comforting to post-trade practitioners in the securities industry whose strongest suits are prudence and predictability. At the same time, we recognise that we failure to adapt to a changing environment is a route to extinction.

In this edition of Radar we look at how far we as an industry can build predictability into our preparations for change. As ‘first wavers’ like SIX SIS get ready for the live launch of T2S in June next year, we are in a testing phase. What response to our efforts can we expect from those further up the transaction chain? How far has T2S piqued their interest? We draw on the work of the ECB in exploring how far enthusiasm for T2S extends.

At Sibos, SWIFT’s annual conference where industry issues get an airing, SIX Securities Services CEO Thomas Zeeb was invited to take part in a panel discussion on the future of market infrastructures. This was billed as a ‘crystal ball’ session and in reviewing that session, we look at what can and can’t be foretold.

With much of the current debate focusing on Europe, it is easy to forget that not all markets face the same pressures or opportunities. Philip Metoudi is a familiar name to many in the world of Asian market infrastructures and we ask him to reflect on how the markets in which he still operates are progressing.

We hope you enjoy this edition of Radar and look forward to your feedback. To contribute to the conversation, log in to www.post-tradeviews.com – a site powered by SIX Securities Services to provide insight into all the moving parts that make up the post-trade world.

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First wave of T2S: why are you there?

TARGET2-Securities (T2S) is scheduled to go live in June 2015, with the first migration wave of CSDs including SIX SIS Ltd, Monte Titoli, Bank of Greece, Malta Stock Exchange and Romania’s Depozitarul Central. Radar spoke to three of these CSDs about their progress towards T2S implementation and why they sought to be part of the first wave.

How close are you to completing your preparations for T2S?

Christophe Lapaire: We are progressing very well. We are fully aligned with the ECB plan and with our own. At the end of September the ECB finalised its acceptance testing and that means that the software is ready and open for testing by the CSDs. In October we initiated the interoperability-testing phase, which will end in CSD acceptance testing at the end of the year. Of course from a client perspective, the most

Participants

Christophe Lapaire, T2S Programme Director, SIX Securities Services

Mauro Dognini, General Manager, Monte Titoli

Dr. Robert Vella-Baldacchino, Deputy General Manager & Member Executive Committee, Malta Stock Exchange
important thing is community testing, which will kick off in March 2015 for first-wave CSDs.

**Mauro Dognini:** Monte Titoli is in a strong position. We have started functional testing and will continue to work closely with our clients over the next seven months to make sure everyone is ready and we can offer a single point of entry into all of the T2S markets.

**Robert Vella-Baldacchino:** Malta Stock Exchange (MSE) is well advanced in its technical readiness and preparations for the T2S planned go-live on 22 June 2015. Technical infrastructure and project planning started soon after the MSE’s decision to join the first wave of migrating CSDs. Our CSD software was totally renewed over a year ago in preparation for interfacing between T2S and MaltaClear®, the MSE’s security settlement system.

The MSE has also recently participated in a T2S “Migration Weekend Dress Rehearsal” to demonstrate the successful technical data interface between T2S and the MaltaClear database. The MSE has publicly disseminated its MSE T2S Adaptation Plan and consulted widely with the Maltese market T2S National User Group, issuers serviced by MSE-CSD and the MSE College of Stockbrokers.

Through its adoption of the so-called “layered model”, the MSE will be grouping all end-investors’ CSD accounts in a technical omnibus T2S account opened on the T2S platform. Technical T2S participant accounts have already been opened in the names of all other MaltaClear clearing members, stockbrokers and banks. Following further business functional testing, the MSE is now looking forward to the start of business users community testing after 5 March 2015.

**Is your impression that, across the board, the first-wave CSDs are progressing according to the ECB plan and are on schedule?**

**Lapaire:** We are encountering a number of technical issues with T2S, but this is not surprising in the context of such a complex project. Defects are reported to the ECB.

“We will not outsource our settlement functionality, as other CSDs are doing. Clients must remain the centre of our focus, and clients are expecting to get the same service after the implementation of T2S.”

*Christophe Lapaire, SIX Securities Services*
and taken care of as with any large-scale software implementation project.

