

## SUMMARY OF RESPONSES RECEIVED TO THE PUBLIC CONSULTATION ON PROPOSALS TO REFORM THE SPANISH SECURITIES CLEARING, SETTLEMENT AND REGISTRY SYSTEMS

---

18.03.11

### 1. Introduction

A total of 23 written responses were received from Spanish financial institutions (6 responses), branches in Spain of euro area financial institutions (3 responses), financial institutions from elsewhere in Europe (3 responses), associations, authorities and organisations in the financial sector in Spain and Europe (5 responses), and Spanish and European operators of securities market and post-trading infrastructures (6 responses). The responses received include a very significant representation of the European financial industry and particularly of European market and post-trading infrastructures and their members and users.

All of the replies include an opinion on the main proposals for reform set out in the consultation paper. The general comments and the replies to the 37 questions in the paper are summarised below.

Some respondents did not address all individual questions and others confined themselves to general comments. All responses were considered in assessing the degree of acceptance/rejection that is mentioned in each case. Some responses were from industry associations and were counted as if they were from individual institutions. Where an institution did not respond to an individual question but stated that it supported the position of its industry association, that response was not counted when assessing the acceptance/rejection of the individual question.

The replies from respondents who stated they would not object to their publication are published in a separate document.

### 2. General comments

The proposals for the reform of the securities clearing and settlement system met with a very favourable response, and practically all respondents agreed with the ultimate goal being pursued in terms of greater convergence of clearing and settlement practices with other European countries and facilitating integration of Spanish post-trading infrastructures into European projects.

Respondents supported the reform's basic proposals i.e. promoting the introduction of central counterparties for clearing stock market trades, replacing the current settlement system based on registry references (RR) with one based solely on balances, introducing standardised procedures for keeping securities accounts that offer similar features in terms of security and supervision, revising the current principle of assured delivery,

shifting finality from the point of trade to the point of settlement, establishing measures to incentivise discipline in settlement, including the possibility of cancelling trades as a mechanism for resolving incidents in the final instance, compensating the affected party for any loss, and covering the costs of resolving or mitigating any incidents.

Respondents agreed on the need to undertake the process as soon as possible, having regard to the various proposals for European legislation which will affect these matters (EMIR, SLD and CSDs) and their secondary regulation currently being developed by the ESMA (formerly CESR) as well as the recommendations of CPSS-IOSCO that were recently released for public consultation. Some respondents urged that the necessary reforms be undertaken as soon as possible, noting that any delays would have a negative impact on the Spanish securities market's competitive position.

Respondents were practically unanimous in that it is necessary to bear the costs of the reform despite the complexity of identifying and assessing such costs at this early stage, given the importance of not diverging from standard practice in Europe with a view to achieving a single market in investment services. Some responses noted the advisability of taking advantage as far as possible of investments that have already been made. Other contributors advocated that Spain should make use of the clearing services of CCPs that are already operational in Europe and insisted that post-trading services cannot be excluded from the existing European policy of free provision of investment services.

Most replies agreed that it is necessary to bear adaptation costs up front in order to attain a reduction in transaction costs in the medium and long-term, which will result in greater efficiency and make it more attractive to trade in the European Economic Area.

In strategic terms, there is a general consensus that separating clearing and settlement activities will have a positive effect in terms of risk management even though it will produce changes in the industry, including increased specialisation, the possible disappearance of some institutions that are unable to meet stricter capital requirements, and greater cross-border activity.

Most responses emphasised the need to avoid conflicts of interest between CCP users and owners by ensuring that the governance structures and risk management bodies are independent, guaranteeing transparency, and assuring non-discriminatory access mechanisms. Some respondents maintained that CCP participants should have an ownership stake and representation on the risk committee, particularly with regard to the design and the presentation of contingency mechanisms. Some responses suggested a business model for CCPs of limited profitability based on moderate transaction costs which do not discourage the proposed reforms or trading in the Spanish market.

