

**AFME Post Trade Clearing and Settlement Committees:  
Response to the CNMV Consultation paper of 14.01.11 on  
Proposed reforms to Spain's securities clearing, settlement  
and registry system**

The Association for Financial Markets in Europe (AFME), through the Clearing and Settlement Committees of its Post Trade Division, is pleased to respond to the consultation of CNMV on proposed reforms to Spain's securities clearing, settlement and registry system.

The Clearing and Settlement Committees of AFME's Post Trade Division, comprising senior operational representatives of its member firms, have consistently emphasised the benefits and desirability of the reform of these processes in Spain. We warmly welcome these proposals and the opportunity to provide our input, and are willing to actively participate and continue to cooperate in the further development and ultimate implementation of the proposals.

**1. Information about the respondent**

Association for Financial Markets in Europe (AFME)  
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United Kingdom  
[www.afme.eu](http://www.afme.eu)

- Field of activity of the respondent's members:  
The respondent's members conduct domestic and cross-border securities operations in the EU/EEA area in their capacity as financial institutions in a wide range of banking activities, on behalf of their customers and for their own account.
- The respondent's members are securities account providers in the context of European and national regulated activities.
- AFME's members and membership structure:  
Of the broader AFME membership (see [www.afme.eu](http://www.afme.eu)) the following members – investment banks, regional and global custodians and wealth management / private banking entities– actively participate in the Post Trade Division:

Bank of America Merrill Lynch  
Barclays Capital  
BNP Paribas  
BNY Mellon  
Citi  
Credit Suisse  
Deutsche Bank  
Goldman Sachs  
HSBC  
J.P. Morgan  
Morgan Stanley  
Nordea  
Pershing  
RBS  
UBS  
UniCredit

## **2. Key points of our consultation response**

In essence, our response emphasises the following points:

- We welcome the proposal to reform the system of registration in Spain, and urge the Spanish authorities to fully eliminate all requirements of this nature, including both abolition of the Registration Name concept as well as the RR. It is crucial that Spain takes this opportunity to implement full reform in a harmonised approach with the rest of Europe;
- We welcome the implementation of a CCP in Spain, and urge the Spanish authorities to consider both the implementation of an existing European CCP and, in due course, interoperability;
- We are concerned about proposals that imply a regulatory role for the CSD Iberclear, and would urge the authorities to reconsider this approach;
- In all cases we would urge the Spanish authorities to adhere to the provisions of the relevant European post trade instruments, namely the Securities Law Directive (SLD), European market Infrastructure Regulation (EMIR); Settlement Finality Directive (SFD) and the ongoing CSD Consultation, and to ensure that Spain takes a lead, alongside the other major markets, in ensuring harmonised approaches to post-trade processing in Europe.

### **3. Responses to the questionnaire**

Our responses follow the order of the document. In addition to answering your specific questions, we have included comments on several draft paragraphs. These comments are included below according to their order of appearance in the original document, and all numbering from this point on related to the numbering in your document.

### **3. Institutional aspects, legal regime, risk management and CCP participants.**

#### **3.1 Role and implications of a CCP**

##### ***Q 1. What do you think of curtailing the assignment process?***

We agree that this is an excellent step to take.

##### ***Q 2. Do you think the aggrieved party should receive the penalty imposed, eventually, to the party in breach?***

We agree with the principle of compensating the aggrieved party. We refer you to our own paper on Market Discipline, and the work of the Harmonisation of Settlement Cycles Working Group, which describe in some detail the standard approach we would prefer to see taken to market penalties and buy-in procedures. We would also comment that in our view any penalties should be redirected into compensation and/or system improvements for the benefit of all participants. They should not be a source of revenue for the body managing the regime.

#### **3.2 Regulatory framework: draft European Regulation**

##### ***Q 3. Do you consider that the elements described above are sufficient to enable CCPs to be managed professionally, independently of their ownership structure? Do you consider additional factors should be added?***

We support the revision of Article 44.bis to allow for CCP services to be provided by entities other than the CSD/*Sociedad de Sistemas*. We support the proposal that the CCP should be ring fenced, within whichever alternative ownership structures ensure safety and soundness. We do not believe that it is necessary for a CCP operating in the Spanish markets to be a Spanish corporation. Firstly, this would make the implementation of interoperable solutions extremely difficult; and secondly, it would remove the ability to select one of the already existing European CCPs to clear the Spanish market. In addition, the introduction of a new CCP in Spain would further fragment the EU post trade environment and therefore create additional risks and frictional costs. We would draw CNMV's attention to the implementation of clearing in Scandinavia, which allowed for the appointment of non-domestic CCPs from the beginning.