The various first-wave CSDs have very different contexts. Three out of five of them will connect as users to the T2S software directly. Monte Titoli and SIX SIS, however, have large-scale businesses and need to connect application-to-application, which is a more complex process.

What makes you well placed to be part of the first wave of T2S?

Dognini: We remain a committed champion of T2S and have been investing in our technology and readiness since its inception in 2006. To ensure readiness as a first wave participant we have invested in our technology and infrastructure throughout that time. Our agile technology has allowed us to develop our new asset servicing capabilities along with our collateral management platform, placing Monte Titoli in a unique position to service new and existing customers when the T2S regime is introduced in June 2015.

London Stock Exchange Group has also recently launched a new Luxembourg-based CSD, globeSettle, which will leverage the IT and operations expertise of Monte Titoli. Through the two CSDs, London Stock Exchange Group is able to provide customers with greater choice and flexibility.

Vella-Baldacchino: To ensure a seamless interface between the domestic and international markets, MaltaClear some years back linked up its clearing and settlement with Clearstream. The MSE is also a partner exchange of Germany’s Deutsche Börse via its XETRA technology. Joining the Eurosystem T2S project was thus both a natural development of MSE’s strategy as well as the next obvious milestone.

As a lean and agile organisation, the MSE appreciates the benefits accruing
from outsourcing clearing and settlement to T2S. MaltaClear processes and procedures can be expediently adapted to ensure compliance with T2S specifications and requirements together with European best practice standards.

Lapaire: Since the very beginning, SIX Securities Services has clearly communicated that it wants to be part of the first migration wave. That was a strategic decision. SIX is not the most important CSD in terms of volumes, because the Swiss Franc will not be part of T2S, but we are actually number one in terms of market coverage. SIX covers 68 markets, providing comprehensive asset and tax services in addition to the traditional CSD service. That makes us quite unique.

With such a business mix, it was very important for us not to enter T2S at a later stage with much higher volumes. We will keep our proprietary settlement application, and add the T2S layer on top. That makes us different as well. We will not outsource our settlement functionality, as other CSDs are doing. Clients must remain the centre of our focus, and clients are expecting to get the same service after the implementation of T2S.

What are the benefits to your market of being part of the first wave of T2S?

Vella-Baldacchino: The benefits to the MSE of forming part of the first wave of T2S are manifold. But the most prominent advantage to Malta lies in its achievement of an internationally recognised optimal standard of clearing and settlement through a comprehensive state-of-the-art technology infrastructure owned by the Eurosystem. The MSE will be able to look forward confidently to focussing its resources on serving particular customer needs and niches that are often overlooked by larger competitors and organisations. Following successful T2S migration in June 2015, the MSE is also looking forward to furthering its regional and international strategy by consolidating its international market links and developing new interoperable networking opportunities.

Lapaire: First of all, it is about reducing complexity and risk for SIX Securities Services and our clients. The Swiss market is in T2S, but the Swiss Franc is actually not an eligible T2S currency. Settlements in euros for the Swiss markets will be well below 10 percent of Swiss market volume. Migrating with lower volumes means clients will be in a position to better focus on harmonising standards in settlement and corporate actions. Second- and third-wave migration CSDs will have to deal with onboarding much larger volumes when migrating with their community.

Dognini: Being a first-wave participant in T2S enables us to assist a broader, more international range of customers. We are already developing our collateral management services, which can be integrated within our core business. We also believe there are opportunities to increase our volumes along with our range of clients, benefitting from our first mover advantage.

Have you identified any potential ‘unintended consequences’ of T2S implementation?

Dognini: Monte Titoli has been working closely with regulators and customers since the beginning of the project so we haven’t, as yet, experienced any surprises during implementation.

Lapaire: I’m not sure the consequences are
unintended. What is clear is that not everybody realises the consequences of T2S for the time being. T2S is setting new standards in post-trade and this will affect the business models of all participants – not only the CSDs, but potentially also global custodians and larger players. The market is currently focusing on technical implementation, but the potential of T2S will only be revealed after upcoming regulatory changes, such as the Central Securities Depositories Regulation (CSDR), which are in the pipeline.