There was general support for the system of penalties to discourage settlement failures that would not be confiscatory and would include a mechanism for alternative compensation. Some contributions considered that it is not advisable to combine a penalty system with one involving indemnity for the aggrieved party in breach since their underlying motives are different. All the responses emphasised that cancelling trades and cash or equivalent compensation should be last resort mechanisms.

Below are summarised the responses to a number of specific questions contained in the consultation paper.

### 3. Responses to questions.

#### 1. Restrictions on assignment process

Most responses (7 out of 13) were in favour. Two respondents were opposed on the grounds that restrictions would increase costs and that they preferred an assignment process via the third-party omnibus accounts, as in the case of fixed-income. Two other respondents made their reply conditional upon there being no increase in costs or restraints on operations (e.g. average prices and multiple allotment). Two other respondents did not express an opinion on the grounds that there was insufficient detail and that it was premature at this early stage.

#### 2. Whether the aggrieved party should receive the penalty that is imposed

A majority (10 out of 13) were in favour of the aggrieved party receiving the penalty for delivery failure. One respondent said that the aggrieved party should receive only part of the penalty. The other two did not express an opinion but one considered that any penalty should be moderate.

#### 3. Sufficiency of the elements described to enable CCPs to be managed professionally, independently of their ownership structure.

The majority of respondents (13 out of 14) considered that those elements are sufficient although some mentioned other elements that they considered to be desirable: the ownership model should include caps on stakes, there should be restrictions on cross holdings, formulas should be adopted to allow clearing members to participate in the management team and governance structures (board of directors, risk committee, contingency committee, etc.), risk control should be a function of the CCP ownership model, governance by users should be encouraged as well as autonomy in management and prevention of conflicts of interest. Several respondents said it would be advisable for there to be several CCPs providing clearing services and that they should be interoperable.

One of these respondents considered that the CCP should not have to be established in Spain in order to operate because this would complicate the implementation of interoperability solutions, making it more difficult for existing European CCPs to clear in the Spanish market and favouring fragmentation of clearing services in Europe.

The other respondent did not address this issue directly. Although they mentioned they were aware of its importance, they considered that the future EMIR Directive would provide sufficient scope for interpretation and application in each jurisdiction.

#### 4. With regard to making it obligatory to channel multilateral trades in listed equities via a CCP.

There was broad support (9 out of 13 responses) for making it obligatory to channel multilateral trades in listed equities through a CCP. Two of these respondents considered that it would be sufficient for the obligation to be imposed in the markets' regulations, without having to be included in the Securities Market Law. Respondents that opposed the idea stated that the CCP should consider what it clears and does not clear as a business option which should not be shaped by legal imperative.

#### 5. Whether it is advisable for CCPs to clear both equities and fixed-income securities.

The majority of respondents (10 out of 13) agreed with the idea that the CCPs should clear both fixed-income and equity securities. The other three respondents rejected the idea, arguing that the CCP should be free to choose its business model without obliging it to choose a specific service format.

#### 6. Non-obligation to use a CCP in a market where trading is not multilateral.

A broad majority (11 out of 13) respondents agreed that it should not be obligatory to clear trades through a CCP in markets which do not apply a multilateral trading model. The other two respondents considered that it should be obligatory.

#### 7. CCP corporate governance.

Most respondents (9 out of 12) considered that the conditions set out in the consultation paper are sufficient, although some nuanced that the requirements should be in line with European legal initiatives (EMIR). The other respondents did not reply to this issue and stated that the proposals need to be developed further in greater detail.

#### 8. Need for a CCP to have access to overnight liquidity from the Eurosystem.

Only half of the respondents (6 out of 12) were in favour of CCPs having access to overnight liquidity in the Eurosystem. Some of them considered that it would be useful to have access to liquidity for resolving incidents and one considered that it is an essential mechanism for reinvesting without collateral risk. Three respondents considered such access was unnecessary, at least on a day-to-day basis, although they did not oppose the idea; one believed such access should be confined to exceptional situation, i.e. that it would be very useful in the event of insolvency but should not be obligatory and not for everyday use. One respondent did not express an opinion.