***Q 4. Do you think it should be legally binding to channel multilateral trades in equities listed in the stock exchanges via a CCP?***

Yes, we agree with this proposal providing the securities are liquid; in other words, we believe that CNMV should adopt the same principles as in EMIR.

***Q 5. Do you think the reform should be addressed on a joint basis so that the CCP handles both equities and fixed-income securities?***

We agree that it would be very good to have a CCP for equities and fixed income; but it is not necessary for the services to be provided by the same entity. In other markets we find operation is smooth and efficient using different existing entities for each.

***Q 6. Do you think the use of the CCP should be optional in markets where trading is not multilateral (e.g. fixed-income outside the electronic platforms, block trades, OTC trades in equities)?***

Yes, we agree that use of a CCP should be optional for non-electronically traded fixed income, block trades and OTC.

**Section 3.8 Conflicts of interest and corporate governance in CCPs**

***Q 7. Do you consider that the conditions set out above about the CCP's corporate governance are sufficient?***

Yes. We would refer to EMIR, and urge the CNMV to adopt the standard approach on corporate governance in it.

**Section 3.9 CCP risk management, capitalisation, management of collateral, and access to liquidity.**

**Para 54:** We do not agree that a CCP's collateral acceptance criteria should be the same as for the Eurosystem's credit operations. Currently CCPs set their own criteria, which are similar to one another's rules but not necessarily identical, and we see no reason to impose an external measure which may not be appropriate or sufficiently flexible in the case of a Spanish CCP.

**Para 55:** We would expect the CCP for Spain to adopt practice in line with European best-practice in this area. Any existing rehypothecation practices should be fully transparent to CCP members (within the rule book) and must not reduce the safe and sound operating of the CCP. Any new rehypothecation arrangements should only be introduced after consultation with CCP members.

***Q 8. Do you think it is necessary that the CCP have access to overnight liquidity from the Eurosystem?***

Although we do not object to CCPs taking up the option of overnight liquidity from the Eurosystem, we do not believe that this should be an obligation for CCPs. This point is currently being debated as part of the European Commission's post trade legislative process, and we advise acting in

accordance with the outcome of these deliberations. Note that CCPs are constantly running dynamic risk management processes, i.e. their processes are necessarily intraday and therefore not entirely suited to an overnight process.

### **Section 3.10 Interoperability between CCPs: risks and additional requirements**

We wish to state our preference for interoperable CCP solutions for the cash equity markets across Europe. Interoperability would enable users to consolidate clearing arrangements at fewer CCPs, allowing significant benefits in terms of risk management and cost efficiency. Cash equity trades in the same security, dealt on several trading venues, could be netted into a single obligation for settlement at the home central securities depository (CSD). The number of payments to margin and default funds would reduce contrasting with existing arrangements, where participants contribute to multiple funds depending on the CCP chosen by the trading venues. This process need not impose costs on those members that wish to remain with the incumbent.

Appropriately framed interoperability arrangements will significantly increase competition and efficiency in the European cash equity markets and can be constructed in a way so as to not to increase risk and ultimately could benefit end investors such as pension funds.

In summary:

- AFME and its members are strong supporters of choice, and hence interoperability, to address the issue of fragmentation in the cash equity clearing space.
- There are genuine efficiencies to be gained by consolidating transactions into fewer CCPs at both the clearing and settlement layers.
- We support robust arrangements for the management of risk by the CCPs.

### **Section 3.12 Failed transactions management mechanisms in the CCP**

**Para 65.** We question the notion of a buy-in becoming applicable “from the moment a CCP becomes aware of a shortfall”. We refer you to work by AFME and the European Harmonisation of Settlement Cycles Working Group (HSC WG) on standardised buy-in mechanisms for Europe, and recommend implementation of a standard regime.

**Para 67:** We fundamentally disagree. A CCP should never be permitted to use member collateral for any purpose other than default management.

**Para 68.** We do not believe that it is helpful to impose cancellation of the trade within such a short timeframe, and refer you both to our response to the European Commission’s CSD legislation consultation paper, and to our previously referenced paper on settlement discipline. In both cases, we argue

for a harmonised approach to these aspects of settlement discipline across Europe.