Today T2S is on the radar screen of COOs and CTOs, but soon it will be on the radar screen of CFOs and CEOs. The technical aspects will recede into the background and the benefits will be unveiled once these different pieces of legislation are implemented. And they will be implemented. It’s not a question of if; it’s a question of when.

Vella-Baldacchino: As the adage goes, “There is no gain without some degree of pain.” The T2S implementation is no exception. Indeed, market users may query the scope of the changes that T2S implementation will bring with it. Much of that is the natural instinctive apprehension that accompanies any market change. The recent Europe-wide switch of the settlement cycle in cash markets from T+3 to T+2 initially raised some concerns, but the benefits of conforming with a European settlement standard, now also enshrined in the EU Central Securities Depository Regulation, prevailed.

T2S implementation will also definitely enforce orthodox settlement practice which the Maltese market by and large already upholds as is evident in its strong track record of negligible market transaction settlement fails on the MSE. All in all however, there is no doubt in our minds that the net benefits of T2S implementation by far outweigh any potential – and inevitable – unintended consequences.
Headlines about collateral shortfalls have been muted in the last year or so, but the penalties for being left short – effectively being cut off both from traditional sources of funding and from key markets and clients – are such that no one is taking any chances.

Demand for high-quality assets has been so intensified by post-crisis regulation that few sources of eligible collateral will be left in peace over the next five years. No stone will remain unturned, no depository unscoured. Both buy-side and sell-side firms are placing a premium on making sure they can put the right collateral in the right place at the right time, potentially whisking those assets away at short notice if a margin call so demands. These market participants are also realising they may need outside help to perform the collateral juggling act that the post-crisis world expects.
Collateral management

“It is now clear that buy-side firms need to manage their collateral much more carefully than in the past and that they are looking for more transparency and safety when it comes to cleared and non-cleared OTC derivatives.”

Helene Virello, BNP Paribas Securities Services

Pre-crisis, collateral needs were generally less frequent, less urgent and less likely to turn up empty-handed. Indeed, many firms’ collateral management functions – if they existed – were under-utilised, under-invested and, in the case of larger banks, fragmented across business lines. As such, the collateral implications of the post-crisis settlement have set many firms on the path to a major reappraisal. Although collateral is now needed to support a much wider range of activities, there are three key drivers. First, the Basel III capital adequacy framework requires banks to bolster their balance sheets with high-quality assets and also imposes new liquidity standards. Second, the G-20-mandated reforms to the OTC derivatives markets force many swaps to be centrally cleared, obliging market participants to post collateral in support and with central counterparties. For many on the buy-side, this involves setting up entirely new processes, Third, swaps that cannot be centrally cleared will be subject to both initial and variation margin for the first time.

Dealing with the unexpected

Many of the new rules kick in next year, but the regulatory timetable rolls on to 2020, gradually increasing demand for high-quality assets. Under normal market conditions, the post-crisis rules might add US$4 trillion to global collateral demand, but stressed market conditions could more than double that level, throwing into question the ability of market participants to get their hands on the assets they need.

In addition, compared to pre-crisis, firms and regulators are now much keener to protect assets and more focused on counterparty risk. Macro-economic conditions also act as a brake on collateral velocity: prolonged uncertainty promotes investor conservatism, potentially burying high-quality assets deep in buy-and-hold vaults.

The increased demand for collateral leads to a number of responses. Market participants need to get better at understanding how much collateral they have, how much
they need, and how to deploy it effectively. If they don’t have enough of the right kind of collateral at the right time, service providers need to help out, working with market infrastructures to facilitate access, valuation and exchange of assets.

Because many had never had to post collateral to a CCP before, and therefore had few existing in-house collateral management capabilities, the buy-side have generally been reckoned to have the biggest post-crisis change of requirements.

According to EY’s 2014 survey of risk management for wealth and asset management firms in EMEIA (Europe, Middle East, India and Africa), with the exception of liability-driven investment and hedge fund firms, most houses were not focused on following which CCPs were being authorised, how to tackle client clearing or how to optimise their risk capital. A total of 56 percent of firms were concerned about a future scarcity in quality collateral (defined as pledged as titled and fully fungible), compared with 48 percent in 2013. Thirty percent of respondents had run or were in the process of conducting a selection process across their brokers and custodian banks to assess their collateral management, execution and prime services. A total of 45 percent of firms were concerned there might be extra costs arising from using OTC derivatives, while 41 percent said they had conducted a study to look at acceptable collateral.

