



# Reform of the Registry, Clearing and Settlement System

24 September 2014

# CONTENTS

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## 0. INTRODUCTION

## I. MAIN CHANGES INTRODUCED BY THE REFORM

## II. CENTRAL COUNTERPARTY (CCP) FOR EQUITIES

### 1. INTRODUCTION

- 1.1. Integration of the CCP into the existing structures: flow changes

### 2. CENTRAL COUNTERPARTY

- 2.1. Scope of action of the CCP
- 2.2. Services provided and liability regime
- 2.3. Members
- 2.4. Accounts
- 2.5. Segregation of positions and collateral of Clients with Individual Accounts and of Segregated Non-Clearing Members with respect to their Clearing Member
- 2.6. Clients
- 2.7. Margins
- 2.8. Providing collateral
- 2.9. Summary of requirements by member type
  - 2.9.1. Requirements as to Equity, Individual Margin, and minimum contribution to the Default Fund, by member type
  - 2.9.2. Other requirements
- 2.10. Intraday Risk Limit (IRL)
- 2.11. Default

### 3. TRADE CLEARING AND SETTLEMENT

- 3.1. Clearing and managing sale trades
- 3.2. Settlement of instructions generated by the CCP

### 4. RESOLVING SETTLEMENT FAILS

- 4.1. Delays in securities delivery
- 4.2. Delays in cash payment: sell-out

### 5. CORPORATE ACTIONS

### 6. TECHNICAL AND FILE INFRASTRUCTURE

### III. NEW REGISTRY AND SETTLEMENT SYSTEM

1. INTRODUCTION
2. SECURITIES REGISTER
  - 2.1. Securities included in the system
  - 2.2. Register structure
  - 2.3. Detailed register
3. ENTRIES IN THE REGISTER
  - 3.1. Addition and removal of securities
  - 3.2. Transfers
  - 3.3. Immobilisation of securities in the register
  - 3.4. Inclusions and exclusions
  - 3.5. Transactions with participants of other Central Securities Depositories (CSD)
  - 3.6. Pledges of securities and financial collateral
4. TRANSACTION NOTIFICATION, MATCHING AND SETTLEMENT
  - 4.1. Notification of transactions executed on markets and trading platforms cleared in a Central Counterparty
  - 4.2. Communication of trades executed on markets and trading platforms without the intervention of a CCP
  - 4.3. Communicating and matching bilateral transactions
  - 4.4. Trade settlement procedures
  - 4.5. Managing failed transactions
  - 4.6. Last-resort securities loan
5. NOTIFICATION OF OWNERSHIP DATA TO ISSUERS
  - 5.1. Daily notification of ownership information
  - 5.2. Notification of ownership at issuers' request
6. CORPORATE ACTIONS
  - 6.1. Mandatory corporate actions
  - 6.2. Elective or mandatory corporate actions with options
  - 6.3. Cash settlement
  - 6.4. General Meetings
7. SUPERVISION AND CONTROL
8. DESIGN OF THE MIGRATION TO THE NEW SYSTEM

## **IV. ANNEXES**

### **A.1. OPERATIONAL SCHEME OF THE POST-TRADING INTERFACE**

1. INTRODUCTION
2. GLOSSARY
3. TRADES PERFORMED IN TRADING PLATFORMS
  - 3.1. Flow scheme
  - 3.2. Description of the flows
4. OTHER ENTRIES IN THE REGISTER
  - 4.1. General flow scheme for register entries made in Iberclear
    - 4.1.1. Description of the flows
  - 4.2. Flows in the case of corporate actions
    - 4.2.1 Description of the flows

### **A.2. IMPLICATIONS OF THE REFORM IN THE TRADING AREA**

1. INTRODUCTION
2. PROCEDURE FOR TRANSFERRING OPERATIONS BETWEEN CCP ACCOUNTS
3. INFORMATION FLOW
  - 3.1. Orders information
  - 3.2. Ownership information
  - 3.3. Available information
4. FUNCTIONALITIES IN THE TRADING AREA
5. OPERATIONS SETTLED WITHOUT THE INTERVENTION OF A CCP
6. IMPACT OF THE REFORM ON TRADING MEMBERS' SYSTEMS

### **A.3. KEY LEGAL ASPECTS OF THE REFORM OF THE SPANISH SECURITIES POST-TRADE SYSTEM**

1. INTRODUCTION
2. LEGAL ISSUES RAISED BY THE OPTIONAL MODEL FOR SETTLEMENT BY FINANCIAL INTERMEDIARIES
3. REGULATORY CHANGES THAT WOULD BE REQUIRED

### **A.4. REFORM TIMELINE**

# 0. Introduction

## INTRODUCTION

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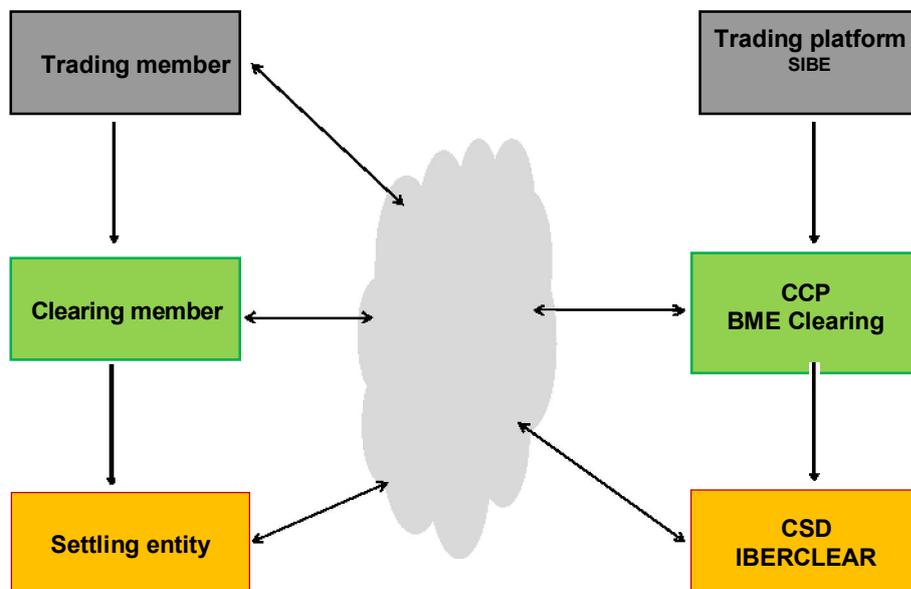
1. This document describes the progress attained in designing Spain's new registry, clearing and settlement system.
2. The document contains the following chapters:
  - 1.- A brief description of the main changes introduced by the reform.
  - 2.- A chapter on the CCP (BME Clearing).
  - 3.- A chapter on the CSD (IBERCLEAR).
  - 4.- Four annexes:
    - Operational scheme of the Post-Trading Interface
    - Implications of the reform in the trading area.
    - Issues considered by the Legal Group created in the framework of the Reform of the Spanish securities clearing, settlement and registry system.
    - Reform timeline.

# I. Main changes introduced by the Reform

## 1. MAIN CHANGES INTRODUCED BY THE REFORM

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1. The reform of the clearing, settlement and registry system introduces three central changes, which lead to numerous operational modifications. Those changes are as follows:
  - a) Transition to a registry system based on balances.
  - b) Introduction of a **Central Counterparty**.
  - c) Integration of **CADE and SCLV into a single platform**.
  
2. With the introduction of the CCP, Spain's Stock Exchange markets will be organised around three infrastructures: the trading platform (SIBE), the Central Counterparty (a new segment of BME Clearing), and the central securities depository (IBERCLEAR).
  
3. The new system will be implemented in two consecutive phases:



- a) First phase: fourth quarter 2015, implementation of the CCP and transition of SCL (equities) to the new system.
  
- b) Second phase: first quarter of 2017, transfer of CADE (fixed-income) to the new system, and connection to T2S.

4. As a result of these new developments, there will be numerous changes in operating procedures, including:
- a) Entities may be participants in one, two or all three infrastructures.
  - b) Each Stock Exchange member may have a contract in place with a General Clearing Member of the CCP (unless it is a member of both infrastructures).
  - c) Each member of the CCP must have a contract in place with at least one IBERCLEAR participant (unless it is a member of both infrastructures).
  - d) Individual Accounts will be introduced in both the CCP and the CSD, for investors who so wish; they may also have individual accounts at the CCP but not at the CSD.
  - e) The CCP will enable trades to be netted before settlement instructions are generated.
  - f) IBERCLEAR will implement and manage a settlement optimisation procedure to maximise the settled trades in exceptional cases where there is a delay in the delivery of securities.
  - g) The current Guaranty Fund will be replaced by the CCP's system of margins.
  - h) Communications between participants and members of the infrastructures will be managed through an ancillary system, the PTI, which will simplify the requirements and burdens on those entities.
  - i) Considerable flexibility will be built into the system; for example:
    - Possibility for CCP accounts to be settled on a net or gross basis.
    - Choice of being an Ordinary Trading Member or a Segregated Trading Member.
    - Possibility, in certain cases, of identifying the ultimate owner on the settlement date.
5. The workings of the trading platforms will not change as a result of the reform, although there will be some changes in the Trading Members' systems:
- a) **Changes in trading procedures:** the protocols for communicating orders to the trading platform will be modified to include new optional information on clearing.
  - b) **Changes in post-trade procedures:** the procedures will be adapted to accommodate new features and contents that will be added as a result of the reform.
  - c) It may be necessary to implement additional controls on market activity for the purposes of relations between Trading Members and Clearing Members.



## II. Central Counterparty for Equities

# 1. INTRODUCTION

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Act 32/2011, of 4 October, amending Act 24/1988, of 28 July, on the Securities Market, establishes that, for greater competitiveness, it is advisable to achieve a degree of standardisation between Spain's post-trade activities and those of structures in other European countries.

The reform entails, firstly, creating a Central Counterparty within post-trade services, which will interpose itself, on its own account, between buyers and sellers in securities trades, assuming the counterparty risk and clearing transactions where appropriate.

Interposing a CCP entails eliminating the concept of assured delivery and replacing the system of pooled guarantees managed currently by IBERCLEAR with a standardised risk management system through the CCP.

## 1.1. INTEGRATING THE CCP INTO EXISTING STRUCTURES: FLOW CHANGES

The CCP will be integrated between the trading and settlement structure for the equities market, and the clearing area will be created. Each participant can decide which areas to participate in (subject to fulfilling the necessary conditions in each case).

The main changes in the current flow structure as a result of interposing the CCP are as follows:

- Trading Members in the trading platforms can either be Clearing Members (CM) or enter into a clearing agreement with a CM. The clearing contract entered into with a CM, whose minimum content will be set out in the CCP Rules, will establish that the CM will be liable vis-à-vis the CCP for fulfilment of all its obligations and the obligations of those with whom it has entered into a clearing agreement.
- Trading Members that are not CM may be of two types, as described later in this chapter.
- IBERCLEAR participants will not accept or reject settlement instructions; rather, under the new system, Clearing Members bear the risk.
- Regardless of their status in the CCP, Trading Members of trading platforms must report, for each order or transaction, the account of the CCP Member where it is to be registered. The account assignment may be internal or external (give-up); it is internal when the trading member assigns the transaction to one of its own accounts at the CCP, and it is external when the trading member assigns the transaction to an account managed by another Member.

The assignment may be done when inserting the order in the market, if the Trading Member fills certain fields enabling it to identify the CCP account to which the transaction should be assigned. External assignment may mean that the transaction will be assigned to accounts under the liability of a Clearing Member other than the Trading Member. Therefore, making the assignment when inserting the order makes it easier to transfer the risk and, consequently, to calculate the margin required by the CCP from the definitive Clearing Member.

- The CCP will receive the information from the platforms in real time and will register each trade in the corresponding CCP Member account, and calculate each Clearing Member's corresponding exposure.
- General Clearing Members will receive trade information in real time from the Non-Clearing Members and clients in order to monitor the exposures.
- The CCP will act as central counterparty, interposing itself for its own account in the obligations arising from the transactions and becoming, through novation, the buyer in every sale transaction and the seller in every purchase transaction. After clearing (if applicable), the reciprocal obligations between the CCP and each account-holder will be replaced by the

obligations resulting from aggregation into a net position. The resulting obligations, which will give rise to settlement instructions following interposition of the CCP and its clearing function, will be different from those initially registered with the CCP.

- The CCP will generate the settlement instructions and send them to IBERCLEAR, after clearing the trades before the first settlement cycle on the day on which settlement is due.
- Each CM and NCM position account in the CCP will have a corresponding settlement account at IBERCLEAR. A give-up makes it possible to transfer a transaction to another CCP member that has contractual relations with other participants.

## **2. CENTRAL COUNTERPARTY**

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### **2.1. SCOPE OF ACTION OF THE CCP**

Act 32/2011, of 4 October, establishes the intervention of a Central Counterparty for trades in shares and other marketable securities that are equivalent or which give entitlement to acquire shares, which are traded multilaterally either on a regulated market or on a multilateral trading facility. Accordingly, the equity instruments that will be handled by the Central Counterparty will be: shares, subscription rights, warrants, certificates, and ETFs. In the first phase of the reform of Spain's securities clearing, settlement and registry system, it is not planned that the CCP will cover fixed-income securities.

Transactions in the LATIBEX segment and in MAB and the electronic voice trading segment will also be supported by the CCP. Exercise and expiration of equity derivatives will be handled by the CCP in the derivatives segment; the Clearing Members of the derivative position will bear the settlement risk of the underlying asset.

The CCP will also offer interposition and clearing services for other non-multilateral transactions in benchmark financial instruments provided that the parties so decide.

The Equity CCP will be managed by BME Clearing, which will add a new segment, in addition to the current ones: Financial Derivatives, MEFFRepo and Energy.

### **2.2. SERVICES PROVIDED AND LIABILITY REGIME**

The Central Counterparty will provide the following services: it will interpose itself and clear obligations, and it will calculate, demand and manage margins.

The CCP will act as counterparty from the moment of novation and, from that point on, will act as seller in buy trades and as buyer in sell trades. The novation takes place at the time the CCP explicitly agrees to register the trades notified to it by a trading platform. Under the novation, the bilateral and reciprocal obligations of the parties to the trade are extinguished and they are replaced by obligations vis-à-vis the CCP, such that the CCP assumes the default risk of those obligations, i.e. the counterparty risk. The CCP's obligations expire when the instructions are settled, as notified to the CCP by the Central Securities Depository.

In the terms to be established in the CCP Rules, the parties that are subject to obligations and bound by liabilities vis-à-vis the CCP will be its Clearing Members, even if they use another entity to settle trades, regardless of whether or not the Non-Clearing Members and Clients have fulfilled their obligations vis-à-vis the Clearing Member.

### **2.3. MEMBERS**

Any of the entities referred to in article 44 ter 3, third paragraph, of the Securities Market Act may become Members. That paragraph states that the only parties that may become Members are the entities referred to in article 37.2.a), 37.2.b), 37.2.c), 37.2.d) and 37.2.f) of the Securities Market Act, the Bank of Spain and other entities, both resident and non-resident, that engage in analogous activities in the terms and subject to the limitations provided by regulation and in the CCP's own Regulations. Each Member may act within the scope of its membership category.

The decision to grant membership lies with the CCP. To become a member, an entity must apply, and sign the corresponding contract with the CCP, as well as any other contract to be signed with other Members depending on its specific category. For example, NCMs must sign a contract with a CM. Likewise, all members of the CCP, both clearing and non-clearing, must sign contracts with participants of the CSD.

Members of the CCP will not be obliged to be participants of IBERCLEAR (or of a trading platform), but they may authorise one or more IBERCLEAR participants to fulfil their obligations. In no event

does this authorisation entail the Clearing Member transferring its liability.

The CCP will have the following categories of Member:

- > **Ordinary Non-Clearing Member ("Ordinary NCM").** A member without liability vis-à-vis the CCP. It does not have its own structure of accounts at the CCP but, rather, is a client of a General Clearing Member (GCM).

If an Ordinary NCM has operations with clients, their positions will be in accounts at the GCM. In the event of insolvency or other cases of breach by the General Clearing Member, the positions registered in the Ordinary NCM's accounts at the CCP will be treated like the other accounts of their Clearing Member, based on the type of account.

It will have access to the breakdown of transactions between the accounts it has open at the GCM.

- > **Segregated Non-Clearing Member ("Segregated NCM").** This is a Member that seeks greater segregation of its positions vis-à-vis those of its Clearing Member.

It may register transactions for its own account or for the account of Clients in the accounts open in its own structure of accounts.

It will be obliged to post collateral with the CCP via its General Clearing Member, which will be jointly liable with the Segregated NCM for providing and maintaining the collateral.

In the event of insolvency or other cases of breach by the General Clearing Member, the Segregated Non-Clearing Members' positions will be unaffected. Non-Clearing Members will be given a time period in which to sign a contract with another Clearing Member. Meanwhile, on an interim basis, the Non-Clearing Member will assume the obligations normally pertaining to Clearing Members vis-à-vis the CCP.

- > **Individual Clearing Member.** It may register transactions for its own account or for the account of Clients, and is liable vis-à-vis the CCP for compliance with all obligations inherent to the transactions registered in their accounts, including the obligation to contribute to the Default Fund.
- > **General Clearing Member.** It may register transactions for its own account or for the account of Clients, and is liable vis-à-vis the CCP for compliance with all obligations inherent to the transactions registered in their accounts, including the obligation to contribute to the Default Fund and those deriving from transactions with their Non-Clearing Members.

## 2.4. ACCOUNTS

In its Central Register, the CCP will maintain the following Accounts with respect to each Clearing Member and Segregated Non-Clearing Member:

- A. Daily Account, which is owned by a Member, in which transactions are entered before give-up to another type of account at the Central Register, where they will be finally registered. Transactions registered in this account will be deemed to be Proprietary Transactions of the Member.
- B. Proprietary Account, in which the Member's proprietary trades are registered.
- C. Client Account, in which transactions for clients are registered. This account may be of the following sub-types:
  - C.1 Third-Party Gross Account: in which margins and settlement instructions are calculated on a gross basis

- C.2 Third-Party Net Account: in which margins and settlement instructions are calculated on a net basis.
- D. Individual Account, in which the trades of a single client (natural or legal person) are registered.  
In this account, margin and settlement instructions will be calculated on a net basis.
- E. Financial Intermediary Special Individual Account. Under IBERCLEAR rules, financial intermediaries qualify for a special clearing model.  
The Financial Intermediary Special Individual Account at the CCP must obligatorily be an individual account, associated with a settlement account (also individual) at IBERCLEAR. The Financial Intermediary Special Individual Account at the CCP may be of one of two types, at the Member's choice:
- E.1 Gross account (i.e. in which margin and settlement instructions are calculated on a gross basis)
- E.2 Net account (i.e. in which margin and settlement instructions are calculated on a net basis)

Within the account structure of the General Clearing Member, the Ordinary Non-Clearing Member will have the types of accounts that it agrees upon with the GCM.

Members (Clearing or Non-Clearing, as the case may be) that own Third-Party Accounts at the Central Register will be responsible for keeping the Detailed Register for such accounts. Any purchase or sale and the ensuing obligations will be entered in the corresponding Third-party Accounts at the CCP Central Register and, simultaneously, in the corresponding Detailed Register kept by Members (detailed accounts):

- Proprietary trades by Members will always be entered in the corresponding Accounts at the Central Register.
- Trades by Members for the account of Clients that have an account in the Central Register (Individual Account) will be entered in the corresponding account in the Central Register, where the Client's identity will be noted.
- Trades by Clients that have an Account in a Member's Detailed Register will be entered in the corresponding Third-Party Account in the Central Register and, simultaneously, in the corresponding account in the Member's Detailed Register, and the Client's identity will be entered only in the latter.

The CCP will be responsible for maintaining and ensuring the accuracy of the Central Register Accounts, while the Members will be responsible for maintaining and ensuring the accuracy of the Detailed Accounts.

## **2.5. SEGREGATION OF POSITIONS AND COLLATERAL OF CLIENTS WITH AN INDIVIDUAL ACCOUNT AND OF SEGREGATED NON-CLEARING MEMBERS WITH RESPECT TO THEIR CLEARING MEMBER**

Regulation (EU) No 648/2012 of the European Parliament and of the Council, of 4 July 2012, on OTC derivatives, central counterparties and trade repositories (hereafter "EMIR") requires that Central Counterparties and Clearing Members keep an independent register of the positions and margins for their own account and for those of their clients.