In summary, we believe that the earliest point at which a potential fail is apparent is SD or SD+1. The first step should be for the participants to attempt to resolve the issue by whatever means and settle the trade. The next step should be a buy-in, on SD+3 or SD+4. Cancellation should only take place within the buy-in process. .

**Para 69. 1).** This provision implies that member collateral could be used to settle transactions. If this collateral is margin collateral, then it should be used for no other purpose than default management. Such collateral should never be used for settlement purposes. See also our comments on para 67 above.

***Q 9. Do you consider the proposed mechanisms for managing failed transactions to be appropriate?***

For the reasons outlined above, we do not fully agree with the proposals, and would urge you to take a lead in ensuring that these practices are harmonised across Europe.

We are in full agreement that good performance should be incentivized, and any penalties must be carefully targeted (on the offending party/source of the fail) in order to be effective.

The mechanism and information on which any penalties are based must be fully transparent to users.

We would encourage CNMV to adopt the principle that a penalty regime should not be a revenue source for the provider. Rather, any fees should be used to give redress to any injured party and be reinvested in system improvements that will support better performance across the market.

#### **4. Changes in the settlement system**

##### **4.1 Settlement by balances**

**Para 78.** It would be helpful to have more clarification on what is behind this proposal. We do not understand the logic of setting different settlement period for on-exchange and OTC trades. In a batch processing environment we can see that this might be necessary or workable, but in the future environment of T2S this is not relevant. Please also refer to our comments on the EC's CSD consultation.

***Q 10. Do you consider appropriate the proposed model of settlement by balances and the elimination of the RR?***

Yes. The elimination of RRs and the introduction of a model of settlement by balances will be a major step forward in reducing risk and strengthening the settlement model for the Spanish market, to the benefit of all participants.

## **4.2 Requirements for participants in the new settlement system**

### ***Q 11. Do you consider it necessary to impose solvency requirements on participants in the proposed settlement system?***

We believe that it is appropriate for the CSD to set reasonable solvency criteria for its members, and in case all account providers will be bound to abide by the requirements of the Securities Law Directive (SLD). We refer to our response to the EC's CSD consultation.

### ***Q 12. Do you consider the participant's proprietary account should be used to cover shortfalls in securities in its customers' accounts?***

In line with our response to the EC's CSD consultation, we believe that:

- If the CSD participant is solvent, then the CSD should take no action. The participant is responsible and should take the appropriate action as per its obligations.
- If the CSD participant is insolvent, then relevant action in line with the provisions of the SLD is appropriate. We would urge the Spanish authorities not to introduce provisions that are not part of the European standard.

## **4.3 Failed transactions management: the role of the CSD**

**Para 84:** While CSDs may facilitate securities lending to improve settlement performance, they should not be obliged to do so, and nor should members be obliged to use such facilities. We refer to our response to the EC's CSD consultation and urge the Spanish authorities to operate in line with the European provisions.

### ***Q 13. Do you consider that the proposed failed transaction management mechanisms are appropriate?***

Yes, these mechanisms seem appropriate.

## **4.4 System of penalties to compensate the non failing party**

### ***Q 14. Do you consider that there should be a mechanism of alternative compensation?***

A mechanism of alternate compensation may be workable, but it must be fair and transparent so that participants can be sure that the party responsible for the fail, not the entire chain, is penalised. We refer to our response to the EC's CSD consultation and to the work of the HSC WG on settlement discipline.

We refer to our comments above on applying the not for profit principle to any monies obtained via a system of penalties. Such monies should be used to compensate the injured party/parties; and if there is additional money or the injured party cannot be found, the monies should be reinvested in the system to the benefit of all participants.

***Q 15. Do you consider it appropriate to establish a penalty system so as to discourage settlement failures?***

Yes, this is fair as long as there is an efficient mechanism in place that facilitates on-time settlement. We refer to our previous comments on management of such penalty systems.

***Q 16. Do you think that the CSD should publish information on trades where settlement failed? If so, in what degree of detail and how often?***

Publication of information can be highly effective, but the data should be published anonymously to all but the party concerned. For example, reports can be published that show participants where they sit in a performance ranking relative to other members, without publishing the names of those other members. Similarly, it is salutary for participants to see publication of the fines levied in general in the market, without needing to 'name and shame' the parties subject to these fines.

The timing of such publication should relate to the fining periods - if fines are charged monthly then the information should be reported monthly, and so on.