For these asset managers, the challenge is made stiffer by the fact that the assets regarded as eligible for collateral by CCPs – typically medium- to long-term debt issued by AAA-rated sovereigns – do not generate high returns for clients and as such are not kept close at hand. But asset managers that are part of large insurance firms typically already have a repo and/or securities lending desk with the skills and the market connections to gain access to the collateral they need. Similarly, the cash management skills developed to handle redemptions and cor-

“I wouldn’t say tri-party agents have an advantage over other custodians in the collateral management space, but there will certainly be an increase in use of tri-party agreements to support the posting of the right collateral with the right counterparty.”

Neil Wright, Sapient Global Markets
Collateral management

Corporate actions can be leveraged to respond quickly to margin calls.

Helene Virello, head of collateral management, BNP Paribas Securities Services (BNPP SS), says buy-side collateral management requirements have evolved. "It is now clear that buy-side firms need to manage their collateral much more carefully than in the past and that they are looking for more transparency and safety when it comes to cleared and non-cleared OTC derivatives," she comments.

Custodians such as BNPP SS have been upgrading their collateral management capabilities to provide an end-to-end service. Typically these services cover three distinct areas: middle-office servicing, which covers transaction management, reporting, evaluation and portfolio reconciliation; capital markets operations, which optimises, transforms and allocates collateral, with financing if necessary; and settlement and custody, which covers the traditional responsibilities of the custodian for ensuring assets are segregated and protected effectively.

It is this second area that is the most complex, because it requires the provider to have a global inventory of the client’s assets, positions and exposures, access to a broad array of assets through accounts and arrangements with market infrastructures, and the ability to identify the right collateral for the job. In BNPP SS’s case the process is highly automated, with a complex algorithm used to aggregate the many inputs and charged with selecting and allocating the necessary collateral to

“Right now, proactive management of assets held by custodians is a relatively complex paper chase, but once T2S creates a single standardised platform for securities settlement spanning 24 CSDs, asset managers will have access to a much deeper collateral pool of CSD-titled assets.”

Dr Anthony Kirby, EY
Collateral management

the correct counterparty. A crucial factor is timing. Virello admits that collateral managers often face a race against the clock to go through the necessary channels to secure the required collateral, especially if they are not also servicing the client’s assets. For this reason, BNPP’s algorithm works in real-time.

She also points out that the range of collateral management services is evolving in line with regulatory drivers, such as the central clearing mandate.

“If a buy-side firm is not comfortable posting margin directly with a counterparty – for example a broker – it can opt instead to hold it in a segregated account with a third-party custodian which offers a separate and safe, but accessible, legal and operating environment,” says Virello.

CSD support

Custodians are also partnering with central securities depositories (CSDs) to hold client collateral required in support of a margin payment to a CCP, which under the European Market Infrastructure Regulation must be held in a securities settlement system. For example, BNPP SS supports the full-segregation client protection model announced by CME Clearing Europe, which segregates collateral with an external custodian at the client level. SIX Securities Services was the first CSD to support the model, meaning collateral posted with CME Clearing Europe can be held in BNPP SS’s account at the CSD.

As well as these new arrangements between custodians and market infrastructures to support market participants’ collateral management needs, collateral managers are crossing the line between the two. BNY Mellon has established itself as a CSD in support of its drive to provide clients with access to collateral, while J.P. Morgan has developed a partnership with globeSettle, the new Luxembourg-based CSD launched by the London Stock Exchange Group for similar reasons. Both US firms are also major European tri-party agents, along with CSDs SIX Securities Services, Euroclear and Clearstream, which means they can act on behalf of clients in the repo markets in pursuit of collateral transformation opportunities.

Neil Wright, industry advisor at Sapient Global Markets, says rising collateral needs will increase the proportion of tri-party repo deals. “I wouldn’t say tri-party agents have an advantage over other custodians in the collateral management space, but there will certainly be an increase in use of tri-party agreements to support the posting of the right collateral with the right counterparty,” he says.