It also requires that Clearing Members offer clients the choice between two types of segregation: "omnibus segregation", in which clients have a separate account from the Clearing Member's proprietary account but share the same third-party account with other clients, and "individual segregation", in which each client has its own account that is separate from the Member's proprietary

account and from the accounts of other members. The CCP and the Clearing Members are obliged to publish the degrees of protection and costs associated with each type of account.

EMIR also requires that, in its rules, the CCP undertake to initiate procedures to transfer clients' positions to other Clearing Members when their own Clearing Member declares insolvency.

In compliance with this, the Equities CCP will offer Individual Accounts as the "individual segregation" option and Third-Party Accounts as the "omnibus segregation" option.

1. Clients with individual accounts in the CCP Central Register (Individual Account) will have provided collateral to the CCP. Their collateral and positions will be segregated from the member's own account and those of the member's other clients.
2. Clients forming part of a Third-Party Account will provide any required collateral to the Member. The Member will deposit with the CCP any collateral which the latter requires for the third-party accounts. Clients' collateral and positions will be segregated from the proprietary account but not from those of other clients.

Additionally, NCMs, as clients of a GCM, may choose the degree of segregation with respect to their Clearing Member. Accordingly, Members of the trading platform may choose to become Segregated Non-Clearing Members of the CCP. In that case, their collateral will be deposited with the CCP via their CM. The positions of this class of Non-Clearing Member will be segregated from those of their Clearing Member. From an operating standpoint, they will have a Member code that is independent of that of their Clearing Member, which will track their activity and give them access, via the CCP, to certain information files. Their collateral will be calculated per account and separately from that of the Clearing Member. In the event of insolvency or other cases of default by their Clearing Member, they may temporarily become a CM until another is found.

## **2.6. CLIENTS**

Any natural or legal person may be a Client of a CCP. A client may have an Individual Account opened in the Central Register or form part of a Member's Client Account, at their choice.

Clients will be liable vis-à-vis the Member for the accounts that they have opened via the latter.

Their obligation is to provide the necessary collateral at any given time to the CCP via the Member (if the account is Individual) or to the Member (if they form part of a Third-Party Account and the Member so requires).

They must authorise the Member so that, in the event of breach of their obligations, the Member may close any unsettled transactions for the client's account. They must also authorise the CCP so that, in the event of breach of obligations by their Member, the CCP may transfer or close outstanding trades, as appropriate. In its contract with the Member, the Client must acknowledge that, in the event that it forms part of a Client Account, it is aware that its Member is the party responsible for calculating and managing the collateral

Members will be obliged to inform their clients, before opening an account, of the various systems available under the CCP Regulations as regards opening an Individual Account or belonging to a Client Account.

## **2.7. MARGINS**

The collateral that Members and Clients provide may only be used to cover liability vis-à-vis entities in whose favour it was provided and for the obligations arising from the trades registered in their accounts at the CCP.

The collateral required and provided to cover positions in Accounts opened at the Central Register must always be provided to, and in favour, of the CCP.

Any collateral required and provided to cover positions in accounts opened in the Detailed Register must always be provided to, and in favour of, the Member. Members must maintain a separate record of the collateral provided in their favour.

Any or all of the following classes of Margin will be required by the CCP in connection with Accounts open at the CCP Central Register:

- A. Daily Margin, which is to cover the risk of an adverse price movement where the CCP must cover a default. It is calculated and required by the CCP on a daily basis.
- B. Individual margin. Required to increase the Intraday Exposure Limit (IEL) that the CCP assigns to Clearing Members for the current session (the IEL is developed in detail in section 2.10). The Individual Margin may also be required of a new Member to attain the required minimum solvency level if the applicant's equity fails to meet the level demanded by the CCP.
- C. Extraordinary Margin, to cover the CCP's exposure in extraordinary situations.
- D. Default Fund; to cover any debit balances arising from default by a Clearing Member.

### **DAILY MARGIN**

The Daily Margin is the margin that the CCP calculates and requires on a daily basis, at the end of the session, for each Account open at the Central Register in accordance with generally-accepted portfolio risk assessment models. The Daily Margin is calculated using two factors: the *Variation Margin* and the *Initial Margin*, which, respectively, consider the change in value, at market prices of the unsettled position (*Variation Margin*) and the interval of adverse price variations if CCP had to close the position (*Initial Margin*).

The CCP will require a Daily Margin for each Account at the Central Register, based on the risk arising from the positions of each ISIN that are pending settlement. The calculation of the risk will consider cleared (net) and uncleared (gross) positions.

Amounts may not be netted between different Accounts in the Central Register.

### **INDIVIDUAL MARGIN**

This is one of the components used by the CCP to assign the Intraday Exposure Limit to each Clearing Member, i.e. the Maximum Exposure that a CM can assume vis-à-vis the CCP at any time in the session.

The minimum amount to be provided under this heading will depend on the total amount of daily margins of all the accounts in the Central Register for which the Clearing Member is acting, including those of Non-Clearing Members, if any. It is calculated as a percentage of the Daily Margin, with a minimum and maximum level established on the basis of the type of Clearing Member. See summary of requirements in section 2.9.1.

Members that fail to accredit sufficient equity to qualify for a specific category of Member may provide Individual Margins in order to attain the minimum required level of solvency. The amount of the Individual Margin to be provided will be 75% of the difference between the required and accredited amounts of Own Funds.

### **EXTRAORDINARY MARGIN**

The CCP will define a level of price variation, the "Extraordinary Margin fluctuation parameter", such as to enable the CCP to recover sufficient collateral in situations of exceptional volatility. The goal is that trading should not be interrupted under any circumstance.

The parties required to provide the Extraordinary Margin are the Clearing Members.

The CCP may require Extraordinary Margins from individual Clearing Members, or from all of them, in situations deemed to be of high risk, in accordance with the criteria and procedures to be established.

## **DEFAULT FUND**

Established for each segment of the CCP in which a Clearing Member operates.

The Default Fund must be provided by the Clearing Members. Independently of the other collateral they have provided, every Clearing Member is obliged to contribute to the Default Fund for each segment in which it operates as a Clearing Member. The contribution will comprise a minimum fixed component depending on the type of Clearing Member. See summary of requirements in section 2.9.1.

The amount of the Default Fund must be sufficient to cover exposure in Stress Test conditions in the terms of the CPSS-IOSCO recommendations and of the obligations established in EMIR. Since the Default Fund is updated on a quarterly basis, the calculation is simulated on a daily basis and the Member(s) affected are required to cover any differences by posting an Individual Margin.

The purpose of the Default Fund is to cover any debit balances arising from default by a Clearing Member which is not covered by the sum of the Daily Margin, Extraordinary Margin, Individual Margin and the defaulting Member's contribution to the Default Fund, and the collateral provided by the CCP.

If the Default Fund has to be used, the amount drawn will be allocated proportionally among the Clearing Members as a function of the amounts of their respective contributions in the last update or top-up. Clearing Members will be obliged to top up their contributions to attain the required minimum.

The contribution to the Default Fund may exceed the require minimum if the sum of the minimum contributions of all the Clearing Members is insufficient. The rules for contributions in excess of the Default Fund will be developed in separate documents, as will the rules on topping up contributions after the collateral has been used.

## **OWN FUNDS ALLOCATED BY THE CCP**

The CCP will assign an amount of its own funds to cover any shortfalls resulting from default by a Clearing Member in excess of the amount resulting from the sum of its Daily Margin, Extraordinary Margin, and Individual Margin and its contribution to the Default Fund. This collateral will be used before drawing on the other Clearing Members' contributions to the Default Fund. The amount will be established in the rules issued in accordance with the provisions contained in Articles 43 and 45 of EMIR, articles 35 and 36 of the Commission Delegated Regulation (EU) No 153/2013, and other applicable related legislation.

Where the collateral provided for a segment has been used, the CCP will top up its contributions immediately once the default management process has concluded. Where more than 50% of the Default Fund is drawn, or where more than one draw is made against the fund in any period of three consecutive months, the CCP's contribution must be double for at least the following three months.

### 3.8. PROVIDING COLLATERAL

Every month, a check will be performed to ensure that at least 30% of the total collateral required of each Member under any heading has been provided in cash. Clearing Members whose collateral under all headings is less than 30% cash must readjust their collateral to attain that percentage.

The Daily Margin, Individual Margin and Default Fund may be provided as follows:

1. In cash, paid by the Clearing Member or its Payment Agent into the CCP's account on the TARGET2 platform. That amount of cash will be invested by means of a cash repo or, at the Clearing Member's request, it will be left in cash in a CCP account on the TARGET2 platform.
2. By a pledge of securities by the Clearing Member to the CCP.
3. By means of an outright transfer of securities by the Clearing Member to the CCP's securities account.

The Extraordinary Margin to be paid where the daily price fluctuation limit is exceeded may be provided as follows:

1. Direct debit in the account of the Member in question on the TARGET2 platform.
2. An MT 202 payment order to the CCP's account on the TARGET2 platform.

From time to time, the CCP will establish the list of assets that qualify for use as collateral.

### 2.9. SUMMARY OF REQUIREMENTS BY MEMBER TYPE

#### 2.9.1. Requirements as to Equity, Individual Margin, and minimum contribution to the Default Fund, by member type (million euro)

EQUITIES			
	NCM	ICM	GCM
Equity	NA	3.5	25 up to 4 NCMs, and an additional 5 million for every 4 additional NCMs, capped at 45
Individual Margin = 2% Daily Margin, within the following maximum and minimum bounds	NA	0.5-1	1-3
Minimum contribution <u>Default Fund</u>	NA	0.5	1

To calculate a Member's Equity requirements, its Tier 1 and Tier 2 equity, per its last audited financial statements, will be used, deducting any amount of Tier 2 equity that exceeds the amount of Tier 1 equity. Members will be required to disclose any change in this respect.

## 2.9.2 Other requirements

Notwithstanding the foregoing, the following documents, among others, must be presented by applicants to become a Clearing Member:

- Certificate by the CNMV or the Bank of Spain to the effect that the entity is an investment firm or bank.
- Latest audited financial statements.
- Assessment of credit risk by the CCP (rating and own funds):
- Securities accounts at IBERCLEAR, both of the members and of third parties, where the CCP has prior authorisation to send the Settlement Instructions.
- The member's own or a third-party account in TARGET2 (cash account at the Bank of Spain, European Central Bank or the central bank of another European Union Member State whose system is connected to that of the Bank of Spain in the framework of the European system of Central Banks) for depositing collateral in cash and for other cash movements. It must authorise the CCP to charge cash against this account. Where the Member does not have an account on TARGET2, it must designate an entity with an account in the payment system as a Payment Agent and notify the CCP of such designation. The Clearing Member and the Payment Agent must sign a contract.
- Accreditation of human and material resources.

## 2.10. INTRADAY RISK LIMIT (IRL)

This is the maximum amount of exposure that a Clearing Member may have vis-à-vis the CCP at any given time during the session, within the real-time exposure calculation system that is in place. Once that limit is attained, the CCP will issue a margin call to the Clearing Member. The limit is assigned for all segments of the CCP where the Clearing Member operates.

The limit assigned by the CCP to each Clearing Member is the sum of three components:

- Solvency limit (SL). A percentage based on the entity's rating (falling from 10% to 5% of its own funds, capped at between 300 and 25 million euro).
- Individual Margin (IM) that the CM has already provided.
- Extraordinary margin (EM) that the CM has already provided.

$$\text{IRL} = \text{SL} + \text{IM} + \text{EM}$$

Once the IRL has been assigned, each CM's risk is calculated in real time for each account, considering the trades in the session and the trades pending settlement from previous sessions:

- The Proprietary Account risk is calculated.
- The Individual Account risk is calculated.
- The Client Account risk is calculated.
- The Daily Account risk is calculated.
- The risk attributable to Non-Clearing Members is calculated:

$$\text{Real Time Risk} = \text{Sum of risks per account} - \text{Collateral already provided}$$

If the real-time risk exceeds a CM's Intraday Risk Limit, the CCP will issue a margin call for an amount such that the calculated risk is not more than 80% of the new Risk Limit.

If, in the course of a month, a Clearing Member exceeds their risk limit in a number of sessions to be determined regulation, the CCP may ask it to increase its limit on a definitive basis.

## 2.11. DEFAULT

Two situations or degrees of default are distinguished:

1. Technical default, i.e. a delay in fulfilling the obligation to deliver securities or pay cash, which is treated as a settlement incident and is discussed in section 4 (Resolving Liquidity Fails) of this chapter.
2. Definitive default by a CM, NCM or Client (as detailed below), related to its solvency, which requires the CCP (or the Clearing Member) to manage the closure of its positions.

For the purposes of this section, Default by an Ordinary Non-Clearing Member is equivalent to default by a Client of a General Clearing Member.

### Causes of definitive default vis-à-vis the CCP:

The following constitute Default by a Member or Client, as the case may be:

1. Failure to provide or maintain collateral in due time and form.
2. Initiation of insolvency proceedings or intervention (regardless of the name) with respect to the Client or Member, its parent company or another significant company in its group, or the adoption by a judicial or administrative authority of a universal measure for the liquidation or reorganisation of the Client or Member or of the significant company in its group.
3. Any circumstance arising at a Client or Member, their Parent company or another significant company in their group, that might generate a risk for the solvency of the Member or the CCP, as the case may be, which may include default by the Client or Member with respect to its obligations in other markets, settlement systems or central counterparties.

Where, in connection with any or all segments of the CCP, a Member or Client incurs any of the aforementioned cases of default, the Member or Client may be suspended from the CCP temporarily.

General Clearing Members must immediately notify the CCP of any default by their Non-Clearing Members.

Likewise, Members must immediately notify the CCP of any default by their Clients.

The CCP will notify the National Securities Market Commission and the competent authorities of the initiation of proceedings potentially leading to a Declaration of Default by a Member or Client.

### Measures to be adopted in the event of a declaration of default.

Once a Client or Member has been declared in Default, the Member or the CCP, as the case may be, may adopt any of the following measures in connection with the Client or Member in Default, and on behalf of the latter:

- Suspend the Member or Client from the CCP.  
Immediately restrict the registration of new trades by the Client or Member in Default.
- Perform such transactions as may be necessary to reduce the uncovered risk, up until they are fully covered.
- Close out the positions affected by default: the CCP may make use of the securities and cash received from other counterparties not in default. The securities delivered to the CCP by a

counterparty not in default may be sold in the market to raise cash to be paid to the selling counterparty not in default. The cash paid to the CCP by a counterparty not in default may be used to finance the acquisition of the securities not delivered by the Member in Default for delivery to the counterparty not in default. Any differences in the prices of the securities will be covered by the collateral.

- The CCP and the Member may execute part or all of the Collateral of any type granted to them. The Member may ask the CCP to execute part or all of the Collateral provided to it by the Client or Member in default.
- Any other measure necessitated by the exceptional nature of the situation resulting from the Default which the Member or the CCP, as appropriate, consider to be necessary, although not expressly provided for above, by informing the Competent Authorities.

#### Closure of positions and transfer of accounts:

##### a) Client Default

- In the event of Default by a Client with an Individual Account, the Member must close the positions affected by the default, making use of the collateral provided to and in favour of the CCP to cover any price difference of the securities.
- In the event of default by a Client that forms part of a Member's Detailed Register, the Member must close the positions affected by the default, making use of the collateral provided by the client to cover any price difference of the securities.
- The Member will refund any surplus Collateral to the Client. The Member may claim from the Client in Default any balance in its favour by any legal means at its disposal.

##### b) Default by a Segregated Non-Clearing Member

- The General Clearing Member will close the position affected by default in the Segregated Non-Clearing Member's proprietary account, making use of the collateral provided to cover any price difference of the securities.
- The CCP will transfer the NCM's Individual Accounts to its General Clearing Member, which will be obliged to accept them. The GCM may decide to close them in the event that the daily margin fails to cover the GCM's exposure.
- The CCP will transfer the Client's Account to its General Clearing Member, together with the corresponding collateral.

The Non-Clearing Member in Default is obliged to transfer, to the General Clearing Member, the corresponding detailed accounts of the Client Account together with the collateral provided by their owners. The General Clearing Member is obliged to accept the transfer of the Client Accounts and the detailed accounts together with their corresponding collateral.

The GCM may decide to close the positions of the Client Account if the risk exceeds the collateral that has been received.

- If the positions are closed, any surplus collateral must be refunded to the party that provided it. In the event of a collateral shortfall, the difference must be covered by the General Clearing Member, which may claim it from the Non-Clearing Member by any legal means available to it.

##### c) Default by a Clearing Member

- The CCP will close the position affected by Default in the proprietary account of the Member in Default, making use of the collateral provided by the Member in Default to cover any price difference of the securities. The CCP will try to transfer the Individual

#### Accounts to other Members.

The transfer will require consent of the Member(s) to which the accounts are to be transferred and of the Clients whose accounts are to be transferred. Where any or all of the Individual Accounts cannot be transferred, or where market movement results in the daily margin for any or all of the Individual Accounts being insufficient to cover the CCP's exposure, the latter may close the positions that are in this situation.

- If the Clearing Member in default maintains a Client Account, the CCP will try to transfer it and its corresponding detailed accounts, together with the corresponding collateral, to another Member or Members. The transfer will require the consent of the Member(s) to which the accounts and the corresponding collateral are to be transferred. Where the Client Account and the corresponding collateral or detailed accounts cannot be transferred, or where market movement results in the daily margin provided to the CCP for the Client Account being insufficient to cover the CCP's exposure, the latter may close the positions that are in this situation.

#### d) Transitional Regime for Segregated Non-Clearing Members of a General Clearing Member in Default

In the event of default by a General Clearing Member, its Segregated Non-Clearing Members must sign a contract with another General Clearing Member within the period to be established, as from the time when the CCP issues a declaration that the General Clearing Member is in default.

During the time which elapses between the declaration of default and the signature of the new contract, non-clearing members must bear the liability corresponding to the Clearing Members, vis-à-vis the CCP, for the accounts owned by them and their clients.

To this end:

- Segregated Non-Clearing Members will agree with the CCP on the collection and payment mechanisms that may be necessary.

#### e) The CCP will require that non-clearing members provide an Individual Margin whose amount will be that which a Clearing Member would have to provide under all headings, including the Default Fund. Use of collateral by the CCP

To handle the closure of positions affected by default of a General Clearing Member, if the Daily Margin proves insufficient, the CCP may make use of the various types of collateral at its disposal in the following order (simplification will be understood when the Member in breach belongs only to the equity segment):

- Execution of other collateral provided by the Member, as follows:
  - One: Extraordinary margin
  - Two: Individual Margin (when it belongs to the segment)
  - Three: The contribution by the Member in Default to the Default Fund
  - Four: Any other type of collateral that the Member has deposited with the CCP, under any heading

The CCP will issue a certificate of the balance (debit or credit) resulting from the settlement.

In the event that there is a credit balance, the CCP will place it at the disposal of the Member in Default. In the event that there is a debit balance, the following collateral will be used until the debit balances covered:

- One: Collateral of the CCP

Two: Default Fund provided by other Members

Three: Own funds of the CCP

- Clearing Members and the CCP may claim, by any legal means at their disposal, the amounts of the Default Fund, CCP Collateral or funds of the CCP that have been executed or been affected by default.

## **3. TRADE CLEARING AND SETTLEMENT**

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### **3.1. CLEARING AND MANAGING SALE TRANSACTIONS**

Trades will be cleared before generating Settlement Instructions in the following accounts: Proprietary Account, Individual Account, Client Netting Account, and Financial Intermediary Special Individual Netting Account.

Trades registered in the following account types will not be cleared: Client Gross Account and Financial Intermediary Special Individual Gross Account.

Trade-Day Netting will apply, meaning that failed trades from other sessions will not be included in the clearing process.

#### **3.1.1 Generation of Settlement Instructions**

If the trades in a CCP account are cleared, one Net Settlement Instruction is generated per account, for the difference in cash and securities between the purchases and sales of a given ISIN, Trade Date, Settlement Date and Clearing Account.

If the trades in an account are not to be cleared because it is a Gross account, the CCP will generate one DVP settlement instructions for the aggregated purchases and another for the aggregate sales of a given ISIN, trade date, settlement date and clearing account.

#### **3.1.2 Managing sale trades for settlement**

The purpose of managing trades for settlement is to ensure that a selling client without a sufficient balance does not use the security balance of others with which it shares a client account at the CSD. This process will take place prior to generating Settlement Instructions.

Members may perform this function by retaining sale transactions.