**5. Changes in the registry system**

We warmly welcome reform of the registry system and would like to see both this and the introduction of a CCP implemented as soon as possible, preferably by the end of 2013. We believe that this is sufficient time for market participants to adapt their systems and practices.

We note that it is not proposed to remove the requirement for all intra-day third party account movements to be reported at the end of the day in order for a reconciliation to be performed between the CSD record and the Custodian record. This is a specifically Spanish process that we believe should be removed. It is not appropriate or necessary for the CSD to perform this reconciliation: the Banks are subject to full banking supervision and believe that this is adequate. It is essential that Spain harmonises with the rest of Europe by removing this process.

**5.2 Maintaining the single, two-tiered registry. Elements of synchronisation between the two tiers of the registry**

**Para 98:** It is not necessarily the case that the clients of the CSD participant "are the owners of the securities". In many cases they are not. We firmly believe that omnibus account structures and the chain of custody must be recognised and accepted.

**Para 100:** This is not acceptable. The CSD has no role in supervising the bookkeeping of its participants, and there is no need either for the CSD to take on this additional burden or to impose it on its participants. No other CSD in Europe has such a role nor is it envisaged that they should have. The introduction of such a requirement would create a barrier to access and put



the Spanish CSD at a competitive disadvantage. It would also certainly be identified as a barrier to smooth cross-CSD settlement within the T2S environment, and find its way on to an issue list of barriers to be eliminated before T2S testing.

As per our comment above, Banks across Europe are already regulated and supervised, and the role and responsibilities of account providers will be further defined and rendered more secure by the SLD.

### **5.3. Acquisition of securities and legal nature of investor rights**

***Q 17. Do you have any other legal comments on this issue?***

We have no other legal comments.

***Q 18. Do you agree with the introduction of the pro rata rule into Spanish law as the method for resolving securities shortfalls in the event of insolvency of a participant?***

Yes. We would expect Spain to comply with the SLD. Our stated position on shortfall in that context is as follows: "A harmonised rule seems to be in order to the effect that if there is a shortfall in an omnibus account, then the risk of a shortfall should be shared pro rata (which is the effect of e.g. the FSA Client Money Rules for cash, where a primary pooling event occurs). Segregated clients should not share the burden of a shortfall impacting the accounts of other segregated clients."

***Q 19. Do you agree with introducing this rule? If so:***

No, we do not agree, and request that Spain is compliant with the requirements of the SLD, without introducing any additional, non-harmonised approaches.

***Q 20. Do you consider that a rule such as the one proposed should be formulated such that all the securities in the insolvent firm's proprietary account may be used to cover any overall shortfall in securities in third-party accounts? or, on the contrary***

No. See 19.

***Q 21. Should the attachment of securities in the proprietary account be limited to the shortfall in third-party accounts of the same class of security?***

Yes.

### **5.5.2 Securities accounts and harmonised coding**

***Q 22. Which of the optional modes of record-keeping do you believe might be a suitable alternative to consider, and which do you believe should be ruled out?***

Various account structure options are possible within the CSD, but they should respect certain principles:

- All end investors should be placed in the same legal position (i.e. some end investors should not be able to benefit from legal privileges that others do not).
- CSD participants cannot be forced to segregate by end beneficiary. They must have the ability to operate multi-beneficiary accounts.
- There should be no discrimination between Spanish residents and non residents.

On this basis we believe that Option 3 would be the most suitable one to consider. However, as per our comment above, we would not support the exclusion of residents.

We would rule out Options 1 and 2 on the grounds that they do not follow our principles set out above, and seem to replicate aspects of the current registry system which we would like to see eliminated.

### **5.5.3 Entry of items in the accounts, and harmonised coding**

***Q 23. Do you agree with the need for harmonised discipline that regulates the accounts and book-entries, and that variations used by participants should be valid vis-à-vis the system?***

Our understanding of this technical question is that the alternate register will remain and continue to be Banks' responsibility, but that additional options will be opened up as to how this can be achieved (direct access or via an agent).

We believe that the reform should go much deeper than proposed, and refer to our previous responses on reforming/eliminating this process..

### **5.6 Control and supervision mechanisms by Iberclear and CNMV**

***Q 24. Do you agree with these general principles on the distribution and identification of tasks and responsibilities between Iberclear and the participants?***

See Q23 and above.