For many market participants, the big collateral management question is: how much do I outsource? Clearly, the challenges are complex, but the optimisation and transformation services are not cheap. The answer may come down to individual circumstances and philosophy. The asset manager that wants to exercise control and expects to use derivatives regularly in its investment strategies may well choose the in-house route.

“AS long as you have the resources and data to take informed decisions on posting collateral, it is entirely feasible to take matters into your own hands, says Wright.

EY’s director of regulatory reform and risk management, Dr Anthony Kirby, suggests that the in-house route may become easier as market infrastructure developments pave the way for smoother access to collateral. “TARGET2-Securities (T2S) could be an eventual game-changer in terms of asset managers’ access to collateral by 2017,” he says. “Right now, proactive management of assets held by custodians is a relatively complex paper chase, but once T2S creates a single standardised platform for securities settlement spanning 24 CSDs, asset managers will have access to a much deeper collateral pool of CSD-titled assets. This should lead to a greater capacity for auto-collateralisation of flows by asset managers that could increase their trading velocity.” •
One session at Sibos in Boston, entitled ‘Market infrastructure crystal ball: what the future might bring and how to get ready for it’, included contributions from, among others, Thomas Zeeb, CEO, SIX Securities Services. Radar asked Chris Hall, Editor, Sibos Issues, to reflect on whether financial market infrastructures are at the mercy of the unknown.

On the tablet of universal laws, somewhere between Newton’s third law of physics (“for every action there is an equal and opposite reaction”) and Murphy’s law (“what can go wrong, will go wrong”), lies the law of unintended consequences. Researched and codified in the 1930s by US sociologist Robert Merton, the law reflects on the unpredictability of effecting change in complex systems, largely due to vested interests and human infallibility (best summarised as, “we can’t agree on everything and we can’t know everything”).
Students of financial markets regulation will have noticed all three laws at work in the efforts of politicians, regulators and institutions to remake the industry in the aftermath of the global financial crisis. Attempting so many structural changes in so little time may be necessary, but it is not without risk. One of the central strands of the post-crisis reforms has been the migration of counterparty risk from banks to financial market infrastructures (FMIs), notably through the trading, clearing and reporting of OTC derivatives on centralised, openly accessible utilities. This represents a profound change in the role of FMIs, which have evolved gradually and sometimes idiosyncratically in national markets to mutualise risks and conduct common processes cost-effectively for members.

Though inevitable, the fact that this shift takes place in parallel with a forced overhaul of the business models and balance sheets of FMIs’ primary users clearly invites the law of unintended consequences.

These issues were debated at Sibos in Boston, notably in ‘Market infrastructure crystal ball: what the future might bring and how to get ready for it?’, which included SIX Securities Services CEO Thomas Zeeb among its panellists. Speaking to SWIFT’s Sibos Issues ahead of the session, Zeeb shared his fears over the “onerous” implications of mandatory clearing of OTC derivatives on central counterparties (CCPs). “I can perfectly understand the perspective of the regulators,” he said. “The question, however, is whether a commercial organisation will continue to want to operate and invest in businesses which have had market and regulatory risks transferred to them.”
“There is a huge opportunity for expansion by CSDs. But to grasp it they must become more international in scope and they must move up the value chain, for example into corporate actions and collateral-related services such as segregated accounts.”

Diego Valiante, European Capital Markets Institute

however, is whether a commercial organisation will continue to want to operate and invest in businesses which have had market and regulatory risks transferred to them.”

To perform their existing roles and to compete for new business, CCPs have had to comply with CPMI-IOSCO ‘Principles for Financial Market Infrastructures’ as well as new legislation which has varied in detail and schedule across G-20 jurisdictions. In the European Union for example, CCPs have had to undergo a reauthorisation process to supply clearing services under the European Market Infrastructure Regulation (EMIR), entailing reappraisal of risk management, collateral management and default and funding arrangements, as well as the development of new account structures, against a backdrop of a constantly shifting deadline for the commencement of central clearing for different asset classes and counterparts. At present, clearing members must be ready to clear the most liquid interest rate
swaps from Q3 2015, with the subsequent timetable rolling out over the next three to four years.