The purpose of retaining sales that form part of the net selling balances of the accounts is to retain sale trades that it is not wished to settle in the next cycle.

Sale retention will have different effects depending on whether it is applied to net or gross settlement accounts.

Where sales are retained by participants in the case of gross accounts, the CCP calculates a Settlement Instruction for the aggregate amount of purchases and another for the aggregate amount of sales that have not been retained.

Where sales are retained in net accounts, retained sales will be deducted from the net selling Settlement Instruction generated by the CCP.

The transaction management module will be at the disposal of IBERCLEAR member entities, who will be able to manage trades in the settlement accounts subject to obtaining prior authorisation from the Clearing Members.

### **3.2. SETTLEMENT OF INSTRUCTIONS GENERATED BY THE CCP**

#### **Securities and cash accounts of the CCP**

As a result of the CCP interposing itself, the settlement instructions will be generated between securities and cash accounts arranged for this purpose by the CCP at the CSD and by the TARGET2 payments module, and the accounts designated by the Members for settlement purposes. Once the CCP is interposed, the sum of securities and cash from all instructions issued for the set of accounts held by all the Members at the CCP will still be zero.

Interposition of the CCP in the instructions will mean that, in the settlement process, the CCP securities account will receive the securities under each ISIN from the accounts with selling obligations, and will distribute those securities to the accounts with purchase obligations, in accordance with the settlement instructions that were generated by the CCP. The CSD may only settle instructions in which the CCP is the seller, as the instructions where the CCP is the buyer are settled progressively.

Consequently, the CCP's account at the CSD is just another account in the settlement process. In this process, the instructions from the CCP and other trades not involving the CCP will be settled simultaneously. Where the balance of any account is insufficient, the CCP's instructions will take priority over other transactions.

#### Settlement optimisation process

For efficiency in settlement, the CSD has optimisation processes, i.e. algorithms that maximise the outcome. These algorithms are entrusted with isolating instructions that will remain unsettled when there are insufficient securities in an account, the CCP did not receive all the securities that have to be delivered, and it is necessary to identify one or more buy instructions that will also remain unsettled.

The use of Partial Settlement at the CSD, at least with regard to settling the CCP's instructions, is part of this optimisation process. The goal is to ensure that the CCP account does not simultaneously hold more unsettled buy and sell trades than are strictly necessary (which would increase its funding needs).

#### Differences in cash amounts

When the CSD isolates the buy and sell positions that are going to remain pending as a result of process optimisation, these isolated instructions will have different associated cash amounts. These differences may require funding for the settlement process if the cash for the buy instruction that is to remain unsettled exceeds that of the sell instruction.

Although, in the first instance, the CCP may have a line of credit to cover limited liquidity needs, the consumption of the Intraday Risk Limit corresponding to positions not yet settled will be calculated in real time. In any event, marking the unsettled positions to market in real time entails consuming the Intraday Risk Limit of the Settling Members to which the risk relates.

Moreover, in order to minimise the CCP's funding needs, all instructions from the CCP that are processed by the CSD will be partly settled in all cycles.

#### Information on the settlement outcome at the trade level

Once the CCP is interposed, the CSD will have only the information on settlement of the net balances or positions that the CCP has sent it (and the instructions for the gross accounts). Therefore, the CSD will send the CCP only the outcome of settlement in terms of balances, without any reference to the original trades. Likewise, the CCP will notify its Members of the outcome of settling the balances.

Several times per day, after each settlement cycle, the outcome of settling the instructions sent by the CCP to IBERCLEAR will be received. The result after each cycle will be used to update the accumulated settlement outcome.

Although the CCP provides information in terms of balances, the Post-Trading Interface (PTI) will provide settlement information with details of each trade. The PTI will contain information on the settlement instructions, the trades involved, and the failed purchases and sales notified by Participants to the PTI.

## 4. RESOLVING SETTLEMENT FAILS

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This section describes the procedure to be followed by the CCP in the event of settlement fails.

### 4.1. DELAYS IN SECURITIES DELIVERY

Under article 15 of Regulation (EU) no 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, which came into force on 1 November 2012<sup>1</sup>, where shares cannot be delivered for settlement within four business days after the day on which settlement is due, the CCP will immediately commence buy-in procedures. Where buy-in is not possible, cash compensation is paid to the buyer based on the market value of the shares plus an amount for losses incurred as a result of the settlement failure. Under that regulation, the CCP will impose penalties for every day that elapses between the date on which settlement is due and the actual settlement date (whether because the seller delivered, or buy-in was resorted to, or because the buyer was compensated in cash). Such penalties must be sufficiently dissuasive. The penalties should distinguish between delays due to non-delivery caused by an insufficient balance and those arising from demonstrable computer or operational error, in which case the penalty should be smaller.

Without prejudice to the foregoing, a Securities Loan will be the first obligatory mechanism to be used in handling settlement incidents. The three steps in the general process are described below:

1. Securities loan

If, in the last settlement cycle on the date on which settlement is due, the CCP has not received sufficient securities to fulfil all the obligations to deliver to buyers, it will try to arrange a securities loan. Once the securities have been received from the lender, they will be delivered to the buyer in the last settlement cycle, thereby settling all obligations vis-à-vis buying members.

2. Buy-ins

Where a securities loan cannot be arranged, it will be necessary to isolate the buy and sell positions that cannot be settled, and a buy-in will be arranged if delivery has not taken place within 4 days. Buy-ins will also take place if the loan referred to in the preceding item is not repaid by the deadline.

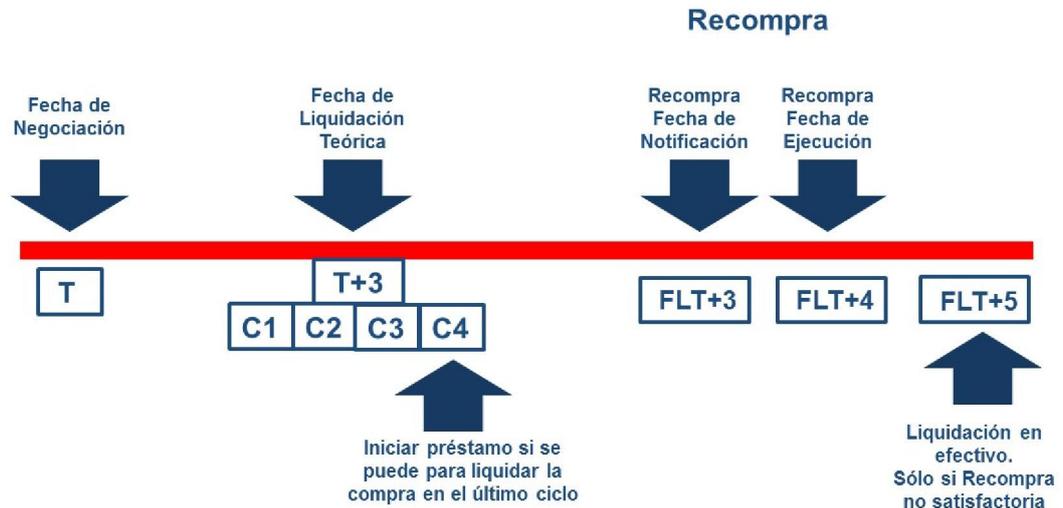
3. Settlement in cash

In the case of highly illiquid securities where a buy-in proves impossible, the trade will be settled in cash, such as to fulfil all pending obligations of the failed seller to the CCP and of the CCP to the buyer.

The subsequent sections detail each step in the incident handling procedure.

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<sup>1</sup> Conditional upon the entry into force of the technical rules on settlement discipline in Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, which was published in the Official Journal on 18 August 2014.



### Securities loan

In the last settlement cycle, if the securities delivered by the sellers to the CCP prove insufficient, the CCP will borrow securities for the account of the seller that does not have securities and will deliver them to the buyers.

The CCP will interpose itself in the securities borrowing process in its own name; the loan may not exceed the maximum period for buy-ins established by European legislation. If the loan is not repaid on that deadline, the CCP will buy in the securities and return them to the lender.

The loan will be arranged automatically, without requiring prior consent of the lenders. The creation of a pool of lenders and a pre-set queue of lenders (based on criteria to be determined) will enable this process to be automated.

### Buy-ins

*Trade-Day Netting* will apply. Under this approach, trades are cleared only on the same trade day, without regard to other buy and sell positions that have failed on a given Settlement Date.

Under this approach, net failed positions and the related purchases by the CSD in a session do not return to the CCP for clearing in subsequent days; rather, they are retained at the CSD and have priority in subsequent settlement cycles. The older the instruction, the greater its priority. Outstanding positions retain their original settlement date and sign and they are retained in the CSD in recycling until the CCP initiates buy-in (in the absence of settlement).

Buy-in will commence if a selling position remains unsettled four days after the date on which settlement was due. Once this situation arises, a buy-in will be initiated on behalf of the failed seller. The securities received by the CCP from the new seller will be delivered to settle outstanding purchases.

Buy-in will also commence if the loan arranged as the initial incident management process is not repaid by the deadline. In this case, the bought-in securities will be returned to the lender.

### Settlement in cash

When it proves impossible to buy in the entire failed selling position, settlement in cash will take place 5 days after the date on which settlement was due.

In operational terms, the net outstanding purchase and sale obligations are eliminated from the

system and a cash transfer is made for the amount of the penalty imposed on the failed seller.

The compensation for the buyer will be established as a percentage of the last session's closing price, having regard also to the price of the original trade.

#### **4.2. DELAY IN CASH PAYMENT: SELL-OUT**

In settlement fails due to non-payment, where the selling member has delivered the securities but the latter have not been delivered to the buying member due to non-payment, then, on the day when settlement is due, the CCP will take measures to sell the securities and take on the failed buyer's obligations.

## 5. CORPORATE ACTIONS

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The CCP's instructions will be adjusted and transformed automatically if there are corporate actions. As detailed below, from the CCP's standpoint, corporate actions are a specific case of default resolution when they occur on an event's Record Date.

IBERCLEAR's register will follow the international standards defined by the Corporate Actions Joint Working Group: the Ex-Date will be prior to the Record Date in a settlement cycle minus one business day. The Record Date is the date that the issuer takes as reference for determining the securities positions that can participate in the financial transaction; the positions settled on that date are the ones that can participate in the transaction.

In the current situation, the Record Date (D-1) is the day before the Ex-Date (D), which implies that the holder's position that will participate in the corporate action is obtained when there are still unsettled trades, necessitating a subsequent adjustment of these trades.

Under the new date scheme, the period between the Ex-Date and the Record Date is used to settle pending trades that were effected before the Ex-Date, so that the position on the Record Date is correct. New trades taking place on the Ex-Date and thereafter may not participate in the financial transaction and will not require any adjustment when settled.

With this new date framework, most trades that are entitled to participate in the action since they were effected before the Ex-Date will already have been settled on the Record Date. There will be only two exceptions:

- 1) Where trades executed before the Ex-Date have not been settled on the Settlement Date, then on the Record Date the IBERCLEAR records will show a securities owner who will be entitled, illegitimately, to participate in the financial transaction. An adjustment between the failed seller and the affected buyer must be made when the trade is settled.
- 2) If an operation is registered bilaterally in IBERCLEAR after the Ex-Date and it is settled before the Record Date, the IBERCLEAR records will show a securities owner who will be entitled, illegitimately, to participate in the financial transaction. In this case, a reverse adjustment will be required.

## 6. TECHNICAL AND FILE INFRASTRUCTURE

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Members may access the CCP via the Post Trading Interface.

They will have access to all the CCP's information using the means that it places at their disposal via the internet and/or dedicated lines.

The CCP will provide a proprietary graphic user interface which the members will be able to access with a browser. Additionally, members may develop their own applications using interfaces supported by the CCP, which will be the most widely-used market standards in each case. The information will also be available in the form of files.

The features to which a given entity has access on the CCP will depend on whether it is a Non-Clearing Member, a Clearing Member or a Participant.



## III. New Registry and Settlement System

## 1. INTRODUCTION

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This chapter describes the workings of the new registry and settlement system which will be implemented in the first phase of the project to reform Spain's clearing, settlement and registry system.

The main characteristics of the new system are as follows:

- The registry and settlement system managed by IBERCLEAR will be the **only** system for all securities (equities and fixed-income, both public and corporate debt), but it will be implemented in two phases, as shown in the project timeline.
- The registry system will be in two tiers and will be based on balances or aggregated positions. The Central Register will be kept by IBERCLEAR and the Detailed Register will be kept by its participants.
- The Central Register kept by IBERCLEAR will be organised into the following **accounts** for each type of security:
  - One or more proprietary accounts to reflect the balances owned by the participants.
  - One or more general client accounts to reflect the overall balances that the participants keep for third parties.
  - Individual accounts in the name of a single owner (natural or legal person).
  - Financial intermediary special individual accounts, for use in the optional order settlement procedure.
- Participants will manage the Detailed Register containing the accounts for each account-owner with the balances of the securities owned by each one. To facilitate supervision, the Reform introduces a **standardised system of reporting** entries made in the Detailed Register by participants, whose features, for the purposes of supervision, are equivalent to those of the current system, which is based on Register References (RR).
- In order to ensure traceability of the trades performed in the markets and trading systems and also of the other entries made in the register, and to facilitate supervision, a **Post-Trade Interface** will be developed which will contain all the entries made by any type of transaction in the accounts contained in the Detailed Register of the participants.
- In the first phase of the Reform project, IBERCLEAR will establish a settlement procedure that enables all entities to settle their trades in cycles or in real time. In the second phase, IBERCLEAR will connect to **TARGET2-Securities** (T2S) and outsource the settlement process, which, from that point onward, will be performed in accordance with the procedures and time periods established by T2S.
- IBERCLEAR will manage the **corporate actions** performed on the shares in the new registry and settlement system in accordance with the international standards defined by the Corporate Actions Joint Working Group (CAJWG) and the Joint Working Group on General Meetings (JWGGM) in order to harmonise, at European level, the treatment of corporate actions as regards information flows, minimum required disclosures, key dates and procedures.

The new registry and settlement system is described in this chapter, divided into eight sections, the first being the introduction.

Sections two and three define the main characteristics of the registry system and its two tiers, and the entries that can be made in them.

Section four describes the procedures for sending instructions for settlement in IBERCLEAR, depending on their nature and on whether or not a Central Counterparty is involved in post-trade processing, and the settlement processes, the mechanisms for handling failures that will be applicable in each case, as well as partial settlement and recycling.

Section five describes the procedures for sending shareholder data to listed companies, distinguishing between daily reporting and responses to sporadic requests for information.

Section six describes how corporate actions arising with respect to securities included in the new system will be handled.

Section seven refers to the mechanisms for supervision and checking that will be established to check the balances in the system and supervise proper book-keeping of the detailed register by participants.

Finally, section eight contains some comments on deadlines and procedures for migrating from the current system to the new system, once it is in place.

## 2. SECURITIES REGISTER

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### 2.1. SECURITIES INCLUDES IN THE SYSTEM

In the first phase of the Reform project, all the securities represented by book entries and listed in Stock Exchanges and securities listed in other official secondary markets or regulated markets and on multilateral trading facilities, if their governing bodies apply to IBERCLEAR for their trades to be registered and settled.

Foreign securities may also be included in the system, either through accounts opened by IBERCLEAR in other central securities depositories or clearing and settlement systems, or via an entity acting as a link between the security's home country and the Spanish registry system, as well as securities not listed on official secondary markets, if the regulations allow.

Securities will be identified by their ISIN code. The balance that will identify, at any given time, the total number of securities or the total nominal amount per ISIN code will be called the *Control Batch* and will be used by the System to control the integrity of the securities that use it.

In the case of securities whose initial registration is entrusted to IBERCLEAR, new ISINs will be added to the System through an "*Issue Technical Account*", into which the total number of securities or the nominal amounts corresponding to the new ISIN will be debited, while simultaneously performing a double entry to credit the accounts held by the entities in the Central Register.

The *Control Batch* will be reflected in the balance of the *Issue Technical Account* and will be equivalent to the total of the securities or nominal values comprising the issue under a given ISIN code.

In the case of foreign securities inserted in the System due to IBERCLEAR opening accounts at another CSD or to the participation of a link entity, IBERCLEAR will use a "*Mirror Technical Account*" to reflect the total value of the foreign securities, by ISIN, entered in the system as a result of inclusion by its participants.

In this case, the *Control Batch* of each ISIN will be contained in the *Mirror Technical Account* and will correspond to the balance maintained in the securities register of the home country in favour of the Spanish system.

Except for the *Issue Technical Account* and the *Mirror Technical Account*, the balances in accounts in the System may never be negative. It will not be possible to deliver securities (and, therefore, make a removal entry in an account) for an amount in excess of the balance in the account before the delivery.

### 2.2. REGISTER STRUCTURE

The book-entry register will be structured in two tiers. The Central Register will be kept by IBERCLEAR and the Detailed Register will be kept by its participants.

Securities will be registered on the basis of balances, i.e. depending on the type of security in question, the nominal amount or number of securities will be entered in the corresponding accounts. In general, entries for equities will reflect the number of securities, while entries for fixed-income will reflect the nominal amount.

Ownership will be accredited by means of the corresponding book-entry: in the accounts kept by IBERCLEAR or in the detailed accounts kept by the participants for their clients.

The Central Register kept by IBERCLEAR will be organised into the following accounts for each type of security:

- a. One or more *proprietary accounts*, reflecting the balances owned by the participants, and at least one *blocked proprietary account* to reflect the balance of securities that the participant has blocked because they are covered by rights in rem or other liens, or about which certificates have been issued.
- b. One or more *general client accounts* to reflect the overall balances that the participants keep for third parties.
- c. *Individual accounts* in the name of a single owner (natural or legal person). Each account may be kept directly or indirectly. Only a very limited set of institutions will be able to keep accounts directly, and it will be necessary to delimit that set (e.g. Central Government securities accounts).
- d. *Financial intermediary special individual accounts*: Financial intermediaries that choose the optional order settlement procedure will be obliged to have at least one individual account at the Central Register solely for use in that procedure. This account will always be kept indirectly.

Additionally, on an exceptional basis, IBERCLEAR may directly keep the central books of all the securities accounts and balances of all the holders of a given ISIN that is registered in the system, having regard to the special circumstances of the securities under that ISIN or of the issuer.

IBERCLEAR will establish an account coding system that is compatible with T2S. Participants will be identified by an 11-character BIC code and the accounts associated with the BIC code will be identified by a 35-character alphanumeric code that plainly indicates the type of account and the entity to which it belongs.

The total balance of each of the accounts in the Central Registry for each ISIN code, except in the case of the blocked accounts, can be subdivided into specific balances to identify the status of the securities included in the account:

1. *Available balance*: Balance of securities entered or settled.
2. *Unavailable balance*: At the request of participants, IBERCLEAR will move the securities from the available balance to the unavailable balance to prevent them from being involved in the settlement process.
3. *Retained balance*: Balance of securities retained by IBERCLEAR during the settlement process prior to checking that there is sufficient cash. Once the settlement instructions have been fulfilled, or rejected due to insufficient cash, the retained balance will be zero.

Entities' *blocked accounts* may only be broken down in the form of a balance reflecting the total securities in such accounts.

From time to time, IBERCLEAR will notify the participants of the position and movements in the securities accounts and the list of transactions pending entry or settlement in the Central Register.

### **2.3. DETAILED REGISTER**

Participants authorised to keep the Detailed Register will be the parties entrusted with the accounting in the accounts of each security holder, which will express at all times the total balance of securities they own, in each class of security.

Those accounts will be identified by a Securities Account Code (CCV), comprising 20 numerical characters structured to provide a unique, universal identifier for each detailed register account.

Entities must keep the detailed register up to date at all times, by entering every single trade performed by the entities with third parties, or on the orders of the latter, that impacts the ownership or availability of the securities, including freezes on securities affected by rights in rem or other liens.

The Reform introduces a standardised system of reporting on entries made in the detailed register by each participant. The data and coding to be used by the entities in drawing up the information to be supplied about entries made in their detailed registers will be specified appropriately.

## 3. ENTRIES IN THE REGISTER

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### 3.1. ADDITION AND REMOVAL OF SECURITIES

Where IBERCLEAR is designated as the entity entrusted with bookkeeping for securities represented by book entries, it will manage the procedures for entering those securities in the register for the first time. It will also manage the process of deregistration.

#### - *Registering securities:*

In order to register a security in the book entry system for the first time, the issuer must present the corresponding issuance document certifying the existence of the security to IBERCLEAR. It must also designate a sole agent, which will send IBERCLEAR the details of the participants to be recognised as holding positions in the newly-registered ISIN.