***Q 25. Do you agree with the proposed approach to control, cross-checks and daily and regular verification?***

We fundamentally disagree with the proposal that CSD participants' codification of their internal security account records must be "regulated and supervised by Iberclear". As per our responses to previous questions, Banks are already sufficiently regulated and subject to appropriate supervision. This proposal also gives us grave concern on harmonisation grounds: this is a specific proposal for Spain and we do not support non-harmonised

procedures.

***Q 26. Do you agree with the proposed approach to dealing with corporate/financial transactions?***

We wish to see Spain participating fully in the pan-European efforts to standardise and harmonise processes for Corporate Actions and General Meetings, with full implementation of the standards agreed by the JWG.

It is critically important that holder identification and information on balances is harmonised. Please take note of the work of the T2S Task Force on Shareholder Transparency.

We support the concept of a single primary source.

***Q 27. Do you consider that this is the right approach or can you propose substantial changes?***

As above, please refer to the work of the T2S Task Force on Shareholder Transparency. It is critically important that we have harmonisation of these processes across Europe.

**5.8 Participants' liability**

***Q 28. Do you agree with the foregoing approach?***

All provisions on participant liability should fall in line with the SLD, which lays out clear responsibilities for account providers.

We do not support the proposal to shift any oversight responsibilities from CNMV to the CSD. Provisions related to sanctions and penalties should remain within the remit of the regulator, not be transferred to a non-supervisory, revenue-generating entity.

We request clarity on how CNMV and Iberclear will operate with regard to supervision and control, and urge CNMV to ensure that any such rules and requirements are in alignment with other developed markets in Europe.

**5.9 Mechanisms for resolving errors in account-keeping**

**Para 161:** We agree that any shortfall is the responsibility of the participant and that these two options are feasible. We would reiterate that implementation of any such action in a shortfall situation is the responsibility of the participant.

***Q 29. Do you agree that the participants of the settlement system should cover shortfalls in securities in their customers' accounts out of their proprietary accounts?***

No. and we are very concerned about this proposal. We disagree, and refer to our previous responses, in particular to Q12, as well as to the SLD.

**Para 162:** This paragraph should be removed. Iberclear does not hold supervisory powers and therefore no such penalty system is appropriate.

## **6. Departure from assured delivery and amendment of the principle of finality**

***Q 30. In your opinion, does any other aspect of finality need to be considered at this time?***

Compliance with the Settlement Finality Directive (SFD) is the overriding objective.

***Q 31. Which of the three options for the time of finality at the CSD do you consider to be most appropriate from the standpoint of protecting the system?***

Whatever is implemented must be harmonised with the rest of Europe and compliant with the SFD: Spain must not impose its own point of finality out of line with the rest of Europe. In addition, under para 170.a. we suggest referring to CPSS-IOSCO.

## **7. Implications for the structure and competitiveness of Spain's financial sector**

***Q 32. Do you think overall system costs will be lower than at present?***

We are pleased that lowering cost is an objective, and we hope that reform will have this effect. It is our view that if a market follows the principles of harmonisation and remains consistent with other European practices then we would hope to benefit from lower costs and increased efficiency. We cannot guess whether your system costs will be; the costs of our members will be helped downwards by a consistent pan-European approach.

***Q 33. In your opinion, will eliminating RRs make settlement and registry processes cheaper?***

Yes, we would hope so, as the system should be made less labour intensive and therefore more efficient and with reduced risk.

### **7.3 Reducing the number of participants: market members, clearing members, settling members and custodians**

***Q 34. Do you think the changes to be introduced by the reform will reduce the number of entities performing these activities?***

We do not have a view on this. It is possible that the implementation of T2S will increase the number of direct Iberclear participants.

***Q 35. What other changes do you think the reform may produce in the current configuration of post-trade activities?***

It is difficult to predict at the current level of detail and with the restricted timeframe for responding to this consultation.

Implementing a CCP clearly introduces new service providers and new models into the market. For example, the GCM may not be the settlement agent, so the risk will move to the GCM from the settlement agent who may be different player to the risk-taker today.

#### **7.4 Functional specialisation**

***Q 36. Do you consider the introduction of non-settling market members to be a good idea?***

Yes, from our perspective the ability to provide GCM services to the market is beneficial.

***Q 37. Do you think separating settlement from custody/registry activities may be beneficial for some entities?***

Yes, unbundling may help drive cost efficiency and innovative service provision, although it is difficult to predict the impact without additional detail.