At the same time, CCPs are being asked to put in place new recovery and resolution arrangements in keeping with the new role regulators have assigned to them. European legislation on CCP resolution is expected in 2015. Central banks are already working with CCPs to address systemic risk concerns. Addressing a conference in London in November, David Bailey, director, financial market infrastructure at the Bank of England said that, “CCPs must consider the recovery tools that they would employ if a non-default loss depletes the CCP’s capital. It is, however, important that recovery arrangements do not dis-incentivise effective management by CCPs of their non-default risks. CCPs should bear at least the first tranche of the loss with an amount of their own capital providing a clear incentive to prudently manage these risks.”

In effect, CCPs are being pushed through a series of regulatory hoops in preparation for a market demand that may not materialise as anticipated, potentially placing them at the mercy of all three of our laws. The situation is made more uncertain by the challenges facing clearing members. Basel III capital restrictions dictate that clearing members focus their balance sheet resources where they can expect the highest returns; i.e., on major clients, rather than extending their services to the mid-tier firms that have never before had to centrally clear. This economic disincentive to offering indirect clearing services could effectively bar potential customers from central clearing, limiting future CCP volumes and revenues.

For European central securities depositories (CSDs), there are similar but not identical challenges ahead. Both the introduction of TARGET2-Securities – the European Central Bank’s harmonised securities settlement platform – and EMIR’s incoming requirement for CCPs to hold collateral in securities settlement systems encourage CSDs to develop new services. “There is a huge opportunity for expansion by CSDs,” says Diego Valiante, head of capital markets research at the European Capital Markets Institute. “But to grasp it they must become more international in scope and they must move up the value chain, for example into corporate actions and collateral-related services such as segregated accounts.”

But at the same time the regulatory burden is intensifying. Blogging in Boston, SIX’s Zeeb noted the tension between business development and systemic integrity and stability: “FMIs have a key part to play in maintaining the integrity of the financial system through the flow of high-quality collateral. If you ask any CSD, each one would agree that CSDs shouldn’t compete on quality of collateral. Regulators have a role to play here by guiding FMIs on issues.”

European CSDs are already undergoing a period of process harmonisation, including migration to T+2, under the European Commission’s Central Securities Depositories Regulation and face the same resolution and recovery demands as CCPs, while being expected to help address the industry-wide challenge of mobilising collateral to support OTC derivatives clearing and the capital and liquidity requirements of Basel III. “It is inevitable that the new rules aimed at reducing systemic risk – such as the increased collateralisation of transactions and requirements for account segregation – will reduce the velocity of collateral. FMIs are already doing a lot to reduce the impact of this slowdown – for example real-time risk management is now a reality - but they still face many sources of uncertainty resulting from the regulatory reform process,” says Valiente.

Among all this reform, it might seem unwise to suggest yet another law, but perhaps there is a need for one more law to bind them: “When proposing two or more new regulations, do not proceed without first considering their interdependencies.”
For more than two decades, Philippe Metoudi has observed the development of markets in the Asia Pacific region from close quarters. *Radar* asked him to sum up the progress he has seen in post-trade operations.

“In 1992, I went to Mumbai to visit a sub-custodian,” recalls Philippe Metoudi, now managing partner, AlfaSec Advisors, in Hong Kong. “Someone took me to a gigantic room full of physical certificates. It was shocking; floor to ceiling. He told me that the trade failure rate was 95 percent. I remember asking as a joke if he could show me the
5 percent that settled on time. He said, ‘No, I don’t know where they are.’

From those dismal days, the principal markets in Asia Pacific have made spectacular advances. “Overall, they are in pretty good shape. In the last 10 to 15 years they’ve made huge progress,” says Metoudi. The key markets in the region are close to international standards and in some cases have turned previously perceived drawbacks into advantages. In some markets, for example, accounts had to be held at investor level rather than in omnibus structures. “During the crisis, a lot of investors were asking for their holdings to be in their name and these markets were able to convert problems into competitive advantages,” he says.