#### 9. Whether the proposed incident resolution mechanisms are appropriate.

Most respondents (7 out of 13) considered the proposed mechanisms to be suitable for resolving incidents. Some considered that these mechanisms should ensure a fair system and conform to actual market practices. Two stated that cancelling trades should be viewed as a last-resort mechanism. Another considered it necessary to include the system proposed in EMIR for member insolvency and to harmonise the various mechanisms that exist in other markets. One respondent supported the measures but considered that more detail was required.

Other aspects mentioned included limits on availability of collateral, the treatment of the CCP as a system for finality purposes, and protection in insolvency proceedings. Additionally, respondents considered securities lending to be a potential source of systemic risk, and some considered that it should be confined to member entities.

One respondent did not explicitly support the proposed mechanisms and considered that some of them were expressed in terms that might not fully match the functions of a CCP, such as selling unpaid-for securities, which might no longer be the property of the member in breach and have become property of the CCP.

Another respondent opposed the use of buy-ins once the CCP observed a shortfall in securities on the grounds that the CCP needs sufficient time for manoeuvre before ordering a buy-in and that the earliest point at which a potential settlement failure becomes apparent is the time of settlement.

## 10. Opinions on the approach adopted for settlement by balances and elimination of RRs.

There was practically unanimous support for the proposed model from the 13 respondents that addressed this issue. One supported the idea of a single procedure for all instruments. Some respondents doubted the advisability of establishing different settlement periods for market and OTC trades, which would not be relevant in the context of T2S. Another respondent made more specific suggestions about the process of message exchange between the CCP, the CSD and the payment system, tallying of securities and cash, and finality. Others emphasised the importance of bilaterality for information purposes and failures and the advisability of establishing some sort of control over short selling.

## 11. Need to impose capital requirements on participants in the proposed settlement system.

The proposed approach gives CSD members more autonomy and responsibility because it eliminates the RR system and introduces a system of balances. A broad majority of respondents (9 out of 14) supported the introduction of capital requirements (some considered them to be essential), although one believed that it was more important to require sufficient collateral.

One respondent maintained that the capital requirements should be the same for settling trades from different markets and another stated that the current capital requirements for settlement, custody and registry should be maintained under an enhanced supervision system (cash checks and reconciliations, audits, standardised book-keeping methods, etc.).

The other respondents recognised that participants will assume greater responsibility under the new system, and one mentioned that the requirements for acceptance as a participant in certain central securities depositories already include capital requirements.

## 12. Advisability of using the participant's proprietary account to cover shortfalls in securities in its customers' accounts.

Nearly all respondents (10 out of 13) opposed the idea of using the participant's proprietary account to cover shortfalls in securities in its customers' accounts. Some respondents raised doubts as to whether this approach would be viable or even legal. Others considered it should wait for the final wording of the SLD, or that, if implemented, it should be confined to situations of insolvency.

## 13. Appropriateness of the proposed incident resolution mechanisms.

There was majority support (11 out of 12) for the proposed mechanisms although some respondents maintained that the CCP should be free from liability with regard to loans, expressed doubts about cancellation of trades, considered it necessary to introduce the possibility of partial settlement or continuous settlement processes, considered it necessary to be more specific even though they agreed with the general approach, or considered that the mechanisms should be confined to trades from the CCP.

The other respondent maintained that further development of the mechanism was required and that there should be coordination between the CCP and the CSD before they adopt a final position.

#### 14. Need for a mechanism of alternative compensation.

Most respondents (11 out of 13) supported the implementation of alternative (cash) compensation mechanisms. Some of them doubted that it would be possible to identify the counterparty. Others emphasised that the mechanism should not be a source of revenues for the CSD, should not include bilateral trades, and that it should be distinguished from penalties.

One of the other two respondents considered that the compensation mechanism is between two parties, whereas the penalty system is aimed at reinforcing efficiency of the settlement system, which are two different planes. The other considered that this mechanism was not necessary because they are bilateral OTC trades.