IBERCLEAR will register a new ISIN in the System using an "*Issue Technical Account*". In that account, it will debit the total number of securities or the nominal amount corresponding to the new ISIN, and simultaneously debit the corresponding number of securities in each of the participants' accounts by means of a double entry.

Once the new issue has been registered in the System, IBERCLEAR will notify the participants that it has been entered in their accounts, and they will register the securities in their detailed account in the name of each holder.

#### - *Deregistration of securities:*

In order to deregister some or all of a security that is registered in the System, the issuer must present, to IBERCLEAR, the documentation certifying that the securities have ceased to exist.

The ISIN will be deregistered from the System on the agreed date by means of a "*Issue Technical Account*". The securities being deregistered will be debited in that account, with a simultaneous double entry in the corresponding accounts of the participants.

IBERCLEAR will notify the participants of the balance debited against them as a result of the deregistration, and they will update their detailed registers.

#### - *Procedure for transferring a register to IBERCLEAR:*

IBERCLEAR may be designated as the entity entrusted with keeping the accounting records corresponding to a specific security already represented by book entries. To this end, it must coordinate with the entity responsible for registering that security up to that point in order to receive the necessary information to perform its function.

Once the formalities have been completed and that information has been received, IBERCLEAR will register the number of securities to be included in the *Control Batch* and will assign the corresponding balances to the accounts of the participants, charging the balance against the *Issue Technical Account*.

The result of including the security in IBERCLEAR will be notified to the participants, which will make the corresponding entries in their detailed registers in the name of each security holder.

#### - *Procedure for transferring registry from IBERCLEAR to another entity:*

If the issuer designates a different entity to take charge of the accounting registry for a class of securities where IBERCLEAR has been performing those functions to date, IBERCLEAR will adopt the necessary measures to transfer registry to the new entity.

Once the necessary formalities have been completed, IBERCLEAR will ask the participants that have

balances in the security that is to be excluded from IBERCLEAR to disclose the data required for the transfer on the date to be determined.

On the business day preceding the date set for communicating the data needed for the transfer, IBERCLEAR will block all of the securities in question until they have been removed from IBERCLEAR's register. Any movement in the securities in question must be processed through the new register entity from that point onward.

Once IBERCLEAR has all of the information, it will transfer it to the new register entity. Once the latter has acknowledged, IBERCLEAR will remove the corresponding number of securities from the *Control Batch*. Additionally, it will debit the securities in the accounts of the participants and credit them in the *Issue Technical Account*.

Once these securities have been removed, IBERCLEAR will inform the entities, which will post a removal entry for the securities in their detailed registers.

### **3.2. TRANSFERS**

In addition to trades in the market and trading systems which are settled with or without a Central Counterparty, the movements resulting from the following transfers must be entered in the book entry register:

#### *- OTC trades:*

The participants must notify IBERCLEAR of any trades in securities listed on the Stock Exchanges that take place outside the exchange.

#### *- Other transfers of securities other than by purchase/sale (changes of ownership):*

A change of ownership is any transfer of security arising other than through a purchase/sale, e.g. inheritance, gift, etc.

The change of ownership may be reported with or without transfer of the related securities to another participant.

#### *- Transfers of account without change of ownership:*

Participants can transfer securities between their respective IBERCLEAR accounts, provided that they maintain ownership of those securities.

Such transfers may be free of payment or versus payment. When they are performed versus payment, the participant which acts as deliverer will receive the corresponding amount of cash from the recipient entity.

#### *- Loans:*

Participants must notify IBERCLEAR of the arrangement and cancellation of bilateral security loans in which they participate; these transactions will be treated as a special form of transfer of ownership other than by purchase/sale.

The transfer of securities as a result of the arrangement or cancellation of a loan may be accompanied by the delivery or return of the cash amount agreed by the parties as collateral for the loan.

#### *- Deliveries/receipts of securities in the deposit supporting the issuance of assets in another country:*

In order to trade financial assets or instruments issued in other countries and backed by securities from issues registered with IBERCLEAR, certain markets require specific records to be kept of all activity in such assets or instruments.

To that end, the securities supporting issuance of financial assets or instruments in another country must be included in the account or deposit administered by the IBERCLEAR participant acting as "custodian".

In order to add or remove securities in the account or deposit supporting the issuance of financial assets or instruments in another country, they must be transferred and delivered by the applicant to the custodian so as to be registered under the same name as the aforementioned account or deposit, or they must be transferred by the custodian to the applicant so that they are registered in the name of the recipient, respectively.

Inscription in the register of all the transfers described in this section will require express notification of the transaction by the entity/ies involved. Where two entities are involved, the instructions issued by them must be matched in the instruction communication, matching and maintenance system kept by IBERCLEAR for this purpose, as described in section 4.3 of this chapter.

### **3.3. IMMOBILISATION OF SECURITIES IN THE REGISTER**

Securities that are affected by limited rights in rem or some other form of lien or about which certificates have been issued will be frozen in the register and therefore will be blocked in the book-entry register.

In the case of securities contained in any of the proprietary or individual account at the Central Register, the freeze will be performed by IBERCLEAR by transferring the securities in question to a blocked account created for this purpose.

Securities in a blocked account will be immobilised and will not be counted in book entry or settlement processes performed by IBERCLEAR.

In the case of general client accounts, the freeze will be performed by the participants in their detailed register.

### **3.4. INCLUSIONS AND EXCLUSIONS**

Securities movements arising from the following inclusion and exclusion transactions must be registered in the book-entry register:

*- Inclusion of securities converted from physical certificates to book entries:*

The participant wishing to enter securities under issues that have been converted into book entries must notify IBERCLEAR with the number to be included and the holders' names, in the case of registered securities.

Once that information has been accepted, IBERCLEAR will increase the number of securities in the *Control Batch* and reduce the balance pending assignment that IBERCLEAR will have for securities of this type. Additionally, the credit will be booked in the account of the participant, with a corresponding debit for the same amount against the *Issue Technical Account*; securities involved in a numbering conflict will not be registered in the name of the holder.

IBERCLEAR will notify the participant of the balance that has been entered and of any securities that were rejected. In the case of registered securities, IBERCLEAR will send that information to the issuer in order for it to express its consent.

*- Inclusion and exclusion of units in exchange traded funds:*

Royal Decree 1082/2012, of 13 July, approving the Regulation implementing Act 35/2003, of 4 November, on UCITS, regulates exchange traded funds (ETFs) in article 79.

Before the first inclusion of an ETF, its management company (SGIIC) must file an ETF identification

form with IBERCLEAR.

The Depository (or the participant acting for the depository, where the depository is not a participant) will assume the following obligations vis-à-vis IBERCLEAR:

- To fulfil the procedures established by IBERCLEAR.
  - To ensure at all times the proper reception and transmission of communications exchanged with IBERCLEAR, particularly those relating to the inclusion and exclusion of securities.
  - To authorize IBERCLEAR to enter the credit or debit balance resulting from the charges and credits attributable to the ETF in the cash account designated for cash settlement.

The Payment Agent designated by the SGIIC must be a participant in the Securities Registry, Clearing and Settlement System and will bear, for the account of the SGIIC, all payments arising from corporate actions of the ETF.

In order to perform that function, the SGIIC and the Payment Agent may notify IBERCLEAR of the characteristics and conditions of the ETF's corporate actions.

Once the formalities have been completed and the ETF has been included in the register, the Depository will be in charge of performing, for the account of the SGIIC, any inclusion or exclusion of ETF units arising from subscription and reimbursement transactions performed by the SGIIC.

*- Inclusions and exclusion arising from voluntary waiver of record-keeping in connection with delisted or dormant securities:*

The owners of record of securities that are delisted or dormant may request voluntary waiver of inscription keeping in the holder's name in the detailed register kept by IBERCLEAR participants.

To that end, IBERCLEAR will have identified in its system the ISINs to which this procedure may be applicable as a result of their being delisted and dormant. In the case of these securities, IBERCLEAR will identify not only the *Control Batch* but also the balance on which the voluntary waiver has been exercised.

The request will be notified by the holder of record to the participant in whose detailed register the securities are registered, and the participant will request that IBERCLEAR register the voluntary waiver of inscription maintenance provided that the necessary requirements are met.

This procedure will also apply when restoring securities to their original registration status at the request of a holder of record who had previously exercised a voluntary waiver of inscription maintenance. Restitution may be performed for the entire number of securities for which the waiver was exercised or for a smaller number, and it may be processed through the same participant involved in the exclusion from the register or through a different participant.

*- Inclusion and exclusion of foreign securities through a link entity:*

Where foreign securities are included in the system other than via accounts that IBERCLEAR opens in other Central Securities Depositories, this may be structured through a scheme involving three types of entity:

- Link entity

Which represents the security issuer and ensures registration of the securities with IBERCLEAR. It must necessarily be a participant of IBERCLEAR.

This entity must be entrusted with control of all of the securities included in IBERCLEAR and will be responsible for performing the inclusions and exclusions resulting from transfers to and from other markets.

- Custody entity

This is an entity in another country which guarantees the existence and immobilisation of the securities that are registered with IBERCLEAR at any given time.

- Payment agent

This party assumes the obligation vis-à-vis IBERCLEAR to make the payments to which the securities are entitled. It must necessarily be a participant of IBERCLEAR and may also act simultaneously as link entity.

Where the securities are included at the instances of an entity other than the issuer, the promoter must be taken into account.

Operations to include or exclude foreign securities will always require the participation of a Link Entity and will involve the inclusion or exclusion of the securities in the *Mirror Technical Account* opened by IBERCLEAR in the Central Register, which will reflect, at all times, the total amount of foreign securities registered in the System as a result of the inclusions by participants.

### **3.5. TRANSACTIONS WITH PARTICIPANTS OF OTHER CENTRAL SECURITIES DEPOSITORIES**

IBERCLEAR may establish bilateral agreements with other central securities depositories (CSDs) in order to open securities accounts for them in IBERCLEAR and to open accounts for IBERCLEAR in other CSDs.

Bilateral agreements will enable IBERCLEAR participants and those of other CSDs to perform certain transactions in the securities covered by the agreements.

In any of the aforementioned situations, IBERCLEAR will inform the participants of the agreements that it signs with other CSDs and state the types of securities in which transactions may be performed between participants of IBERCLEAR and those of other CSDs.

Depending on the securities involved, the following cases can be distinguished:

- *Transactions in securities included in the IBERCLEAR Register:*

IBERCLEAR will open an account in the name of the CSD with which it has established an agreement, which will reflect at all times the balance of securities that IBERCLEAR recognises in the name of the other CSD (and the latter, in the name of its participants).

IBERCLEAR participants can perform transactions in securities in the IBERCLEAR Register with participants of another CSD through the latter's account at IBERCLEAR.

Bilateral trades resulting from this procedure must necessarily be matched in IBERCLEAR, in accordance with IBERCLEAR's established procedures, information flows and deadlines.

IBERCLEAR will guarantee that CSDs that open an account in its system will have access to the PTI on the same terms and conditions as any other participant.

- *Transactions in foreign securities included through an account opened by IBERCLEAR in a CSD:*

IBERCLEAR can open a securities account in another CSD with which it has signed an agreement. This account will reflect the balance of securities that the other CSD recognises in IBERCLEAR's name (and the latter, in the name of its participants).

IBERCLEAR participants may conduct transactions with other participants of another CSD in securities that are included via IBERCLEAR's account at the other CSD. These transactions will entail the inclusion or exclusion of foreign securities in the Mirror Account that IBERCLEAR will open in its system, which will reflect the balance that IBERCLEAR has at the other CSD. This account will be used by IBERCLEAR to reflect the total foreign securities registered in the system as a result of inclusions by participants.

Depending on the provisions of the agreement, the foreign securities may be included or excluded on a DVP or FOP basis, and matching and, in the event, settlement will take place in the CSD acting as issuer of the securities.

### **3.6. PLEDGES OF SECURITIES AND FINANCIAL COLLATERAL**

IBERCLEAR will register the provision and cancellation of pledges or financial collateral on book-entry securities in the proprietary accounts or in the directly-kept individual accounts open in the Central Register. The member entities will be responsible for entering, in their Detailed Register, the provision or cancellation of pledges or financial collateral on book-entry securities in general third-party accounts or in indirectly-kept individual accounts.

## 4. TRANSACTION NOTIFICATION, MATCHING AND SETTLEMENT

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### 4.1. NOTIFICATION OF TRANSACTIONS EXECUTED ON MARKETS AND TRADING PLATFORMS CLEARED IN A CENTRAL COUNTERPARTY

Under current legislation, trades in shares and other equivalent marketable securities or which give entitlement to acquire shares which are traded multilaterally either on an official secondary market or on a multilateral trading facility must necessarily be settled through a Central Counterparty.

Also, transactions in shares that are not traded in multilateral trading segments may optionally be settled via a CCP.

Introducing a CCP into the post-trade process entails establishing three distinct areas:

- *Trading area:*

Managed by the trading platforms. Trading members will be entities entitled to arrange transactions in the platforms.

Where the participation of a CCP is required to clear the transactions arranged by the member, the latter must participate in the clearing area either directly or by signing a contract with a general clearing member.

- *Clearing area:*

This will be managed by the CCP, whose main functions are as follows:

- Interposition between the parties to the sale contract by novation, becoming the counterparty of the buyer and the seller.
- Risk management, to which end it must have tools such as requiring that its members post margins and contribute to a default fund.
- Clearing or netting, if applicable, of some or all of the trades to obtain the net buy or sell position, which will be sent to IBERCLEAR for settlement.
- Management of failures arising in the process of settling the transactions in which it intervenes.

- *Settlement area:*

Managed by IBERCLEAR as Central Securities Depository. Settling entities will be responsible for settling transactions in IBERCLEAR.

In some cases, the same entity will act as trading, clearing and settling entity, while in other cases the different roles will be played by different parties, depending on the areas in which the entities decide operate.

IBERCLEAR will arrange agreements with the CCPs to allow settlement of those transactions that are novated in those CCPs on securities or asset classes covered by such agreements.

In addition, participants may enter into settlement agreements with CCPs that have an agreement with IBERCLEAR, which they must notify to the latter. In this way, the CCPs may send settlement instructions to IBERCLEAR for transactions assigned to them from the clearing area, for settlement on the arranged date in the securities accounts that such entities have authorised.

In its system, IBERCLEAR will have identified the settlement agreements that each of its participants has established with other CSDs with which IBERCLEAR has an agreement.

In this way, the entities receiving settlement instructions will be obliged to accept and settle the

settlement instructions assigned to them from the CCP, and may not reject them.

The approach to settling trades in multilateral trading facilities offers two alternatives. One is used generally, and the other is an option for settling orders by financial intermediaries.

- *General approach:*

The flow of information between the various participants in the system will be initiated by the trading members, which insert orders into the trading platforms for execution. The platforms execute these orders against others received in the opposite direction, leading to executions, which contain economic information and information of relevance to the clearing area.

The trading platforms will send the executed trades to the CCP for it to novate the inherent obligations. The novation process implies that the CCP interposes itself between the parties to each trade. This means that, during the entire process, until the trade is settled, the CCP acts as counterparty of both the buyer and the seller, and bears any settlement risk arising from default by any of the parties.

The CCP will calculate the cash and securities positions of the trades referred to it and, as a result, will generate net and gross settlement instructions, depending on its approach.

The settlement instructions are sent by the CCP to IBERCLEAR, and they reflect the CCP's buy and sell positions vis-à-vis the participants designated in those instructions.

IBERCLEAR will receive the settlement instructions and will verify, inter alia, that the participants designated in each one have an agreement with the CCP with which IBERCLEAR has an arrangement.

IBERCLEAR will forward the settlement instructions to each participant involved, which will be obliged to execute the instructions assigned to them from the clearing area.

Settlement instructions from a CCP will be executed as described in section 4.4. The outcome of settlement will be notified to the CCP and to the participants involved.

- *Optional model for settlement by financial intermediaries (OMSFI):*

In addition to the general procedure, there is a procedure for settling orders from financial intermediaries that they may use, optionally, when at the time of trading they do not know how the purchases and sales will be distributed among the final holders to whom they provide brokerage services; in this case, the intermediary undertakes to make such allocations by means of ancillary transactions before the process of settling the trades concludes.

For these purposes, financial intermediaries will be understood to mean Investment Firms and credit institutions that are officially authorised to transmit orders for the account of third parties, regardless of whether they are trading members, participants in a trading platform, or clients of either of the two.

The optional settlement procedure may not be used where the final beneficiary of the transactions is a retail client, or it is a prop trade by a financial intermediary, the participating trading member or an IBERCLEAR participant. Moreover, it will not be applicable where trades are executed on a platform through high frequency trading or as a consequence of market-making programmes or by liquidity providers.

The requirements for this optional process are as follows:

- The financial intermediary must have chosen this approach beforehand, on the basis of a contract with the participants of the post-trade infrastructure.
- The financial intermediary must open at least one special individual account in the CCP and in the IBERCLEAR Central Register, which will be linked to each other univocally.
- The post-trade infrastructure's regulations must expressly allow this approach.

- The financial intermediary must identify an account in its name at the participant with which it has a relationship (an individual account in the Central Registry), which will be used by IBERCLEAR to assign ancillary transactions in the event of incidents in matching or settling the ancillary transactions by the established deadlines.

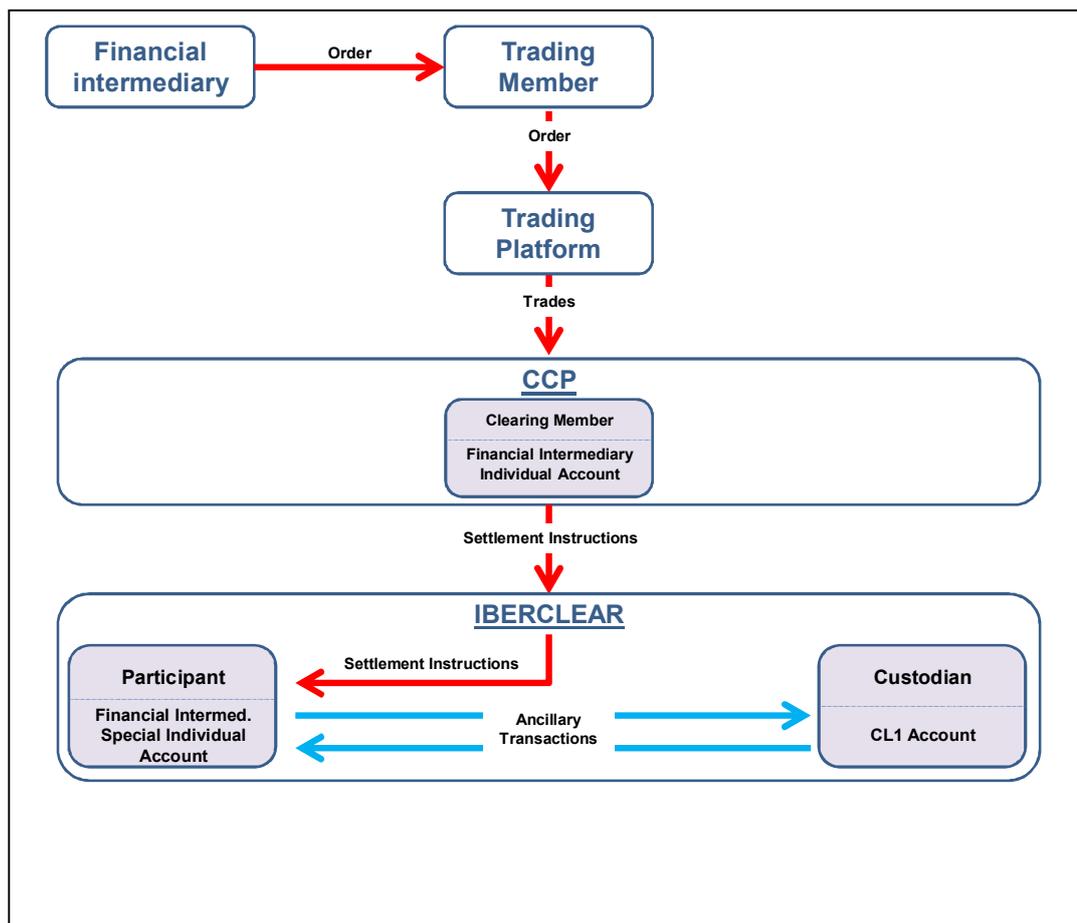
If the pre-requisites are met, the trades will be entered at the CCP in the special individual account that the financial intermediary has opened via its clearing member. Also, the positions resulting from trades sent by the CCP will be entered in the special individual account that the financial intermediary has opened in the IBERCLEAR Central Register through its participant.