Markets have also grown in breadth. “When I started my career, there was virtually no securities lending in Asia. Now everybody has it and overall it works fairly well,” says Metoudi. He stresses, however, that Asia is far from homogeneous. “Most of the transactions in each market are domestic,” he says. “If you talk to Hong Kong investors, the majority of their investments will be in their local market and the same applies elsewhere in the region.”

**Bilateral links**

The impetus for closer operational links among Asia Pacific markets has therefore come mainly from CSDs and exchanges. “They are hoping that by linking to other markets, they will experience an increase in efficiency as well as new revenue opportunities,” says Metoudi. There is, however, insufficient volume at the moment to support an expansion in bilateral links. For the moment, he suggests, “We are still looking west and deciding what could be applied in Asia. Believe it or not, there are discussions about having a possible TARGET2-Securities Asia, but that is not something that is going to happen tomorrow given the lack of a common currency.” In addition, says Metoudi, part of the ICSDs’ strategy is to offer these markets through their hub and spoke structure.

Metoudi does, however, see one new development as a potential game-changer: Shanghai-Hong Kong Stock Connect, popularly known as Shanghai Connect. Launched in late November, this new operational link allows foreigners to access China’s mainland ‘A’ shares through brokers on the Hong Kong exchange (HKEx) and investors on the mainland to buy Hong Kong shares through their Shanghai brokers. Shares bought through Shanghai Connect are held in custody in their respective markets.

The scheme is subject to quotas, both daily and total, which to date have not been exceeded. Purchases through the link are capped at 13 billion yuan a day and 300 billion yuan in total for mainland stocks and 10.5 billion yuan and 250 billion yuan respectively for Hong Kong Stocks.

“In the financial markets in Asia I think you’re going to have pre- and post-Shanghai Connect,” Metoudi says. “My colleagues at AlfaSec, Roger Harrold and Giles Elliot, have done a lot of work with customers looking to prepare for Shanghai Connect. I think many observers are underestimating its potential impact.” He suggests that while initial volumes have been good, it will become an issue of business retention. “If you don’t have that capability, you will lose customers,” he says.

He does not, however, expect Shanghai Connect to kickstart similar initiatives between other market centres in the region. “Shanghai Connect is an obvious link,” he says. “First, Hong Kong and Shanghai sit under the ‘one country, two systems’ umbrella. Secondly, there is obviously a political will to make this happen.” No doubt, he suggests, there are specific investors who would welcome further market linkages for collateral management purposes, but, he adds, “Most of the fund managers we speak to in the region are not that engaged with the idea. Intra-Asian trade volumes are, after all, still quite low.”
Earlier this year, the ECB published a series of interviews conducted by Mehdi Manaa, Head of the Market Infrastructure Development Division, Directorate General Market Infrastructure and Payments, European Central Bank with representatives of different segments of the value chain: issuers, investors, banks, CSDs and CCPs.

The questions covered business as well as technical and regulatory considerations. The excerpts below suggest that at the start of the securities transaction chain, appreciation of the consequences of T2S is far from uniform.

The investor

Mick McAteer, Director of The Financial Inclusion Centre/Chairman of the Financial Services User Group (FSUG)

In your opinion, what benefits could investors expect from T2S?

In theory, T2S should deliver tangible benefits for end-investors. The European financial market infrastructure is, let’s be frank, ridiculously complex and fragmented – certainly compared with the US system. T2S, if implemented properly, should address much of the unnecessary complexity and fragmentation in our market infrastructure and lead to a streamlining of the critical processes involved in market transactions. Furthermore, in theory, there should be more competition amongst central securities depositories (CSDs). This could result in significant reductions in settlement costs which, if other parts of the market supply chain are working and regulators are supervising markets effectively, could in turn lead to reductions in costs for the real customers of financial markets – end-investors and real economy firms.

Similarly, in theory, T2S should contribute to the development of more stable and resilient financial markets. The less fragmented infrastructure and more streamlined processes should also allow for better monitoring of financial markets and in turn more effective systemic risk management.

There is an additional, less obvious ben-
The issuer
*Markus Kaum, Head of Division at MunichRe/Chairman of Joint Working Group on General Meetings*

Do you expect T2S to trigger regulatory changes that will affect issuers?