#### 15. Need to establish a penalty system so as to discourage settlement failures.

Most respondents (10 out of 13) support establishing a penalty system. One suggested distinguishing between failures due to technical problems and failures due to lack of securities or cash; another suggested that the system should not discourage trading in the Spanish market; and a third considered that, in chained trades, the penalty should apply only to the first party in breach.

Two of the other respondents consider that it is not necessary to establish the penalty system outside the CCP and noted that there are markets that work with a CCP where no penalty system has been established.

The remaining respondent did not have an opinion.

#### 16. Whether the CSD should publish information on trades where settlement failed. If so, in what degree of detail and how often.

Most respondents (9 out of 13) considered it advisable that the CSD should publish information on failed trades, although one of them made such publication conditional upon publication of the penalty report, with both publications having the same frequency. Three other respondents considered that publication should be anonymous. Four respondents prefer monthly publication, two preferred daily publication and the other two preferred weekly and quarterly frequency, respectively. The level of detail in the information would depend on who had access to it.

Of the four respondents who opposed publication, one considered that this sort of information is not normally published elsewhere in Europe, another did not consider publication to be necessary since we are dealing with bilateral OTC trades, a third saw no added value in publication, and the fourth stated that the information should be sent only to the regulator.

#### 17. Other legal factors with regard to the changes in registry.

A broad majority of respondents (10 out of 13) explicitly supported the proposed changes in registry. Some added the comments and suggestions set out below.

As regards registry oversight, one respondent mentioned that the proposed new system does not, in principle, increase the scope for defrauding clients. Two others suggested the possibility that the auditor certify the integrity and correlation of the balances between the first and second step, and the possibility of introducing mechanisms of resolving incidents in the detail registry. Another respondent warned that segregating accounts and giving the first step precedence over the second would have consequences

with regard to establishing liens or issuing ownership certificates. Another respondent suggested that the obligation to report intraday movements in the third-party account at the end of the day for reconciliation between the CSD and custodians should be eliminated.

With regard to the nature of investors' rights over the securities and the contractual relationship between CSD participants and their clients, one respondent considered that the title to the securities should be recognised as set out in the books of the CSD participant, and that the credit right would require harmonisation of the legislation with the other jurisdictions. Another respondent considered that the investor's right should be considered as a right *in rem* on the securities, held individually. Another respondent mentioned that it would be advisable to consider the extent to which the contractual relationship might be affected by the choice of the point of finality and the changes in the assignment process. Another asked for clarification about the client's rights from the time the order is issued until the trade is settled and how this might affect dividends, short-selling and attachments.

With regard to account segregation, one respondent expressed concern about the option of segregated accounts with a shared registry, while another noted that segregation might result in clients, particularly non-resident institutional clients, seeking protection against insolvency through segregation by pressing for a model of direct accounts; the respondents considered it prudent to define and limit who would have access to segregation. Another respondent advocated that omnibus accounts and the chain of custody should be recognised and accepted, and opposed the idea that the CSD supervise accounts in the second step of the registry.

The other three respondents did not explicitly express an opinion on the proposed changes in registry. One of them considered that it is necessary to define more precisely the nature of the investor's rights to the securities considering that, in a situation of changes to the current system of rights *in rem*, it would be necessary to analyse the consequences in other areas of law, such as tax law. They also requested greater clarity with regards to the hierarchy and the seniority of the accounts in the first and second steps.

#### 18. Introduction of the pro rata rule to resolve securities shortfalls in the event of insolvency of a participant.

Most of the responses (9 out of 11) explicitly supported this proposal, and almost all agreed that the ruling should only apply in the final instance, for example in the context of the legal proceeding, and that its impact on insolvency proceedings should be analysed.

One of the other two respondents considered that the first criteria to be applied when addressing the shortfall of securities are the registry principles (priority, chain of title, presumption of good faith, etc.) so that the pro rata rule would only be applied in exceptional cases where these principles proved insufficient to resolve a shortfall in securities. The last respondent did not give an opinion.

19, 20 and 21. Introduction of a rule whereby, in the event of insolvency of a participant, the securities held in its proprietary account may be used to cover shortfalls in its third-party accounts, and whether this rule should refer to all securities in the proprietary account or only those of the same class of security in which the shortfall arose in the third-party account.