The ancillary transactions allowing for allocation, on the settlement date, of the securities positions between the financial intermediary's individual account and the accounts of the end holders in the participant's detailed register must be performed before settlement concludes. For all purposes, the trade and settlement date of the ancillary transactions will be one stated in the trade instructions received from the CCP.

At the end of the settlement date, the individual account held by the financial intermediary through its IBERCLEAR participant will have a balance of zero.

In the event of incidents that prevent communication or matching or the settlement of the ancillary transactions on a timely basis, IBERCLEAR will assign these transactions to the proprietary account designated by the financial intermediary for this purpose.

The information flows will be the same as in the general procedure, except that the flows arising from the ancillary transactions must also take place.



#### 4.2. COMMUNICATION OF TRADES EXECUTED ON MARKETS AND TRADING PLATFORMS WITHOUT THE INTERVENTION OF A CCP

Trades executed in non-multilateral segments of official secondary markets and in Multilateral Trading Facilities (MTF) may be settled with or without the intervention of a CCP. The CCP's participation in settlement is determined in the trading area.

Trades that are settled without involving a CCP are open to counterparty risk. This means that the failure in settlement by one of the counterparties involved will result in the trade not being settled. Unlike a trade that is settled via a CCP, such trades do not benefit from the risk management mechanisms that a CCP provides.

IBERCLEAR may establish agreements with official secondary markets or multilateral trading systems in order to settle trades that are arranged in bilateral trading segments on securities or asset types covered by such agreements.

The flow of information between the various participants in the system will be initiated by the trading members, which insert orders into the trading platforms for execution. The platforms execute the orders against other orders in the opposite direction, resulting in executions.

The trading platforms send the executions to IBERCLEAR. In addition to economic data, each execution carries information about the participants responsible for settling it in IBERCLEAR. Unlike transactions that are settled via a CCP, for settlement purposes the counterparty in each trade is the participant designated in the trading area, with no other party involved.

IBERCLEAR will receive executions and check, among other things, that it has an agreement in place

with the trading platform that originated the trade.

IBERCLEAR will forward the settlement instructions for each execution to the participants designated in the trading area.

In general, the designated participants may not reject transactions sent from a trading platform. However, transactions whose characteristics do allow rejection (arising from corporate actions) may be rejected by the entities before the deadline established for this purpose. This feature will apply on the basis of the transaction type. In this case, the participants are free to accept or reject the settlement by the established deadline.

Once that deadline has passed, any instructions not expressly accepted or rejected by the participants will be deemed to have been ~~rejected~~ or accepted tacitly. Instructions that were rejected by one or both parties will not enter the settlement process and, consequently, will not be settled.

In general, settlement instructions from a trading platform will be settled as described in section 4.4.

### **4.3. COMMUNICATING AND MATCHING BILATERAL TRANSACTIONS**

IBERCLEAR will operate a system for matching settlement instructions notified to it by the participants with the goal of settling the bilateral transactions arranged between them.

The bilateral transactions that are notified via the IBERCLEAR matching system can include the transfers referred to in section 3.2 and the inclusion or exclusion of foreign securities.

Once those transactions have been communicated, IBERCLEAR will validate, match and maintain the settlement instructions.

The purpose of the validation process is to ensure that the information in the instructions communicated to IBERCLEAR by the participants is correct in order to be able to perform the functions for which they were sent to IBERCLEAR.

The process of matching bilateral transactions consists of comparing the information contained in the settlement instructions notified to IBERCLEAR by the delivering participant and the receiving participant in order to ensure that both parties agree with the terms of the settlement.

When the transaction is between accounts of the same entity, the participant may report both instructions for matching in IBERCLEAR or may report the matched instruction.

The matching process is applied as a function of the fields in the instructions, which are divided into three groups: Obligatory match fields, additional match fields, and optional match fields.

Instructions that must be matched in IBERCLEAR and which pass this process will attain the status of matched instructions.

If settlement instructions have not been matched upon expiration of the period established for this purpose, IBERCLEAR will automatically cancel them and issue a settlement instruction cancellation message.

The instruction maintenance system offers features not contained in the current system, such as the possibility of bilateral cancellation of matched trades, retention of trades that had already been released, trade recycling, and amendment of the partial or real-time settlement flag that can be added to the settlement instructions.

#### 4.4. TRADE SETTLEMENT PROCEDURES

Trades notified to IBERCLEAR by a Central Counterparty, a trading platform or the participants, in accordance with the procedures described in the preceding sections, will be settled on the settlement date indicated in the instructions.

FOP instructions are settled in real time. DVP instructions are settled in the settlement cycles that IBERCLEAR establishes for this purpose, unless the parties expressly state their intention that the settlement be performed in real time.

Therefore, two settlement procedures arise:

General trade settlement procedure: Settlement in cycles.

Each settlement day, IBERCLEAR performs several settlement cycles in which it will try to settle the settlement instructions it has received and the FOP and DVP instructions which, in principle, should have been executed in real time before the cycle but are pending at that time. Therefore, back-to-back trades are possible and the settlement process is optimised.

- Settlement cycles will be performed on every valid settlement day.

Once the settlement instructions sent in by the various participants have been validated, IBERCLEAR will verify that there are sufficient securities available in the securities accounts maintained by the participants in the Central Register.

To this end, technical netting of securities will be applied. IBERCLEAR will check that there are sufficient securities in order to process the settlement instructions on an all-or-nothing basis. In any case, changes in the securities accounts will be carried out for the amounts indicated in the settlement instructions.

If there is sufficient balance in the accounts identified in the settlement instructions, IBERCLEAR will settle the securities against the retained balance and then commence the necessary checks for the cash settlement. IBERCLEAR will retain the securities in its Central Register by reducing the balance available in the corresponding account and increasing the retained balance.

It will then prepare to settle the cash positions based on the information received and on the balance of securities retained in the Central Register. The settlement will be performed in the accounts opened by entities in TARGET2 in accordance with Procedure 5 (simultaneous multilateral settlement). Settlement cycles will be settled or rejected as a whole.

Once IBERCLEAR makes the settlement account available to TARGET2 with the actual cash amounts to be settled in same, the debtor settlement institutions will be required to make payment by the established deadline. TARGET2 will notify IBERCLEAR of the outcome of each settlement attempt.

If the settlement instruction is accepted, the retained balance is reduced and the securities are settled in the recipient's available balance. At the close of each business day, the balance of retained securities will be zero since the settlement instructions will have been settled or, otherwise, rejected; therefore, there will no longer be a retained balance.

If, during the defined settlement process, the balance of securities or cash in the account of any debtor entity is found to be insufficient to settle all the instructions in the cycle, IBERCLEAR will trigger an optimisation process to maximise the settlement outcome.

As a result of the process of optimisation, IBERCLEAR will identify the instructions that cannot be included in the cycle due to a shortfall of securities or cash, and their corresponding counterparties.

Pursuant to its "Default management" procedure, IBERCLEAR will apply partial settlement mechanisms as part of the optimisation process.

- *Real-time settlement:*

Each settlement day, IBERCLEAR will perform multiple settlement processes in real time, which may include the same instructions as in the general settlement procedure.

Real-time settlement will be run every settlement day, between 07:30 and 16:00 (for DVP transactions) or between 07:00 and 18:00 hours (for FOP transactions).

FOP transactions will be processed as soon as the instructions are matched. IBERCLEAR will check the availability of securities and settle the transactions by making the corresponding credit and debit movements in the available balance of the accounts in question.

Transactions that are matched before their value date will be entered as soon as the real-time settlement processes commence on their settlement date. Transactions that are matched on their value date will be entered in real time.

DVP transactions will be processed at intervals of approximately 15 minutes. Once there is found to be sufficient securities and cash, the trades will be settled in the register.

DVP transactions will be settled in the accounts that the entities have open in TARGET2 in accordance with the Procedure 3, bilateral settlement (i.e. real-time settlement, trade by trade).

#### **4.5. MANAGING FAILED TRANSACTIONS**

The measures to be taken in the event of failure depend on whether or not a Central Counterparty is involved in settlement.

When a Central Counterparty is involved, its own rules will apply. IBERCLEAR will confine itself to reporting the incident to the CCP and will await its instructions, unless CCP has already indicated how to proceed by default in such cases.

When settlement is made without the intervention of a CCP, IBERCLEAR will manage failures depending on the following features: partial settlement and recycling.

##### *- Partial settlement*

IBERCLEAR allows partial settlement of any type of instruction, including FOP transactions. In settlement instructions for bilateral operations, the entities may indicate whether they wish their instructions to be partially settled. Unless a counterparty expressly states otherwise, in the case of a shortfall of securities, an attempt at partial execution will be made above the minimum thresholds of cash and securities.

If the operations in a cycle can be settled partially, IBERCLEAR will try to settle in the entity's specified securities account: firstly, all the securities in the operation and, if not possible, the total amount of securities in the account's available balance.

Under the recycling rule, IBERCLEAR will try to settle the remaining transactions on the next business day. Where there are party settled operations, an attempt will be made to settle for the outstanding amount; where there are operations that could not be settled, an attempt will be made to settle for the total amount.

##### *- Recycling*

Where operations have not been settled by the date on which registry/settlement is due, settlement attempts will continue on subsequent settlement days until the operation is settled or the counterparties cancel it bilaterally. In principle, there is no limit on recycling matched operations once their intended settlement date has passed.

Following international standards for this purpose, any operation that can not be settled due to lack of securities or cash will follow the recycling rule. Nevertheless, IBERCLEAR may set a limit on the recycling period.

Accordingly, if an operation cannot be settled due to a shortfall of securities or cash, settlement will be

transferred to the next settlement period. If this is due to a shortfall of cash, the securities will be released first. The next settlement attempt may take place on the same day or on following day.

Operations will remain in the system until they are settled, until the maximum recycling period has elapsed, or until the counterparties cancel the operation bilaterally.

#### **4.6. LAST-RESORT SECURITIES LOAN**

IBERCLEAR will place at the disposal of the CCPs and participants a module for last-resort securities loans, whose goal will be to enable the CCPs, if they so agree with IBERCLEAR, to borrow securities in order to manage failures arising in settlement of the instructions sent by the CCPs to IBERCLEAR.

Participants interested in acting as lender must sign a standard agreement in this connection with each one of the CCPs that offer the last-resort securities loan service. The standard agreement will specify the conditions of this service.

Once the last settlement cycle has commenced, IBERCLEAR will check whether there are sufficient securities in the securities accounts identified in the settlement instructions, applying technical netting of the securities for this purpose.

In the event that there are not enough securities to settle all the instructions sent by a CCP, IBERCLEAR will inform the CCP immediately so that the latter may arrange a last-resort securities loan.

Loans will be instrumented as FOP or DVP operations, depending on the wishes of the CCP. In accordance with the general settlement procedure, these operations will be settled in the last settlement cycle.

## **5. NOTIFICATION OF OWNERSHIP DATA TO ISSUERS**

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### **5.1. DAILY NOTIFICATION OF OWNERSHIP**

IBERCLEAR will send a daily notice to issuers of registered securities and, upon request, to any others with data from the operations that entail a change in their register books.

Since accreditation of ownership is determined by the entry in the corresponding account, IBERCLEAR will communicate data for settled operations only.

The notice will include information about the type of operation that led to the entry/settlement. It will also be specified whether the transaction entails registration/de-registration or is a transfer of account without change of ownership. Operations that affect the *Control Batch*, such as inclusions and exclusions, will represent an insertion or removal without a balancing counter-entry.

Issuers will be able to update their record books using that information.

### **5.2. NOTIFICATION OF OWNERSHIP AT ISSUERS' REQUEST**

IBERCLEAR will provide issuers the service of channelling requests by them for identification of securities owners to the participants so that the latter can respond with the necessary shareholder identification data.

To this end, the issuers will send to IBERCLEAR, sufficiently in advance, a request indicating the date on which they wish to be informed about each holder's position and information about the security to which the request refers.

IBERCLEAR will receive this request and relay it to the participants, who will be obliged to supply IBERCLEAR with the security positions of each holder of record in the *Detailed Register* in the two business days following the date indicated in the issuer's request.

The participants will obtain and produce the ownership information in accordance with the accounting standards required by IBERCLEAR.

Once IBERCLEAR has all the required information and has consolidated it, it will forward the ownership information to the issuers that requested it by this service.

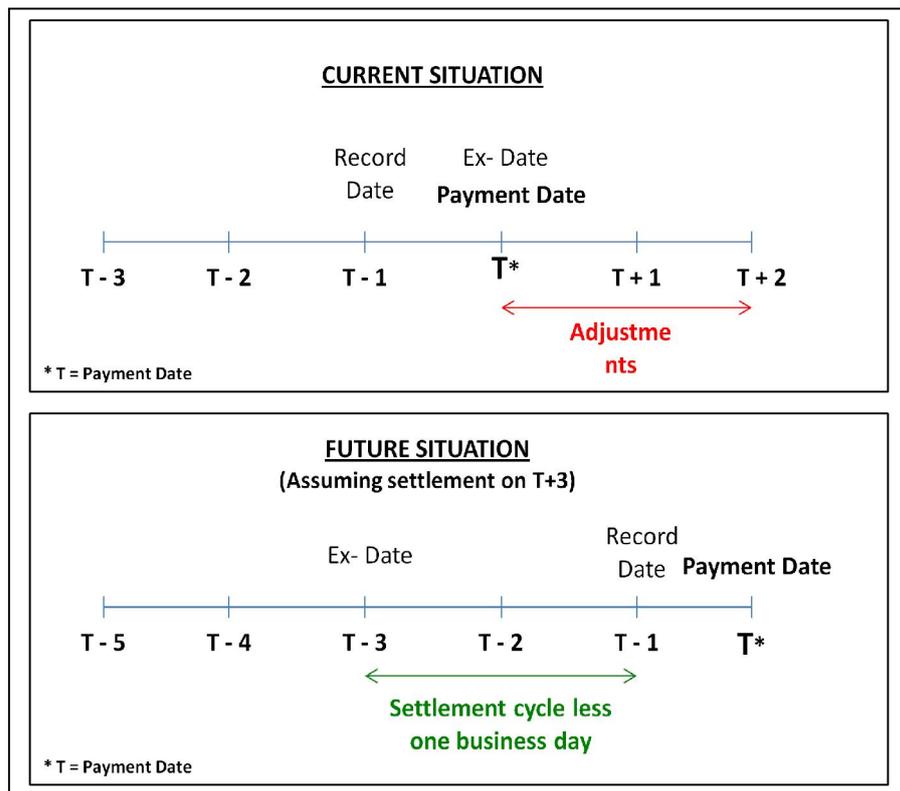
## 6. CORPORATE ACTIONS

IBERCLEAR will manage corporate actions in the securities contained in the new registry and settlement system in accordance with international standards defined by the Corporate Actions Joint Working Group (CAJWG) and the Joint Working Group on General Meetings (JWGGM) in order to harmonise, at European level, the treatment of corporate actions as regards information flows, minimum required disclosures, key dates and procedures.

These standards are not binding, but their implementation is recommended in order to harmonise the treatment of corporate actions among all European CSDs.

As discussed below, one of the principal changes introduced by this harmonisation lies in the way of establishing the *Ex-date* and the *Record date*, which determine who is entitled to participate in a corporate action.

The two graphics below explain the dates currently used to manage corporate actions and those which will apply when the new system comes into force, using a T+3 settlement cycle as at present.



Other significant new features that will be introduced in handling corporate actions are as follows:

- The issuer of the security to which the corporate action refers must designate, for the purposes of IBERCLEAR, a single agent to manage the action; that agent must be an IBERCLEAR participant.
- Information will be exchanged between the agent, IBERCLEAR and the other participants using standard communication formats.
- The issuer and the agent must notify the details of the corporate action to IBERCLEAR, which will check that the action is valid and that the information provided by the two entities matches.

- Issuers must make the charges and credits deriving from the corporate action through IBERCLEAR using the same system as for other cash movements, i.e. through the entities' accounts in TARGET2.

Under international standards, corporate actions are classified into two categories:

- a. Distributions: by which the issuer distributes securities or cash to the holders of the securities in question.
- b. Reorganisations: cases where some type of action other than a distribution is performed with respect to the security.

This classification refers to both mandatory and elective corporate actions.

## **6.1. MANDATORY CORPORATE ACTIONS**

IBERCLEAR will process mandatory corporate actions on the basis of the position in a given ISIN held at any given time by each of the participants.

To this end, it will provide the participants involved in the corporate action with the information about the action and the position in connection with which each of them is entitled to participate in same.

As soon as the corporate action has been settled, IBERCLEAR will update the *Issue Technical Account* and the accounts of the participants in the Central Register in accordance with the securities registration and deregistration movement, as the case may be. The participants will also update the third-party detailed accounts registered by them on the basis of the confirmation of the corporate action which they receive from IBERCLEAR.

The relevant dates for calculating the positions eligible to participate in a mandatory corporate action are as follows:

- Ex-date: the date from which the security is traded without entitlement to participate in the corporate action. The Ex-Date will precede the Record Date in a settlement cycle minus one business day.
- Record Date: the date on which the positions to be considered in calculating the action are determined; operations pending settlement will be adjusted.
- Payment date: the date on which the financial transaction is settled. The Payment Date will be after the Record Date; if possible, it should be the following business day.

Based on those dates, positions obtained as a result of a trade on or after the Ex-Date will not be taken into account since trades executed from that date onwards are ineligible to participate in the corporate transaction.

### ***Adjustments***

Where, as a result of the corporate action, the issuer distributes an amount in cash or securities among the holders of the security to which the corporate action refers, IBERCLEAR will manage the adjustments that prove necessary in order to pay the amount to the rightfully entitled participant on the dates established for this purpose by the issuer.

There are two types of adjustments:

- a. When the trade date falls before the Ex-Date but it has not been settled by the end of the Record Date.
- b. When the trade date coincides with or is subsequent to the Ex-Date and it was a settled before or on the Record Date.

## - *Transformations*

Where the corporate action consists of a mandatory reorganisation involving a pari passu, split, grouping or exchange of the security in question, IBERCLEAR will perform the corresponding transformation on the set of balances, on the matched trades pending settlement at that time and on trades not yet matched at that time.

## **6.2. ELECTIVE OR MANDATORY CORPORATE ACTIONS WITH OPTIONS**

IBERCLEAR will process elective and obligatory corporate actions with options in such a way that it will be optional for holders to participate. In the same way, it will manage actions that allow holders with a position in the security in question to choose among the several options offered by the issuer with regard to specific way of participating in the action.

Elective or mandatory corporate actions with options will be processed in the same way as mandatory corporate actions. Nevertheless, since elective corporate actions offer the holder options as to the form of participation, participants must inform the agents designated by the issuer on the option chosen by each of their clients.

The relevant dates for calculating positions entitled to participate in an elective or mandatory corporate action with options are as follows:

- **Guaranteed Participation Date**, i.e. the last trading date of the underlying security with the right attached to participate in the action.
- **Market Deadline**: last date to send election instructions to the agent, based on the options provided by the issuer.
- **Payment Date**: date on which the corporate action is settled, which will be subsequent to the Record Date (if possible, the next business day).
- **Buyer Protection and Transformations**

In cases of an elective or mandatory corporate action with options, IBERCLEAR offers the option for the buyer to notify IBERCLEAR of the option it would have chosen if the operation had been settled in time. This service will be offered to buyers in failed operations, which were not settled on time due to a default by the seller. IBERCLEAR will transform and adjust unsettled matched operations in accordance with the terms notified by the buyer. This is a manual feature that is available only in two cases: - where the buyer is a Central Counterparty that requested this service or is acting as a counterparty. - where the home country of the corporate action has implemented the buyer protection service.

## **6.3. CASH SETTLEMENT**

IBERCLEAR will manage the cash payments and receipts that are to be performed as a result of a mandatory or elective corporate action.

To this end, it will use the same system as for other cash movements, i.e. through the entities' accounts in TARGET2.

When, as a result of a corporate action, cash payments are made to participants with a position in the pertinent security, settlement will take place in accordance with Procedure 2 of TARGET2, by charging the corresponding amount to the agent's account on TARGET2 and paying it into IBERCLEAR's technical accounts on TARGET2. As soon as the charge to the entity's account becomes final, under TARGET2 Procedure 3, the payments corresponding to the participants on the basis of their respective net positions and the unit amount of the action will be paid out of IBERCLEAR's technical account.