Most market participants currently see T2S as a settlement engine, which will not change the regulatory environment. I personally believe that T2S will provide better efficiency and increased speed for cross-border security transactions and that both effects may expose national or certain service providers’ inefficiencies, as the users will be able to make an unhindered assessment of such services. Some intermediaries argue that, in order to reap the full benefits of increased efficiency and speed within T2S, “regulatory changes” may be required even before T2S is fully operational. These calls for regulation seem to mainly concern legislative proposals which have turned out not to be acceptable to investors and issuers across Europe so far.

As an issuer representative I would argue in favour of first implementing T2S fully before discussing the regulatory changes that some market participants believe to be necessary. Both as an issuer and investor we strongly favour the approach of T2S achieving the envisaged results mainly by improving market infrastructure. While T2S itself provides a new level above existing national market infrastructures, all the envisaged benefits will only be achieved when existing market infrastructure and IT technology, especially exchange-traded funds (ETFs), which will adopt the T+2 settlement cycle. However, indirectly, there will be an impact:

- on the buying and selling of the underlying assets;
- on collateral: in a more remote manner, T2S could impact negatively the quality of the collateral delivered to hedge derivatives (both for bilateral and for centrally cleared transactions) as it will facilitate access to central bank funding through delivery of high quality assets against credit line facilities.

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*Mick McAteer, Financial Services User Group*
at global and local custody banks, are also improved in order to deliver state-of-the-art operations to issuers and investors.

Although I would not expect a tidal wave of regulatory changes as a result of the introduction of T2S, there are certain areas where regulatory changes are needed in order to improve the current situation with respect to cross-border security transactions, especially as regards the free exercise of rights of investors that have acquired a security. For instance, from the point of view of an investor in registered shares, the transfer of the shareholder data from the end-investor to the issuer is very well organised domestically in all major European markets but there are severe, sometimes insurmountable problems when it comes to the transfer of those end-investor data across borders. The introduction of T2S may even lead to a greater lack of transparency, especially in situations where competition among CSDs will lead to issuers or investors moving out of their traditional markets with respect to either central or investor custody of securities. As a result of both issuer and investor demand for the unhindered exercise of shareholder rights across borders – which is based on the mutual knowledge of investors and issuers – I expect regulatory change to bring pan-European clarification that end-investor data has to be forwarded from the bank the end-investor banks with to the issuer. This can be achieved very easily, and hopefully will be achieved within the context of the revision of the Shareholder Rights Directive.

As a further but more indirect result of increased cross-border investment in Europe I would expect formalities to be harmonised and regulated on a European level. For example, currently the proof of entitlement presented by an end-investor (shareholder) to an issuer, showing that a certain person is indeed a shareholder, is not harmonised within Europe. A certificate issued by a bank in one Member State to one of their customers may not be recognised by an issuer in another Member State due to formalities. End-investors will no longer accept that they cannot exercise their shareholder rights across borders owing to such differences in formalities.

Susannah Haan, Secretary General, European Issuers

To what extent are issuers following the T2S Programme?

Most issuers are not really following the programme – only a minority among my members are interested.

Do you think that they have access to the right level of detail and documentation regarding T2S?

No, I don’t think that they have access to the right level of detail – companies want high-level summaries of the key points relevant to them; normally there is too much technical detail for the subject to be accessible to most issuers, hence in part the lack of interest. What would be useful would be a one-page summary from time to time, written in business language that issuers can understand, i.e. not too much technical jargon, and more focused on the issues that companies care about.

Do you think that this will allow them to measure the changes and opportunities that T2S implies for issuers?

As to whether we will be able to measure the changes – the danger for us is that T2S may lead to more cross-border settlement and that more cross-border transactions will mean less access to information for issuers, and so companies will continue to lose information on their shareholder base as it becomes more international. So T2S could be more of a threat than an opportunity from the issuer perspective. This we can measure via anecdotal evidence; probably the CSDs would have better access to information on the market as a whole.

The full interview series can be found here: https://www.ecb.europa.eu/paym/t2s/pdf/specser/T2S_SpecialSeries_issue4.pdf
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