The broad majority of respondents (10 out of 12) did not openly support this measure or expressed opposition, and asked for greater clarity in the proposed system, e.g. whether the proposal referred only to cases of insolvency or whether it would apply to shortfalls of securities arising in day-to-day settlement. Some respondents suggested that, in the case of insolvency, it would affect not only the proprietary account but also all of the assets of the failed entity; others noted the possibility that this approach might breach the principles of law.

Of the other two respondents, only one favoured this measure; the other did not express an opinion.

Since most respondents were not in favour of this measure, they did not reply to the other two questions. In contrast, some of them reproduced the arguments set out earlier and even considered that the lowest-impact solution would be to limit application to shortfalls in the same class of security.

## 22. Optional methods of keeping accounts that might be advisable, and forms of keeping accounts that should not be allowed.

The 13 responses diverged considerably with regard to account segregation. Some respondents favoured direct account keeping on a general basis or confined to certain ISIN codes, whereas others were opposed to the idea, while one of them warned about the risk of segregation as a mechanism for protection against insolvency which, if taken to the extreme, would lead to a system of direct account keeping. Some respondents called for a more complete debate over the need for direct accounts.

Most respondents opposed the use of omnibus accounts solely for non-residents and recommended that there should be no discrimination; however, some respondents considered that this possibility should not be confined to non-resident investors.

One respondent did not answer the question.

## 23. Need for harmonised regulation of accounts and book-entries, and that variations that may be used by participants be enforceable vis-à-vis the system.

Half of the 12 respondents considered it necessary to have a more standardised, disciplined methodology for keeping accounts, but that it should have some degree of flexibility and consider implementation and management costs as well as system users' opinions and needs.

Five other respondents mentioned that the current Spanish system already envisages coding accounts and movements, suggested confining standardisation to a standardised messaging format, expressed the opinion that it was not necessary to create intermediate accounts, and warned that the provisions of T2S and the adaptation costs need to be considered.

## 24. General principles on the distribution and identification of tasks and responsibilities between the CSD and the participants.

Slightly over half of the responses (6 out of 11) agreed with the proposals, and one mentioned that it would be advisable to establish proper divisions inside the CSD between the supervision functions and the provision of services to participants. Another did not expressly state an opinion but noted that Iberclear already has supervisory functions.

Another two respondents stated that it was advisable to define the CSD's liability regime more precisely and that the general principles on the distribution and identification of tasks and responsibilities should be shaped by the method of keeping accounts.

Another respondent considered it necessary to impose a system of responsibilities on the CSD if it is to have supervisory powers.

The last respondent did not express an opinion.

## 25. Methods of periodic oversight, balancing and verification.

A minority of respondents (5 out of 13) agreed explicitly, and one suggested that a special annual check should be included, while another asked for more clarity in the details of the oversight and supervision mechanisms.

A sixth respondent did not answer the question but considered that the proposed measures are in line with the European Commission's public consultation on CSDs.

Four respondents believed the checks to be too exhaustive in terms of number and frequency considering that they would apply to entities that are already under supervision.

Another respondent disagreed with giving CSDs supervisory powers.

The other two respondents did not answer the question. One considered it necessary to have more details about the proposed approach in order to be able to express an opinion, and stated that the objectives and goals of the new accounting registry system would require the CNMV to exercise direct supervision of the participants.

## 26 and 27. Whether the proposed approach to dealing with corporate actions is appropriate.

Most of the respondents (8 out of 12) opposed giving the CSD the exclusive right to manage corporate actions since these are standard transactions performed by participants and because it is advisable to separate the functions of CSDs and their participants. One of these respondents mentioned the advisability of standardisation with Europe in terms of the exercise of corporate right (dividend payment dates).

Two other respondents favoured centralisation on the grounds that it simplifies and facilitates reporting in the system.

The other two did not answer the question.

## 28. Approach to participant liability.

Five out of 11 respondents supported the proposed approach.