Reversals of a cash distribution will be settled using TARGET2 Procedure 3.

Otherwise, if the corporate action entails a payment to the issuer by the participants (e.g. capital call, subscription, rights issue, etc.), the opposite entries will be made, i.e. the corresponding amount will be charged to the participants and paid to the agent designated by the issuer using TARGET2 Procedure 4, standard multilateral settlement (first, the amounts are charged and paid into the technical account, and then the payments are settled out of the technical account).

Corporate actions that entail settlement of charges and payments to the various participating entities will be settled using TARGET2 Procedure 4.

Where a corporate action does not have the same effect on all securities in the issue (e.g. cancellation by drawing lots, voluntary, etc.), the corresponding payment will be made on the basis of the securities positions affected by the action at each entity.

Cash adjustments will take place in the settlement cycle following that in which the underlying transaction that gave rise to them took place.

The cash settlement corresponding to a corporate action may be executed on any day that is a business day for entries in the entities' accounts on TARGET2. Where the date of payment is not a business day for the purposes of entries in cash accounts, than settlement will be executed on the following business day for the purposes of the payment system, except where the terms of the corporate action establish otherwise.

#### **6.4. GENERAL MEETINGS**

IBERCLEAR will forward notice of a General Meeting to all participants which, at the time of sending, have a position in the security or have transactions awaiting settlement.

## 7. SUPERVISION AND CONTROL

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The reform of the Clearing, Settlement and Registry system will entail the need to implement a new securities registry supervision model. In this new supervision model, markets and post-trade infrastructures must play an active role as both basic suppliers of information and as the parties directly responsible for certain aspects of supervision.

Throughout the design of the supervision model, the Post-Trading Interface (PTI) is considered a key component in ensuring that full details of every transaction are registered so as to ensure traceability from trading through to registration, and vice versa, of all transactions reported and entered in the settlement and registry system.

The information collected and stored in the system should be sufficient for supervising and ensuring the following:

1. Full traceability in both directions between trading and registry, so that the association between a market execution and the corresponding book entry in a securities account is immediate and simple to perform massively by electronic means.
2. Proper supervision of risks and margins so that the system is protected and the likelihood of an incident that is impossible to resolve with available resources is minimised.
3. Supervision of proper keeping of the two tiers of registry so as to safeguard the exact correspondence between the total number of securities in the issues registered with the system and accredited by the various ownership accounts controlled in the system and the relevance and correctness of the entries made in such securities accounts.
4. Supervision of effective settlement of all transactions, especially those which, as a result of Netting, are settled through internal procedures within the same entity.

Because of the design of the PTI, the information entered into it should guarantee full two-way traceability between trading, clearing, settlement and registry. To achieve this, each infrastructure will use an identifier that links their operations and serves as a nexus with the other infrastructures involved in subsequent processes. If the information submitted through the PTI is maintained properly, its mere existence guarantees the traceability of transactions and book entries, and becomes a cornerstone for the supervision of the whole system. To ensure proper keeping of the data reported to the PTI, specific verification procedures must be implemented to ensure the integrity and validity of the information and data that are reported.

As a central component that absorbs and mitigates counterparty risk, the CCP has a very important role in the post-Reform system due to its system of evaluating risks and requiring margins. Moreover, with regard to risks and margins, EMIR also requires proper design and control of the CCP supervision process.

The CCP will perform its management tasks on a daily basis. In particular, it will determine and constitute sufficient margins in the CCP, including the corresponding settlements, and will perform the following tasks:

- Review and control of the variations in asset prices and volatilities.
- Drawing up the report on risks.
- Overseeing and tracking excesses above the Intraday Risk Limit.
- Overseeing the risk premium.
- Reviewing haircuts applied to collateral provided.

In principle, there will be three levels in the specific supervision of risks and margins performed by the CCP:

- External review (at least once per year) of the operating processes, such as drawing up regular risk reports, calculating members' equity, the established solvency limits, and computing bank guarantees.
- Annual validation, by an external third-party, of the risk management procedures and the models and parameters used.
- Supervision of CCP Members by adopting the necessary measures to ensure that Clearing Members maintain a sufficient level of margins at all times.

The Central Securities Depository (CSD) must fulfil all the requirements set out in Regulation (EU) 909/2014 on Securities Depository Regulation (CSDR), which was published in the Official Journal of the European Union on 28 August 2014<sup>2</sup>. The CSD will draw up a Supervision Procedures Manual setting out all the elements required for supervising the functions entrusted to it, principally settlement and registry.

### 1. Supervision and control of settlement.

The supervision model in the new settlement system, which is to be implemented under the Reform, must be based on actions with regard to information on securities movement received for settlement in the system, proper and efficient settlement processes, and tracking and analysis of settlement incidents, final entry of the movements in the first-tier accounts at the Central Registry, and permanent supervision of the balances entered in those accounts crossed against the total volume entered in the system.

To this end, the settlement and registry procedures will adhere to the following principles:

- Settlement of instructions received in the CSD is entered in the security accounts in strict compliance with the DVP principle.
- Cash settlements are made using central bank money.
- Entries in top-tier securities accounts due to settlement of instructions received in the CSD are made using the double-entry principle.
- Any credit or debit movement in a CSD participant's securities account must be accompanied by a simultaneous opposing movement (debit or credit) in another top-tier securities account or in the account representing the total registered balance of the ISIN code in question.
- The system will not allow participants' top-tier securities accounts to have a negative balance, or the accounts representing the total registered balance of a given ISIN code to have a positive balance.

These automatic checks, which will be performed continuously, guarantee that the balances entered in any top-tier account are backed by the total number of securities registered in the system, which contributes to assuring the integrity of uncertificated issues.

### 2. Supervision and control of the securities registry.

The supervision model for the new securities registry system that will be implemented with the Reform must be driven by actions based on the following three pillars:

1. Supervision of the information channelled through the PTI, with daily checks to ensure that all movements entered in the Central Registry accounts have been broken down and that has been provided, and that all necessary information has been entered in the entities' second-tier securities accounts.
2. Supervision that the second-tier balances match those of the Central Registry, by checking that the sum of balances in the second-tier accounts matches the balance of third-party accounts.
3. Supervision of the registry of owners of the securities registered in the Iberclear participants' accounts.

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<sup>2</sup> Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012

In the entities' second-tier accounts, executions may only be aggregated if they have the same ISIN code, date, owner, direction and price. Information for proper traceability of grouped transactions will be channelled through the PTI.

Transactions by professionals and eligible counterparties (as defined by MiFID) must be reflected in the detailed registry in the form of a purchase and a sale transaction, at least. The current special registry of securities loans will no longer be kept, and a new communication file will be designed that will enable the CNMV to ask participants to establish, cancel and report outstanding balances of loans of a particular security.

The cross checks and controls will also apply to the instructions that other CCPs send to Iberclear for settlement, which instructions must be reported to the PTI. This must be set out in the agreements signed by the CCPs and Iberclear. Likewise, supervision of the securities accounts owned by the CSDs and ICSDs linked to Iberclear, as (I)CSD-Investors, will follow the same procedures as apply to the top-tier securities accounts of Iberclear participants.

Of the foregoing three points, the first refers to the information channelled through the PTI. This system should contain a copy of every single entry that the Iberclear participants make in their second-tier securities accounts (i.e. those of their clients). The information resulting from trading in multilateral platforms will be transmitted to the PTI by those platforms, and the market members will be responsible for supplying the corresponding breakdowns, so that they are accessible to the Iberclear participants, which are responsible for settlement and registry. In bilateral transactions notified directly to Iberclear by participants, the latter will be responsible for disclosure to the PTI. In this way, any movement in Iberclear top-tier accounts must be properly disclosed in the PTI system. Iberclear will perform a daily check of the information entered in the PTI, by identifying, at the end of each day, any errors arising due to lack of detailed disclosure or lack of proper disclosure. The result of the daily check will be notified to the entities that are required to report information so that they can make any necessary amendments.

With regard to the second point, supervision of the second-tier accounts in the Registry will be carried out as follows:

- Regular cash checks (at least every quarter) of the omnibus third-party accounts at Iberclear with the balances of the second-tier accounts maintained by entities for their clients. On the basis of information obtained in previous cash checks, and of the data that Iberclear has available to it by virtue of its functions, the test checks may be performed solely on a statistically representative sample of the securities or on all the securities that an entity has in omnibus third-party accounts.
- Regular complementary and random cash checks and tallies in which a participant will be asked to provide the balances of its clients' securities accounts at end of business on two specific dates. The registration and deregistration movements for securities in those accounts between the two specified dates will be extracted via the PTI in order to check that the balances are true.

A specific procedure will be established for overseeing the keeping of the financial intermediary special individual accounts. The results obtained in all supervisory activities will be reported to the CNMV.

Regarding the third point above, Iberclear will establish a procedure having the same versatility and providing at least similar information to that contained in the current X52 file. A procedure will also be established to enable the CNMV to oversee the coherence between ownership information reported to the PTI by market members and that registered by custodians in their securities registries.

Additionally, the performance of participants in the area of settlement and clearing will be monitored permanently by tracking such operating parameters as: Incidents in the daily settlement of transactions, in transaction matching, and in information channelled via the PTI. This supervision will be used to determine the frequency with which participants will be asked to supply information, with the result that checks would be more numerous and deeper in the case of entities showing signs of having less efficient systems.

## 8. DESIGN OF THE MIGRATION TO THE NEW SYSTEM

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The new registry and settlement system represents a major change with respect to the procedures, flows, messages and deadlines used at present and will require new processes to be implemented. Therefore, the migration from the current system will require detailed planning.

Following analysis, it is believed that the most viable approach is for the two systems to co-exist for at least 3 days.

This means that there will not be a single switch-over point but that the change will take place on the basis of the nature of the transactions themselves. Accordingly, trades pending settlement will be grouped into blocks on the basis of similarity, and these blocks will be treated independently.

The trade blocks are as follows:

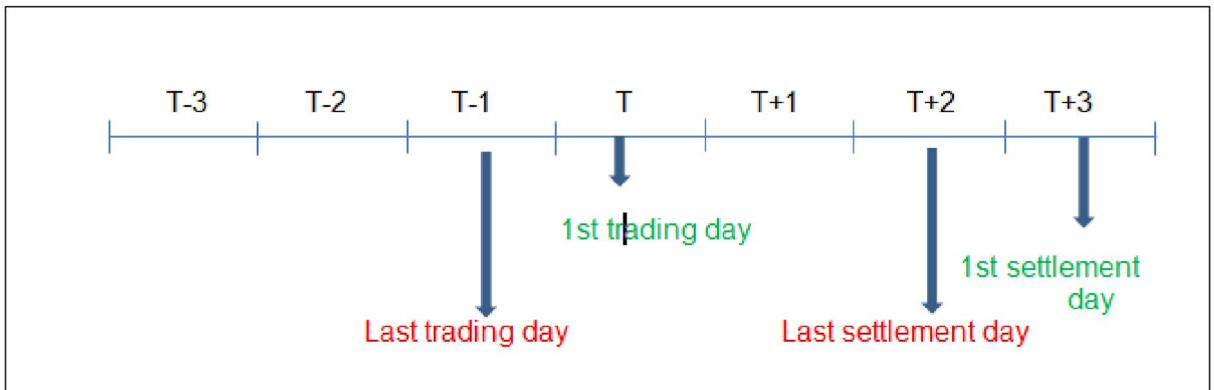
- a) Purchases and sales on the stock exchanges and of securities listed on the stock exchanges but which took place in other regulated markets or multilateral trading systems, and which are notified to IBERCLEAR by participants operating on the account of the CCP involved in the operations to be cleared and registered<sup>3</sup>, as provided in Title V of the IBERCLEAR Regulations.
- b) Buy-ins for stock market operations pending settlement.
- c) Purchases and sales of securities listed on the stock exchanges that are performed outside of the stock exchanges and are settled in accordance with the provisions of Title V of the IBERCLEAR Regulations (OTC trades).
- d) Operations disclosed and matched via the Single Matching System (e.g. securities transfers and loans).
- e) Operations in which the communication date is the value date (e.g. changes of ownership and inclusions/exclusions).
- f) Immobilisations.
- g) Financial transactions.

Trades performed on the stock exchange are communicated to IBERCLEAR for settlement in accordance with operating rules known to the parties at the time of the trade. Those rules entail respecting the guiding principles of the system as set out in article 56 of Royal Decree 116/1992, which states that: "*The clearing and settlement system will be governed by the principles of universality, delivery versus payment, objective settlement dates, assured delivery, and financial neutrality*".

Accordingly, all stock market trades arranged prior to D-Day, the first day of trading under the new system, must be settled in accordance with the guiding principles of the settlement system (article 56 above), which include assured delivery.

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<sup>3</sup> In the new registry and settlement system, since it will not be necessary to provide RRs, it will not be necessary to design a specific procedure for disclosing and settling transactions of this type.



Therefore, it will be necessary to maintain two settlement systems and, consequently, two assurance systems—one under the Central Counterparty and the other under IBERCLEAR—while any stock market trades arranged under the old system remain to be settled. IBERCLEAR will keep the collateral posted by its participants in order to assure any unsettled transactions that were arranged before D-Day, until settlement is completed.

Detailed analysis suggests that the best time for switching the pending information is on a Friday evening/night, with a view to commencing operations with the information in the new system on Monday morning. This approach offers sufficient time to set up a contingency plan in the event that the migration process is unsuccessful.

Since the Reform will have a major impact on the IBERCLEAR participants, their connections will be readied and the processes and preparations required to integrate them into the new registry and settlement system will be performed sufficiently in advance. Also, a sufficiently broad period will be established prior to the scheduled date of implementation of the first phase of the Reform during which the participants must notify IBERCLEAR whether they wish to be participants in the new system.



## IV. Annexes

# A.1.How the Post-Trading Interface works

# 1. INTRODUCTION

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The Post-Trading Interface (PTI) is configured as a part of the infrastructures that will be established by the reform, i.e. the Central Securities Depository and the Central Counterparty, providing two distinct services. Firstly, it will provide a gateway to that infrastructure, offering numerous message types; secondly, it will keep a historical record of operations and owners, to ensure traceability for supervision purposes.

The purpose of this document is to describe the workings of the PTI, which will have two basic features. Firstly, it must serve the goals of traceability and supervision established in the supervision model defined by the CNMV and, secondly, it must serve as a vehicle for information between the various entities involved in infrastructure, all the while maximising the efficiency of post-trade flows and minimising operating costs.

To fulfil these objectives, the PTI will make use, as far as possible, of the modules currently in use so as to enable the entities to undertake the necessary changes at the lowest possible cost. To that end, it will use the current modes of connection and communication languages, and adapt them to a standard language so that each entity uses the option that best fits its systems.

For this purpose, the functions of the PTI will be detailed on the basis of the various phases of a trade, by analysing the flows arising between the infrastructures and the entities involved in the transaction, focusing on two different approaches. One is secondary market trading, and the other refers to all other register entries deriving from operations described in the Iberclear procedures.

For example, in secondary market trades, the PTI will provide each entity with the following basic information:

- To Market Members: executions and executed orders; allocations and the outcome of allocations; owner data; financial intermediary mode owner data; settlement outcomes; details of defaults.
- To CCP members: executions and executed orders; allocations and the outcome of allocations; retentions; exposures; settlement instructions; settlement outcomes; details of defaults.
- To Settlement Agents: executions and executed orders; outcome of allocations; retentions; owner financial data; financial intermediary owner data; settlement instructions; details of defaults.

In this way, all the information is handled in a very efficient process from the moment the execution is sent to the CCP until the time it is settled and registered. Each entity will have access only to the information that concerns it, because it refers to the entity's trades, its clearing accounts or its settlement accounts, as the case may be.

The PTI will also store that information and place it at the disposal of the entities and the CNMV for as long as is considered advisable.

In short, the PTI is configured as an efficient post-trade management tool for all entities involved in the process, using standardised procedures and languages for communicating the necessary information between the entities, and between them and the infrastructures, ensuring access to information on an equal footing and maintaining confidentiality.

## 2. GLOSSARY

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The terms used most frequently in this chapter are described briefly below:

- Infrastructure: the markets, the CCP and the CSD (Iberclear).
- CCP: Central Counterparty.
- Market members: the trading members.
- CCP members: members of the Central Counterparty.
- Settlement agents: participants of Iberclear.
- Executions: trades made in the markets.
- Allocations and the result of allocations: entire process of *give-ups* (transfers of trades between accounts owned by different CCP members) and transfers (i.e. between accounts of the same CCP member).
- Financial Intermediary mode: optional settlement procedure for financial intermediaries' orders:
- T: refers to the trade date.
- S: refers to the settlement date.
- PTI: post-trading interface.

### **3. TRADES PERFORMED IN TRADING PLATFORMS**

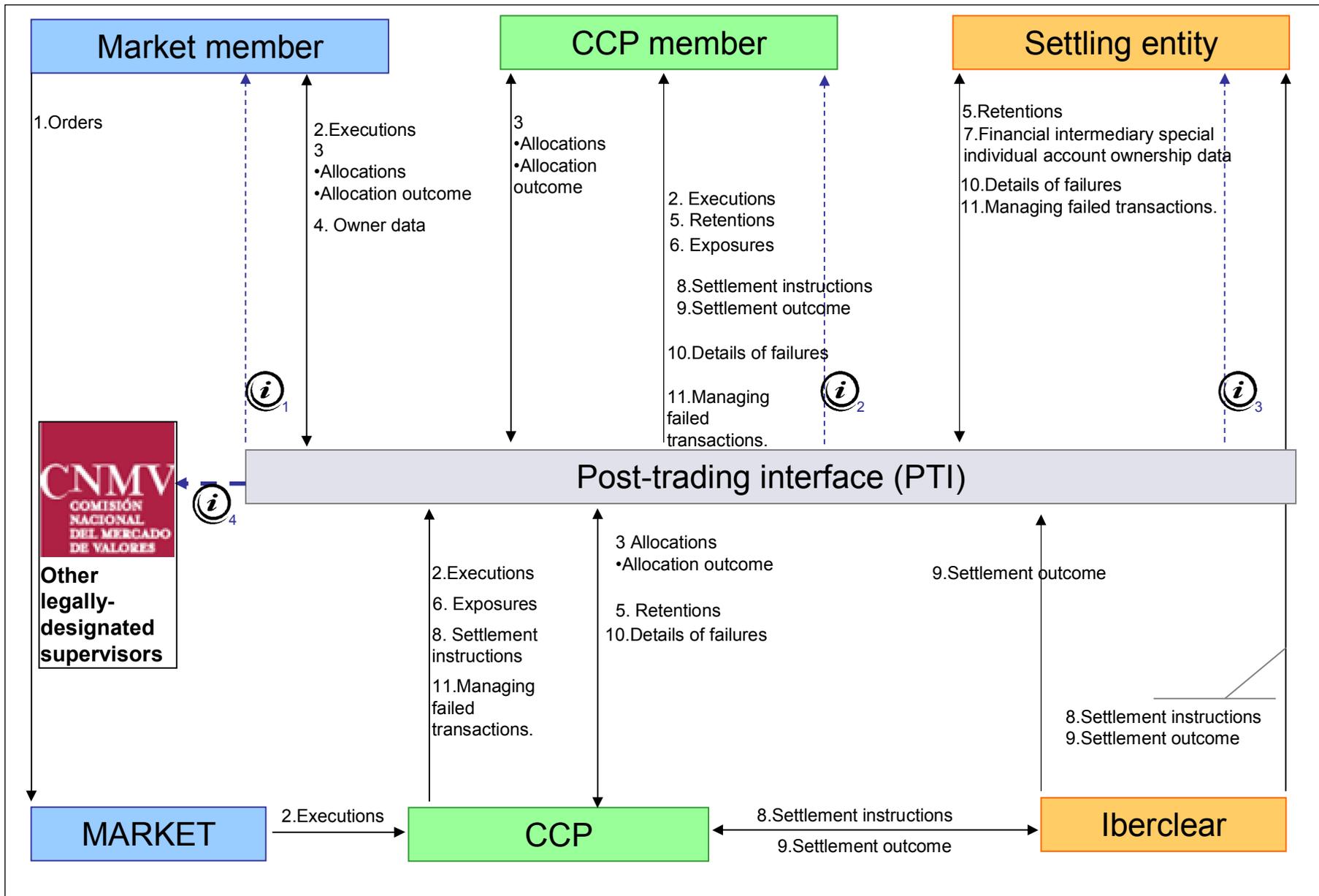
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This chapter describes the workings of the PTI, detailing the functions of the various stages of the flows that arise after trades are performed in a secondary market.

