

UPDATE ON THE REFORM PROCESS TO THE SECURITIES CLEARING AND SETTLEMENT SYSTEM IN SPAIN

In line with the CNMV's commitment to inform periodically on the situation of the reform of the Spanish securities clearing and settlement system, which began with the public consultation paper from February 12 to March 15, the CNMV reports on the work carried out to date.

Summary of the replies received to the Consultation Paper

There have been a total of 15 replies, all of them from financial entities from within the Euro Zone, almost half are non-resident entities or Spanish branches of financial entities. A significant number of responses come from market and post-trading infrastructures, although most of them come from individual financial entities or from associations of financial entities.

All the responses, without exception, support favourably the reform initiatives and the main contents. At the same time, the responses back the intended scope of the reform, and believe these will impact in a positive way on the post trading services on Spanish securities. In addition, respondents expect compatibility with the operational processes of the T2S project. Some contributions underline the fact that changes must be faced urgently. The majority of respondents ask for a periodic update on the status of the reforms, especially at the moment when the details of the proposals are finalised.

There is unanimous support for the proposal to shift the determination of the settlement finality towards the time when the effective settlement is produced, and for revision of the guaranteed delivery principle. This will allow harmonisation of the settlement finality of shares with the existing one in the Iberclear settlement platform for the Spanish fixed income regulated markets and also harmonization with current market practice in major European markets. One respondent wonders if in parallel with the shift in settlement finality, the moment of the transmission of the associated legal rights will also change.

All responses support the proposal of establishing a Central Counterparty (CCP) in that the effects of netting and centralized risk management tend to improve efficiency in the settlement processes and in the use of collateral.

Some of the responses recommend selecting the services of the existing CCP in the Euro Zone, establishing a model which eases and guarantees its interoperability, with maximum transparency, sufficient resources, adequate risk management systems, access to immediate liquidity facilities and sufficient supervision. One respondent suggested that the use of the CCP must be mandatory in the settlement of multilateral trading in cash-equity and optional in bilateral trading. This respondent also recommended that clearing of fixed income trades shall be permitted.

The majority of the replies support the proposal of modifying the beneficial owners tracking system through the delivery of Registration References (RR) after the effective settlement has been produced. One contributor wonders if the maintenance of the RR could reduce the netting opportunities of the CCP.

Some of the replies ask for alternative mechanisms to RR to be explored, allowing market regulators the same capabilities of supervision and tracking. The goal is to favour harmonisation and to avoid falling into greater costs compared with other markets which do not use RR.

Summary of work carried out on CCP and risks

Discussions in this field have been focused on the analysis of some functional and institutional features of the CCP, the solvency requirements of the central counterparty and its participants, the mechanisms of risk management and the procedures to manage failed transactions. In analysing these points, current market practices of the main CCPs in the European Union have been taken into account.

Within functional aspects, the main categories of the currently existing clearing members have been analysed, as have the necessary legal and solvency requirements, the procedures for termination of the activity and the risk assumptions on behalf of their clients.

With regard to the solvency of the CCP and its participants, the adequate level of its own resources has been discussed, as have the waterfall of solvency lines, the need for a liquidity coefficient in terms of the own resources, the level of the requested hedge collateral, the range of eligible assets to act as guarantee, the guarantee fund and other alternatively solvency sources.

The main risks that the CCP faces have been analysed. These include legal, operational, settlement, liquidity and counterparty risks. The usual mechanisms and tools to control and mitigate the risks have been considered, including internal control arrangements, procedures to protect securities of the clients, the treatment of crisis situations and contingency plans. Additionally, alternatives for managing settlement failures have been discussed, including possible mechanisms to act as an incentive or disincentive, such as penalties.

Summary of work carried out on settlement finality and registry

The activity carried out regarding the settlement finality and registry system has focused on aspects of registration and, more specifically, on the modifications required, both legal and operational, in order to move the time of settlement finality towards the effective settlement and to modify the associated controls related to the RR.

Firstly, a comparative study has been started on the institutional and operational setting of the clearing systems as well as on the settlement finality moment of the transfer orders in the main European systems.

In the same way, the consequences of setting the settlement finality of the transfer orders around the time of effective settlement have also been studied, distinguishing three possible scenarios: i) settlement finality in the matching of the buy and sell orders, ii) settlement finality once that the funding is checked (cash and securities) or iii) settlement finality in the effective settlement of the orders.

Moreover, there has been a preliminary consideration of the problems regarding the time of the settlement finality in the context of different scenarios of interoperability of CCP and CSD in a cross-border environment.

Finally, regarding the use of the RR, the problem of removing the obligation of delivery of RR before settlement has been analysed. Work in this field has been focused on two aspects of the reform: firstly operational issues, and secondly the consequences of the acknowledgement of beneficial ownership at the registry level.