One of the 4 respondents who opposed the proposal maintained that the system of responsibilities should not alter the standards currently attained in Spain. Another proposed that supervision should be conducted only by the CNMV, while two others supported aligning the proposal with the SLD with regard to supervisory responsibilities and sanctioning powers.

Another respondent maintained that, in the final instance, lack of diligence might lead to withdrawal of a participant's licence. The last respondent did not answer the question.

### 29. Requirement that the participants of the settlement system should cover shortfalls in securities in their customers' accounts out of their proprietary accounts.

Most respondents (8 out of 12) opposed the idea, although some would support it if it were a last-resort mechanism.

One respondent suggested that it should be voluntary and another pointed out that this possibility is practically non-existent in other markets.

The other two respondents did not answer the question.

### 30. Aspects of finality not expressed in the consultation paper.

Of the 13 responses, 7 considered that the document already covered all relevant issues in this area.

Some of the other respondents mentioned the need for more precise definition of the time of finality, suggested that there might be a time lapse between finality in the CCP and the CSD which would need to be addressed, or considered that there should be convergence with the criteria of the Finality Directive.

### 31. Most appropriate approach to finality at the CSD from the standpoint of protecting the system.

Almost all respondents (12 out of 13) considered the best approach was to shift finality to the point of settlement, although two of them considered it should be at the time that sufficiency of securities and cash is confirmed (pre-funding), two others advocated the time of effective settlement, and two others proposed the beginning of settlement, once sufficiency of securities and cash had been confirmed. One of these respondents also mentioned that there should be no difference between finality at the CCP and the SCD, on the grounds that the only valid point is that marked in settlement by the existence of sufficient securities and cash. Another noted that it would be advisable to harmonise with general practice in Europe, which is that finality takes place at the time of settlement.

The other respondent preferred finality to be achieved when the trade is matched.

### 32. Whether the overall costs of the proposed system will be lower than at present.

Only one respondent (out of 12) considered that costs would be higher, due to changes in the assignment process.

The vast majority of respondents acknowledged that it is difficult to form an opinion at this early stage, but expressed a conviction and a desire that the reform reduces costs; as favourable factors, they identified netting, compression of trades in the CCP, and elimination of RRs. The scale of adaptation costs, the degree of complexity involved in the new registry system, the period for amortising investments, and the degree of convergence that is attained with European practices were cited as decisive factors with regard to the final cost reduction that is attained. One of these respondents suggested the possibility that a clearing member of a CCP might have several settling agents, which would eliminate transfers and, consequently, reduce costs.

The other respondent did not reply to the question but merely emphasised the importance of costs as a key factor for competitiveness.

### 33. Whether eliminating the RRs can make settlement and registry processes cheaper.

Four of 11 respondents believed that eliminating RRs can lower costs, while one disagreed and 5 raised doubts as to whether the new strengthened supervision, reconciliation and cross-checking mechanisms might increase costs. One respondent did not express an opinion.

### 34. Whether the reform will reduce the number of members, clearers, settlers and custodians.

The bulk of respondents (9 out of 13) consider there will be changes in the sector and some believe there will be concentration among clearing and settling entities as a result of specialisation, capital requirements, adaptation costs and scale economies, although they expect the number of custodians will not change. Some consider that greater specialisation plus harmonisation will bring in non-resident players. Two respondents did not express an opinion.

### 35. Other changes that may arise from post-trade reform.

Of the 11 respondents, 8 consider the reform may lead to outsourcing, the adoption of new business models and specialisation in clearing and settlement, as a result of greater standardisation with European practices, which will make it possible to use capital more efficiently and will make the Spanish market more attractive because of lower costs and operations that are clearer and simpler than at present.

The other three respondents consider that there is not enough evidence on which to base a reply.

### 36. Introduction of the non-settling market member.

The seven respondents that mentioned the idea of a non-settling market member approved the idea.

### 37. Possible unbundling of settlement and custody/registry.

The majority of respondents (6 out of 11) consider unbundling to be beneficial. Four respondents did not support unbundling on the grounds that those activities should be kept together because of their interconnections. One respondent did not express an opinion.