All the information is handled in a very efficient process from the moment the execution is sent to the CCP until the time it is settled and registered. Each entity will have access only to the information that concerns it, because it refers to the entity's trades, its clearing accounts or its settlement accounts, as the case may be.

#### **3.1. DESCRIPTION OF THE FLOWS**

To provide an overview of the entire post-trade process, the following flow set-up basically shows the information that is produced from the time the execution is sent to the CCP up to the point of settlement, including actions by the various entities and infrastructures in the process, as detailed in each area.



### 3.2. DESCRIPTION OF THE FLOWS

The flows in this scheme are described below:

1. Orders: orders are inserted by Market Members into the Trading Platform.
2. Executions: executions in the market are sent to the CCP, for novation and entry in the account of the corresponding CCP member. The executions, with the information added by the CCP, will then be sent, via the PTI, to the pertinent Market Members and CCP Members, which will keep records.
3. Allocations and the result of allocations: Market members and CCP Members can initiate a *give-up* or transfer process. This process follows the steps described by the CCP. The PTI will register the status of those movements.
4. Owner data: Market Members will report the ownership data for each execution to the PTI, which will register it.
5. Retentions: settlement agents notify retentions and releases in the process of transaction management. This information is sent to the CCP, which distributes it to the pertinent CCP members, and it is registered in the PTI.
6. Exposures: the CCP calculates the exposures on the basis of the information it receives.
7. Financial Intermediary Special Individual Account ownership data: In this procedure, the custodians, which generate ancillary transactions, are responsible for notifying ownership of same to the PTI, while participants that are financial intermediaries will associate the ancillary transactions with operations in the clearing house in order to match the ownership data.
8. Settlement instructions: the CCP will generate the Settlement Instructions for each account and will send them to Iberclear and the PTI. The PTI will make the connection between the Settlement Instructions, the operations in the CCP, and the executions available to the Entities. Iberclear will include these settlement instructions in the corresponding settlement cycle.
9. Settlement outcome: Iberclear sends the settlement outcome to the Participants, the CCP and the PTI, which registers the information.
10. Details of defaults: in the event of a settlement failure, the Settlement Agents involved must detail, in the PTI, the associated purchase and sale executions. The PTI must include that information in its disclosures. Managing defaults: the CCP will report on default management actions it performs, which will be registered in the PTI.

Moreover, depending on the type of entity, the following information will be available in the PTI:

-  1. The information available to Market Members will refer to the following:
  - Executions and executed orders.
  - Allocations.
  - Outcome of allocations.
  - Owner data.
  - Financial Intermediary Mode owner data.
  - Settlement outcome.
  - Detail of defaults.
-  2. The information available to CCP Members will refer to the following:
  - Executions and executed orders.
  - Allocations.
  - Outcome of allocations.
  - Retentions
  - Exposures.
  - Settlement instructions.
  - Settlement outcome.
  - Detail of defaults.
-  3. The information available to Settlement Agents will refer to the following:
  - Executions and executed orders.
  - Outcome of allocations.
  - Retentions
  - Owner data.
  - Financial Intermediary Mode owner data.
  - Settlement instructions.
  - Settlement outcome.
  - Details of defaults.
-  4. The information available to the CNMV and other legally-designated supervisors will refer to the following:
  - Executions and executed orders.
  - Outcome of allocations.
  - Owner data.
  - Financial Intermediary Mode owner data.
  - Settlement instructions.
  - Settlement outcome.
  - Detail of defaults.

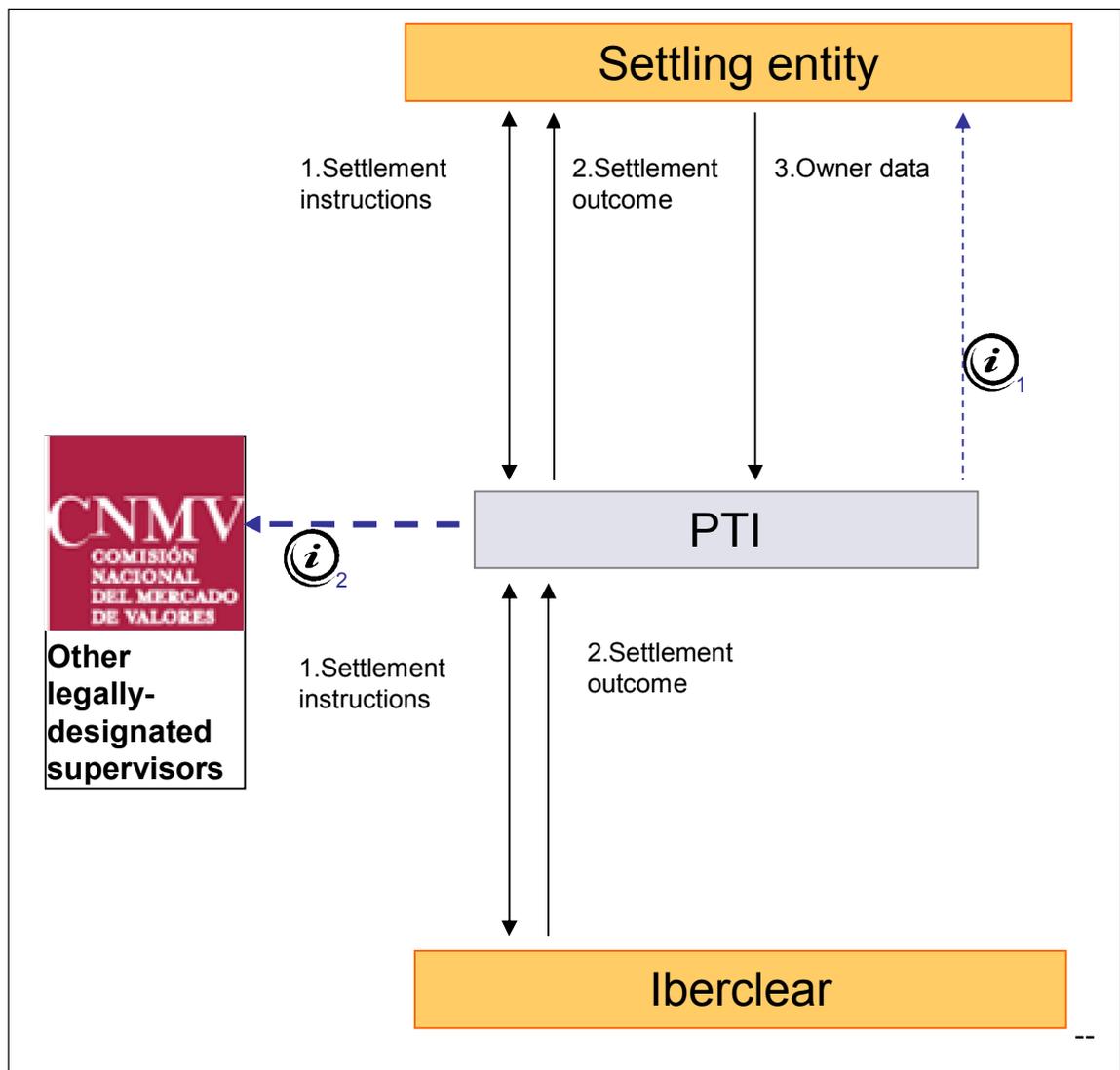
## 4. OTHER ENTRIES IN THE REGISTER

This section analyses how the PTI registers operations performed in Iberclear for reasons other than a stock market trade, which involve inscription in the detailed register; a distinction is made between two types of operations: corporate actions, and other operations.

### 4.1. GENERAL FLOW SCHEME FOR REGISTER ENTRIES MADE IN IBERCLEAR

As defined in the document entitled "New Registry and Settlement System", this general scheme covers both transfers (give-ups, loans, etc.) and all inclusions/exclusions performed in Iberclear.

This general flow scheme is a generic representation of the flow of information from the point the Settlement Agents communicate settlement instructions to Iberclear up to the point where they are settled.



#### 4.1.1. DESCRIPTION OF THE FLOWS

The flows in this scheme are described below:

1. Settlement instructions: Settlement Agents send their instructions for transfers (give-ups, loans, etc.) or those that entail additions to or removals from the register as a result of inclusions or exclusions. Based on Iberclear's procedures, the information exchange established in each case will take place between the Settlement Agents and Iberclear.
2. Settlement outcome: On the settlement date, Iberclear will send the information about the operations that have been settled to the PTI and the Settlement Agents. Since settlement may be partial, the PTI will receive information about the settled part and any part that remains to be settled.
3. Owner data: on the settlement date, Settlement Agents will report the identifies of the owners to the PTI, which will register that information. Ownership data will only need to be communicated in the case of transactions in general third-party accounts.

Moreover, depending on the type of entity, the following information will be available in the PTI:



1. The information available to Settlement Agents will refer to the following:

- Settled Operations
- Settled volumes
- Volumes not settled
- Owner data.



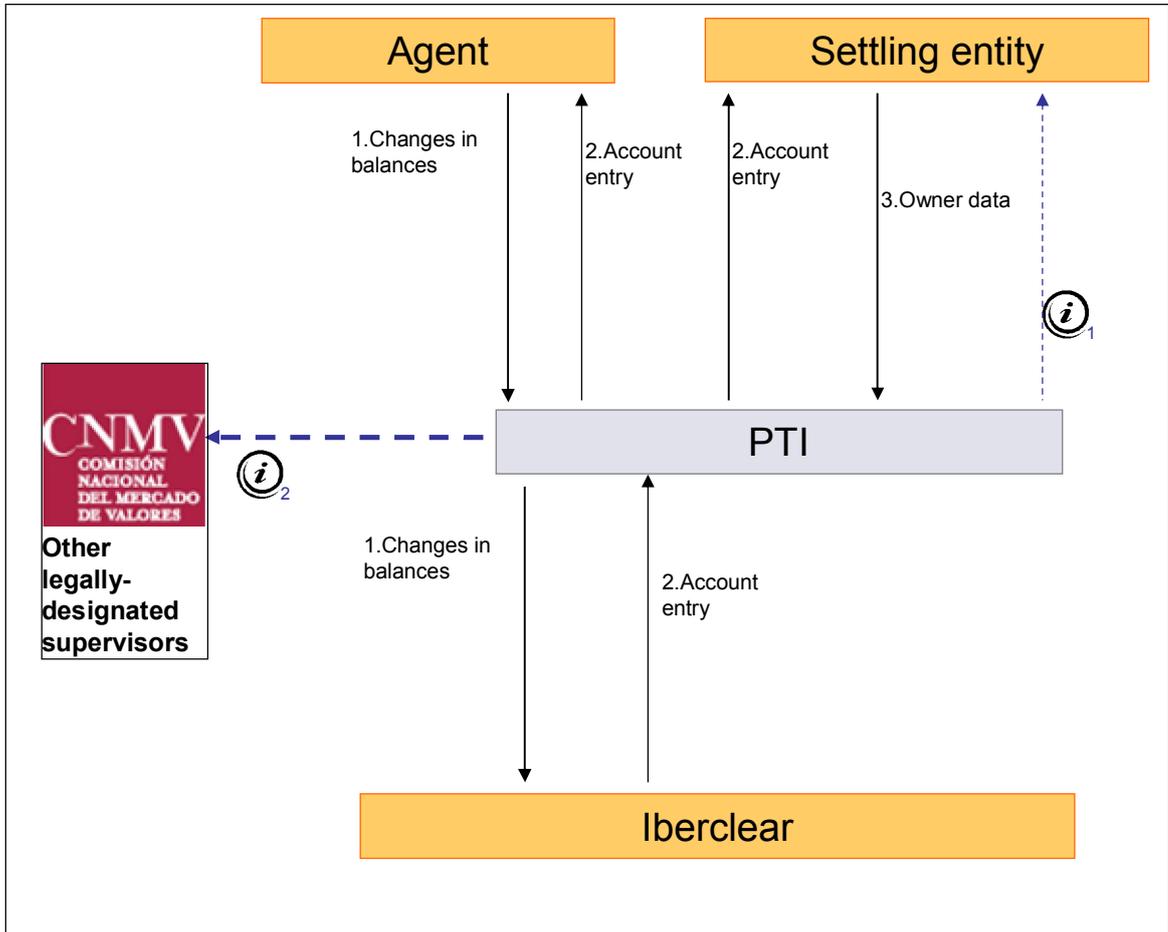
2. The information available to the CNMV and other legally-designated supervisors will refer to the following:

- Settled Operations
- Settled volumes
- Volumes not settled
- Owner data.

#### 4.2. FLOWS IN THE CASE OF CORPORATE ACTIONS

As defined in the document entitled "New Registry and Settlement System", corporate actions refer to the following additions and removals of securities.

This scheme represents the flow of information from the time the corporate action takes place until it is entered in Iberclear's Central Register, including actions performed in the process by the Settlement Agents and Iberclear.



#### 4.2.1. DESCRIPTION OF THE FLOWS

The flows in this scheme are described below:

1. Changes in balances: the Agent communicates changes in balances to be made in each account and at the Settlement Agent for the purposes of the corporate action, as established in the Iberclear procedures.
2. Account entries: on the date on which the corporate action is to be registered, Iberclear sends the PTI and the Settlement Agents the registration/deregistration movements to be made in the Central Register for each account and settlement agent involved in the corporate action. Iberclear will associate those movements to the information of reference: type of corporate action; reference of the action; security to which the action refers; and date of entry in the Central Register.
3. Owner data: on the settlement date, the Settlement Agents will inform the PTI of the ownership and the volume corresponding to each client participating in the action, with the detailed references. The PTI will register this information. Ownership data will only need to be communicated in the case of transactions in general third-party accounts.

Moreover, depending on the type of entity, the following information will be available in the PTI:

The information available to Settlement Agents will refer to the following:

-  1 - Owner data.
  - Type of corporate action
  - Reference of the action
  - Volume to be registered
  - Volume to be deregistered.

The information available to the CNMV and other legally-designated supervisors will refer to the following:

-  2 - Owner data
  - Type of corporate action
  - Reference of the action
  - Volume to be registered
  - Volume to be deregistered

## A.2. Implications of the reform in the trading area

# 1. INTRODUCTION

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This document describes the impact on trading of the implementation of the first phase of the project to reform Spain's securities clearing, settlement and registry system.

The introduction of a Central Counterparty (CCP) will modify the existing structure of flows and, more specifically, the post-trading procedures. Specifically, the current process of allocation and breakdown communicated to the Participants will be communicated to the CCP in the future.

The process of allocation and breakdown will enable the trading member to commence, from the trading and clearing areas, the process of accounting and breakdown of the executions performed in the platforms, i.e. the *give-up* of operations in the CCP between CCP accounts and members.

A trading member of a trading platform may also be a member of the CCP. Depending on the membership classes in the CCP, the trading member may be<sup>4</sup>:

- Clearing Member of the CCP: General Clearing Member or Individual Clearing Member
  - A General Clearing Member is liable vis-à-vis the CCP for fulfilment of all obligations deriving from the trades of Non-Clearing Members, under the contract that they must necessarily sign with the General Clearing Member.
  - An Individual Clearing Member may register transactions for their own account or for the account of Clients, and they are liable vis-à-vis the CCP for compliance with all obligations inherent to the transactions registered in their accounts.
- Non-Clearing Member of the CCP: Segregated Non-Clearing Member or Ordinary Non-Clearing Member
  - Segregated Non-Clearing Member. Will work via a GCM, which will be liable vis-à-vis the CCP. It may register transactions for its own account or for the account of Clients in the accounts open in its own structure of accounts.
  - Ordinary Non-Clearing Member. It will be a client of a GCM. If it has its own clients, their positions will be in accounts at the GCM.

In any event, the trading member must establish a contractual relationship with a clearing member of the CCP, which may exercise supervision on the trading member's activities.

Under this relationship, executions arranged by a trading member are entered, by default, in the trading member's daily account at CCP member with which it has signed the contract.

A trading member has the following features at its disposal via orders from the trading platform, and via the PTI:

- Performance and outcome of account movements for the operations
- Ownership information in connection with the operations.
- Information on executions in the settlement area.

The market model for the trading platforms will not be affected by the entry into force of the first phase of the Reform project.

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<sup>4</sup> Types described in the chapter "Central Counterparty for Equities".

## 2. PROCEDURE FOR TRANSFERRING OPERATIONS BETWEEN CCP ACCOUNTS

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Executions in the trading platforms will be sent to the CCP in real time for novation and will be entered, by default, in the trading member's daily account at the CCP member with which it has a contractual relationship.

Nevertheless, through the order information, the trading platform will provide trading members with the necessary means to request changes to the operations, i.e. to the identity of the CCP member and clearing account, so as to arrange a transfer of account without change of ownership or a give-up to other accounts at other CCP members.

That information will be supplied to the CCP in the executions it receives, and, depending on the inform they contain, it will perform one of the following actions:

- *Non-identification of the clearing account:*

This will give rise to an *entry* in the trading member's daily account at its CCP member.

- *Identification of the daily account that the trading member has at its CCP member.*

This will give rise to an *entry* in the trading member's daily account at its CCP member.

- *Identification of an account other than the trading member's daily account at the CCP member.*

This will lead to an entry in an account of the same CCP member.

- *Identification of an account of a CCP member other than the trading member's CCP member.*

This will lead to an *entry* in the trading member's daily account at its CCP member, and to a request to initiate a *give-up procedure*, which must be taken up by the CCP members involved in same, i.e. the trading member's CCP member and the CCP member that is the target of the *give-up*.

Also, at some time after execution, the trading member may also request a give-up via the post-trade infrastructure.

Give-ups requested by the trading member will be processed in clearing in accordance with the rules and procedures established by the CCP.

Also, if the clearing account belongs to a financial intermediary that applies the special clearing mode for financial intermediaries, the corresponding procedures will apply. That mode may be used if, at the time the trade is executed, the financial intermediary is unaware how the purchases and sales are allocated among the clients or final owners to which it is providing brokerage services, but where it undertakes to perform the allocation during the settlement process.

### 3. INFORMATION FLOW

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This section details the features offered from the trading area, describing the flow of execution information from the time the order is inserted in the trading platform until it is executed and sent to the CCP.

#### 3.1. ORDER INFORMATION

On inserting an order, the trading member may identify the CCP member and the clearing account using the following procedures:

- Directly. By identifying the CCP member and the clearing account in the order.
- Indirectly. Through other fields in the order that can be used to identify the CCP member and clearing account using a parametrisation module.

For this purpose, in addition to the data required by the trading platform, the trading members can supply additional information using the fields provided for this purpose.

##### Direct identification

In this approach, the trading member identifies the CCP member and the trading account in the order data.

CCP members and clearing accounts identified in this way take precedence over any identified by the indirect method (described in the next section).

##### Indirect identification

Executions with indirect identification go through a parametrisation module managed by the trading member. In this module, each definition is linked to a CCP member and a clearing account, so that the member and account information can be obtained from the execution data entered in the order.

Trading members may use the combination of information contained in the order to identify the CCP member and the clearing account.

#### 3.2. OWNERSHIP INFORMATION

Trading members will send ownership information on executions to the post-trade area, within the periods and using the formats established for that purpose<sup>5</sup>.

Trading members will also receive ownership information from the optional settlement mode for orders from financial intermediaries.

#### 3.3. REPORTING SETTLEMENT FAILS

In the event of a settlement fail, whether internal or external, due to retentions in the CCP, or because

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<sup>5</sup> The ownership and address formats adopted by the *AEB-CECA Technical Committee on Securities and BME* in June 2009, as revised by the *IBERCLEAR Technical Advisory Committee*, will be used.

a Settlement Instructions does not deliver or receive securities, the Settling Entity for the account in question must detail, in the PTI, the failed or affected trades using the format established for this purpose.

#### **3.4. AVAILABLE INFORMATION**

The post-trade area will provide trading members with access to information enabling them to query, manage and supervise data relating to:

- The outcome of transfers and give-ups initiated by trading members.
- The status of executions in the clearing area.
- The status of executions in the settlement area.
- Ownership data, both that reported by the member and that related to settlement of allocations arising from settlement of orders that were aggregated by financial intermediaries.

## 4. FUNCTIONALITIES IN THE TRADING AREA

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In accordance with current regulations, the trading platform will provide the following features for better risk control:

- Static and dynamic price ranges

The static and dynamic ranges will be calculated using the most recent historical volatility data for each security.

The static range defines the maximum variation allowed with respect to the static price, which is the price set in the last session. This price is expressed as a percentage.

The dynamic range defines the maximum variation allowed with respect to the dynamic price, which is the price set in the last trade. This price is expressed as a percentage.

- Securities volume filter

Up to 9,999,999 securities may be inserted in each order.

- Cash volume filter

Validation by an authorised operator will be required to insert an order where the cash amount exceeds:

- 6% of the adjusted daily average cash amount in the last completed calendar quarter for each security that is a component of the IBEX-35 index.
- 25% of the adjusted daily average cash amount in the last completed calendar quarter for each security that is not a component of the IBEX-35 index.

This filter will apply to cash amounts in excess of €30,000.

- Cancellation due to disconnection

This option allows for automatic cancellation of all orders in the market order book if the trading members' systems are disconnected from the trading platform.

- Kill button

This tool enables the CCP or a CCP member to determine that a trading member may not insert any more orders into the trading platform until it is re-authorised; it may also entail expulsion of all unexecuted orders from that member in the order book.

- . Additional services

The trading platform will provide the entities with additional services to enhance their ability to control and manage the amounts that have been traded or are to be traded. They include:

- *Drop Copy: Entities can receive a copy of order and executive information.*
- Risk management tools, for supervision of trading members' activities.

## **5. OPERATIONS SETTLED WITHOUT THE INTERVENTION OF A CCP**

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Operations executed in a BME trading platform that are settled in IBERCLEAR without involving a CCP will be bound by IBERCLEAR procedures as regards information flows.

Accordingly, the BME trading platform will supply IBERCLEAR, by the deadline and within the hours established for this purpose, with information on executions and any other data that may be of interest to the settlement area, depending on the terms of the agreement between the platform and IBERCLEAR.

## 6. IMPACT OF THE REFORM ON TRADING MEMBERS' SYSTEMS

Implementation of this system will entail a change in trading members' systems in two areas:

### . Changes in trading procedures

These changes refer to new features that trading members may implement, at their choice, depending on how they plan to operate.

These changes refer only to:

- *Protocols for communicating orders to the trading platform*, which affect terminals and external applications, through the addition of new fields to identify the CCP member that will handle the order executions, as well as the clearing account.

### . Changes in post-trade procedures

An attempt will be made to take advantage of existing procedures as much as possible when adding the new features required as a result of the Reform.

Those features, which will be developed by the trading members depending on how they plan to operate, via the Post-Trading Interface (PTI), refer to the following:

- *Parametrisation module*. The trading members will develop communication protocols for accessing and managing data in the fields of this module, as described in section 3.1 of this document.
- *Procedure for making account changes after the fact*, via protocols to be established with the CCP.
- *Procedure of communicating ownership information* for executions.
- *Access to information* on the status and situation of executions, as described in section 3.4.

The contractual relationship between the trading member and the clearing member may make it necessary to implement new checks on their activities.

## A.3. Legal aspects of Reform of Spain's securities post-trade system

## 1. INTRODUCTION

This Annex sets out the main legal issues that were analysed by the Coordination Committee for the process of reform of the Spanish Clearing, Settlement and Registry System.

Firstly, it contains a number of legal comments on the optional procedure for securities settlement by financial intermediaries, since this procedure is a novelty with respect to the current post-trade system in Spain. To this end, a Legal Group was created with the task of studying the legal viability of the optional model of order settlement by financial intermediaries. On the basis of that study, the Coordination Committee drew its own conclusions.

Secondly, there is a list of the legal amendments that are considered to be necessary or advisable as a result of the reform of the Spanish securities post-trade system and of the European regulations on Central Securities Depositories. In this way, the CNMV complied with its task of making proposals and providing advice to the Government and the Ministry of the Economy and Competitiveness, in accordance with the provisions of article 13 of the Securities Market Act.

## 2. LEGAL ISSUES RAISED BY THE OPTIONAL MODEL FOR SETTLEMENT BY FINANCIAL INTERMEDIARIES (OMSFI)

The process of reform of the clearing, settlement and registry system envisages a general approach to settling trades performed in the stock exchange or in other trading venues. This approach will be applicable by default, and it is designed for cases where the trading members can supply client identity data within the general disclosure period. Under this approach, when a purchase order is inserted into the market, the market member would provide the participant in charge of settlement with the necessary data to enable it to enter the operations in the name of the buyers on the settlement date. Apart from this general approach, an optional securities settlement model (OMSFI) is provided for cases where, at the time of inserting the order in the system, the trading member is not in a position to identify the clients to which it is providing brokerage services but undertakes to do so within the maximum period set out in the rules to be established by the Central Securities Depository (CSD). In these cases, the market member inserts orders in the name of a person or entity (the "OMSFI orderer") which must be a financial intermediary that is entering orders into the system on behalf of a client or several clients together.

Therefore, this approach enables a trading member to insert securities purchase and sale orders in the name of the OMSFI orderer, without having to identify the end client until the last possible moment, in accordance with the rules established for settlement.

The work of the Legal Group consisted of determining whether this approach could fit appropriately within current legislation and identifying what regulations would be required to regulate this form of settlement. In particular, the group considered the risk of insolvency on the part of the OMSFI orderer in the interim period when the purchase or sale of securities is registered in the intermediary's account at the CCP or CSD.

Under this approach, the OMSFI orderer must be a financial intermediary which, under its regulatory status and contractual relations, is entitled at least to insert orders for its own account or that of third parties, and to have segregated securities accounts in its own name at the CCP and the CSD.

This approach is an alternative to the general model, and its use should be optional for the OMSFI orderer and its clients and for the other intermediaries involved: trading members, clearing members and settlers. Therefore, the application of the system, as well as its requirements and costs, must be agreed contractually between the parties involved.

From an operating standpoint, the peculiarities of the registry system for uncertificated securities as provided in this reform, which is still structured in two tiers, requires that the operations and securities settled for the OMSFI orderer be entered, during the initial phase, in a special account opened in the name of the latter at both the CCP and the CSD. Subsequently, once the final clients of the various operations that have been settled in the OMSFI orderer's settlement account have been identified, the purchased securities will be transferred to the accounts of the final clients in a second phase. These transfers will be linked to the settlement operations by means of a code. Therefore, these operations would be settled in two phases.

It would appear to be advisable to adopt a special identification for accounts in which the OMSFI orderer is operating on behalf of clients, so that those accounts are used solely for this purpose. Therefore, these accounts in the name of the OMSFI orderer, both at the CCP and the CSD, should be special segregated (or individual) accounts subject to specific supervision by those infrastructures.

The Coordination Committee decided that it did not appear to be necessary to enact any legislation in connection with this form of settlement. Nevertheless, it is important that the Iberclear Rules regulate this procedure so that it is clear that it consists of two phases (entry in a special financial intermediary account, and subsequent entry in the client's account or the intermediary's proprietary account) and that, until both phases have been completed, the transactions are still undergoing settlement in the terms of article 12.bis.2 of the Securities Market Act. Likewise, the Coordination Committee has proposed an improvement to the wording of article 70.ter.1.f) of the Securities Market Act in order to make express reference to the fact that, in the event of insolvency of a depository or settling entity, the purchased securities must be delivered to their owners (the current wording merely states that the

cash proceeds from the sales must be delivered to the sellers).

Once the Group had determined that the optional clearing and settlement model was legally admissible in general, it then considered other aspects.

Firstly, the time during which the securities are temporarily entered in the name of the OMSFI orderer should be kept to a minimum. The securities should be transferred from the orderer's account to that of the final clients at the end of the settlement day (T+3 or T+2).

Once the two-phase settlement has concluded, the orderer's clients will be entitled to receive the economic and political outcomes of the acquisition as from the time the securities were entered in the orderer's account, and the acquisition should have tax effects from that date since, as noted above, the orderer has acquired securities on behalf of the client, not for itself.

As regards the transaction reporting requirements in article 59.bis of the Securities Market Act, it would appear appropriate to report transactions under this system to the CNMV on two occasions: firstly, in the name of the orderer (T+1, at the latest), and, secondly, when the securities have been assigned individually to the accounts of the client (these two communications being linked by a code).

The Legal Group also studied the way in which transfer orders attain finality under this optional model, at both the CCP and the CSD, given the importance of determining finality of transfer orders inserted into a clearing and settlement system with a view to reducing systemic risk. In this connection, even though this optional approach takes place in two phases in operating terms, a single moment of finality in the settlement system should be established so as to protect the transfer order until the purchase securities are registered in the name of the final buyer.

There is also controversy as to the legal consequences if, once the interim transaction is settled in the OMSFI orderer's account, the securities are not allocated to the final client by the deadline established for this purpose in the CSD's rules. The Legal Group considered that, in these cases, without prejudice to penalties and other disciplinary measures that may apply, the securities should be transferred directly to the orderer's proprietary account, such that the securities should be deemed to have been settled, registered and acquired for its own account for all purposes (registry, ownership and tax), and that the orderer should be considered liable to all intents and purposes for any consequence of its failure, without prejudice to its entitlement to proceed against its own clients. It is considered that this type of situation should be minimised by establishing sufficiently dissuasive penalties for the orderer in breach.

The Legal Group also considered that the model should be clearly delimited in the regulations of the infrastructures involved (regulated market or MTF, CCP and CSD). Those regulations should require that the orderer formally arrange to operate on this basis by means of contract with the members of the trading, clearing and settlement infrastructure to which it is to provide services, that the orderer should have supporting documentation for the orders it receives from final investors at the disposal of both parties and of the supervisor, and that the orderer should accept the consequences of failure to finally allocate the securities to its final clients. Accordingly, and without prejudice to what may finally be determined by the infrastructures' regulations, the Group suggested that the contract between the orderer, on the one hand, and the trading member, clearing member and CSD participant should contain at least a basic set of clauses, including the obligation for the orderer to declare this approach when it is inserting orders, the obligation to report the identity of the end clients before the settlement process concludes, the obligation of the orderer to maintain the supporting documentation it receives from the final clients, and the caveat that, if these securities are not ultimately allocated to their final clients, they will be assigned to the orderer's proprietary account.

As noted in the introduction, the Legal Group addressed this approach firstly from the side of the purchase. Subsequently, on the instructions of the Coordination Committee, it addressed the legal aspect from the side of the sale.

The optional model proposed here allows a financial intermediary to act for the account of the final clients in both purchases and sales of securities, with the only proviso that, in the case of a sale, the intermediary inserting the order on behalf of its clients must have registered the securities in the special segregated account at the CSD sufficiently in advance to allow for settlement on the scheduled date, so that the ancillary transactions between the account of the final clients and that of the orderer

will be the opposite of those in the case of a purchase.

Specifically, the Group was asked whether, in the event that the securities are not delivered, the orderer should assume the legal position of the seller and deliver securities itself, thereby indirectly bearing the consequences of the failure. The Group's conclusions are the same as in the case of a purchase: if the deadline established by the CSD passed and the orderer has failed to disclose the identity and registry account of the clients, the buy or sell position should be transferred by the CSD to the orderer's proprietary account and treated as if the sale had been arranged for the orderer's proprietary account for all purposes (registry, ownership and tax). The orderer will be liable for any costs, expenses and penalties, without prejudice to its entitlement to claim against its clients. The consequences of the orderer's position in the case of sales must also be addressed by the aforementioned amendments to the regulations.

### 3. LEGISLATIVE CHANGES

#### a. Act 24/1988, of 28 July, on the Securities Market.

1) Regarding securities registry. The following amendments should be made to Chapter II of Title I of Act 24/1988, of 28 July, on the Securities Market Act (SMA): "Securities represented by book entries":

a. The Act should be amended to include certain aspects of securities registry that are already part of the system and are reflected in other regulations: the need for securities listed in trading systems to be represented by book entries; the need for a public instrument for the issuance of equity securities; and the two-tier system of book-keeping for the securities registry.

b. Some new features should be introduced, such as the elimination of the principle of irreversibility for book-entry securities and the introduction of a basic description of the account structure at CSDs, including individual third-party accounts. The pro rata rule contained in article 12.bis of the SMA, which is applicable in the event of insolvency of the member and the balance of securities being insufficient, needs to be adapted to the new account types in order to clarify that the clients of a member that is in a situation of insolvency whose securities are in an individual third-party account at the Central Securities Depository will not be affected by the pro rata rule in the event of a shortfall in the general third-party account.

2) Treatment of corporate actions (yields on securities). In this connection, the SMA should be amended to state that, from the time of the trade, the buyer is entitled to receive the purchased securities and any economic rights generated from that point. Additionally, it should be established that, when managing corporate actions, issuers should follow the rules of the trading systems and of the central security depository.

3) Protection against client breach. It is considered advisable to introduce the rule to protect settling entities, trading members and clearing members in the event of definitive breach or insolvency on the part of their clients. In these cases, the Act should allow these entities to enter trades of the opposite sign (i.e. sell the securities purchased or buy the securities sold by the clients) before the transactions are settled, or be paid out of the cash or securities already settled, provided that these assets are free of liens.

4) Post-Trade Information System (PTI). Given its function as a technical tool serving the market infrastructures throughout the securities post-trade system, and its relevance for the performance of the CNMV's supervisory functions, the PTI should be given sufficient legal coverage with regard to such aspects as its configuration and functions and the obligations of infrastructure managers and their members and participants.

5) Supervisory functions. The SMA should be amended to include the principles that govern the system supervision and vigilance functions incumbent upon the markets, the CCP and the CSD, and the obligations of the members and participants in this connection.

6) Adaptation of the SMA to the Regulation (EU) No 909/2014 on Central Securities Depositories<sup>6</sup>. Following publication of the Regulation in the Official Journal of the European Union on 28 August, it is necessary to make a number of amendments to the SMA in order to coordinate the two legal texts appropriately.

7) Improvement to article 70.ter.1.f). It would be advisable to improve the wording by stating that, in the event of insolvency by a depository or settling agent, the purchased securities will be delivered to their owners (the article currently only mentions that the cash proceeds from the sales will be

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<sup>6</sup> Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012

delivered to the sellers), all without prejudice to the rights of any financial institutions that advanced funds (which have been mentioned earlier).

8) Administrative penalty law. The scope of application of articles 99.c) and 100.z) sexies should be expanded to include members and participants of trading and settlement systems and central counterparties so that the most serious infringements of those infrastructures' regulations may be punished under administrative law.

**b. Act 22/2003, of 9 July, on Insolvency.**

Additional provision 2 of the Insolvency Act (22/2003, of 9 July) needs to be revised to introduce, as special legislation, the measures to protect the securities trading, clearing and settlement systems against situations of insolvency on the part of their clients. .

**c. Regulations on fixed income.**

1) Fixed-income securities traded on the stock market. It is suggested that legislation with the rank of a Royal Decree be enacted to allow fixed-income securities traded on the stock exchanges to be incorporated into the Iberclear-CADE settlement platform.

2) Change in settlement period. The Bank of Spain recently announced the change, effective October 2014 of settlement period for fixed income securities traded in CADE from T+3 to T+2, and this amendment would need to be incorporated into the rules of the market and trading systems whose transactions are settled in CADE and also in those of the CSD.

**d. Royal Decree 116/1992, of 14 February, on the representation of securities by book-entries and clearing and settlement of stock market transactions.**

This item of legislation needs an in-depth review. It may be necessary to enact an entirely new Royal Decree to regulate the new securities post-trade system.

With regard to clearing, changes need to be introduced in the system of handling failed trades, since the process will be transferred from Iberclear to the CCP. In parallel, the current system of guarantees required of members should disappear since collateral will now be provided in the scope of the CCP and in the terms provided in EMIR.

In the area of settlement and registry, assured delivery should be eliminated as a principle of action of the CCP. Some basic rules on coordination between the CCP and the CSD and their participants need to be included. In particular, the use of partial settlement should be allowed in order to minimise the CCP's funding needs, and the basic lines of the process for determining the counterparties affected by failed settlements should be described. The accounts structure in the CCP and the CSD also needs to be coordinated and expanded, in particular to take account of individual accounts at both the CCP and the CSD. The regulation on registry references should be eliminated, giving way to a system of registry and settlement based on balances. Finally, it would be advisable to review the rules and procedure for becoming a member of the CSD.

**e. Royal Decree 361/2007, of 16 March, implementing Act 24/1988, of 28 July, on the Securities Market with regard to holdings in the capital of companies that manage secondary markets in securities and companies that manage securities registry, clearing and settlement systems.**

It would be advisable to eliminate asymmetries with respect to EMIR and the SMA regarding the thresholds for disclosure and the competent authority in the matter of significant holdings in the equity of post-trade infrastructures.

**f. Royal Decree 1282/2010, of 15 October, regulating official secondary markets in futures, options and other derivative financial instruments.**

This legislation should be adapted to the provisions of article 59 of the SMA. The part concerning the CCP should be regulated in the aforementioned Royal Decree to regulate the form of the securities post-trade system; accordingly, part of the content of this Royal Decree will be eliminated.

**g. Royal Decree 726/1989, of 23 June, on Governing Companies and members of Stock Exchange, Sociedad de Bolsas, and the Guaranty Fund.**

It would be advisable to expressly derogate certain rules (which have already been derogated tacitly) referring to the connection between the status of member and the status of shareholder in the market governing company (articles 1.4, 2.3, 3 and 4.1).

**h. Decree 1506/1967, of 30 June, approving the Rules of the Official Stock Markets.**

Following the approval of the Stock Markets' own rules, the current Rules of the Official Stock Markets should be derogated, as provided in Additional Provision Three of Royal Decree 1310/2005, of 4 November. In any event, the content of that 1967 Regulation should be reviewed to determine which rules should be incorporated into the general provisions listed above and which should be incorporated into the Rules of the Stock Markets.

**i. Tax implications.**

The CNMV has no competency in tax matters. Accordingly, it is necessary to notify the General Secretariat of the Treasury and Finance Policy of the need to discuss any issues arising from the reform with the tax authorities. The issues that have been identified include: whether the reporting obligations of trading members of the Stock Exchanges persist or whether they should be transferred to the Iberclear members; the maintenance of the tax treatment for securities loans duly adapted to the operational changes; tax neutrality in the event of settlement delays or corporate actions; tax neutrality in the case of cash compensation being paid due to settlement incidents; tax treatment of compensation for failed trades.

# A.4. Reform timeline

## TIMELINE

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The project to Reform Spain's clearing, settlement and registry system and connect it to TARGET2 securities (T2S) introduces significant new features that affect all classes of securities and all post-trade activities.

For this reason, one of the first decisions adopted by the Reform Coordination Committee was to design the project timeline, having regard to the following premises or objectives:

- a. Separation of the major changes (e.g. the introduction of the Central Counterparty and the replacement of the RR system with a system based on balances in equities) from the migration to T2S, the goal being to reduce operating risk by implementing these changes in separate time periods, thereby avoiding the risk that delays in one project might affect the other.
- b. Making the changes with regard to equities as soon as possible because of the international situation (competition between trading venues, EU Regulations on CSDs and CCPs), the goal being that this system should be fully tested and operational by the time T2S comes into force.
- c. Minimising the additional costs to the sector as a whole of connecting to T2S, by ensuring that the changes made by the Reform in the area of equities (registry approach, messaging, etc.) produce maximal compatibility with T2S, so that only marginal adaptations (if any) will be required.

Based on these premises, it was decided to address the Reform of Spain's clearing, settlement and registry system and its connection with TARGET2 Securities (T2S) as a single project implemented in two phases:

1. The first will take place in October 2015 and will involve setting up a new system for equities to include all the changes envisaged in the Reform, including the creation of a CCP in post-trade whose design must be compatible with T2S (messages, account structure, definition of operations, etc.). Accordingly, the SCLV platform will be discontinued.

That system will continue to settle by the current deadline of T+3 (T being the trade date), although that should be reduced to T+2 within a period of approximately 1 month, thereby conforming to the deadline established for this purpose in article 76 of Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories.

The CADE platform will continue to operate unchanged and cash settlements in the new system will be made in the TARGET2-Bank of Spain cash accounts, as at present.<sup>8</sup>

- The second phase will be implemented to coincide with IBERCLEAR's connection to T2S, scheduled for February 2017. At that time, fixed-income securities will transfer to the new system, and CADE will be discontinued.

Equities will also be settled in accordance with the procedures and time periods of T2S, so that the interim settlement procedure used in the first phase will be discontinued.

The second phase will entail unifying the registry and settlement approach for both equities and fixed-income.

The chart below depicts the two phases in which the project will be implemented:

