

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

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

Summary of work carried out on CCP and risks

According to the last published update of the reform process the working group dealt first with several issues in relation with functional and institutional features of the CCP, the solvency requirements of the CCP and its participants, the mechanisms of risk management and the procedures to resolve failed trades.

Since the last update the analysis has been focused on the development of mechanism to resolve failed trades and some work has been done in the area of information flows between the markets, infrastructures and participants and the necessary changes in the settlement models. The compatibility of the main changes in the system with T2S project has been also part of the study.

In the area of management of failed transactions, different basic elements have been identified, such as the ones utilized in the main European post-trading infrastructures, including the trade cancellation and the corresponding cash compensation mechanisms as well as their support in the current regulation. They have been also discussed the criteria to identify counterparties which are failing to delivery the assets on time, distinguishing failures concerning securities delivery and cash payments. Deadlines of final resolution of failed trades were also studied. The particular case of a temporary failure in delivery and the necessary coordination between CCP and CSD in order to avoid duplicities in the actions to resolve failed trades have also been analysed.

Discussions over information flows of the clearing and settlement system have been based on the relationships established for the delivery and reception of information between the different elements of the system: the Stock Exchanges or the Multilateral Trading Facilities (MTFs) and its members, the CCP and its participants and the CSD and the settlement agents. The advantages and disadvantages of each different alternative have been considered, as well as the most adequate time for delivering or receiving information between the different institutions and system' participants.

With regard to possible changes in the settlement model, some alternatives that could provide a greater convergence between the two current settlement platforms for fixed income and cash-equity trades have been discussed and the advantages and disadvantages of a shorter settlement period than the current T+3 and a wider offer of the length of the settlement cycles and settlement options were taken into account as well. It has been analysed the feasibility of introduce a real time settlement facility, that could also be used as a mechanism to resolve failed trades. Finally, the costs in terms of management the access to liquidity if an overnight settlement cycle was put in place were also assessed.

All before mentioned issues have been studied from a comparative perspective of the current market practices in jurisdictions where a CCP is already in place.

Summary of work carried out on settlement finality and registry

Regarding settlement finality, although the work is not yet finished, an important progress has been done. Firstly, a comparative study of the settlement finality in the most relevant European clearing and settlement systems has been carried out (Germany, France, Italy and United Kingdom). From the study it could be concluded that the majority of the European CCP and CSD have notified to the European Commission their condition of “systems” under the Directive 98/26/CE, about the settlement finality in the payment and securities settlement system, and that the determination of the concrete settlement finality moment for the different types of orders is established in the internal rules which govern their systems instead of in their general legal frameworks. Being considered as a “system” under the scope of the above mentioned Directive allows protecting these institutions from possible systemic risks as a consequence of insolvency proceedings of any of its participants.

In every “system” the rules about settlement finality are established depending on its particular features and considering always the different types of transfer orders that the “system” intends to protect (orders that come from regulated markets, from MTFs, bilateral trades, orders for transferring securities or cash orders, etc.).

In Spain, the introduction of CCP services in post-trading activity will require that the CSD and the CCP include in their own rules some specific provisions on settlement finality.

Once the on and off-exchange trades are received and accepted by the CCP this will be liable by a double mandate: novation by becoming counterparty of the buyer and the seller and secondly facilitating the settlement of the trades (clearing and transmission of transfer orders of securities and cash to the CSD). Novation should take place, due to efficiency and market safety reasons, as much close in time as possible to the on exchange execution (practically on a real time basis). Once the acceptance and novation of the orders have taken place settlement finality must occur simultaneously in the CCP for the transfer orders. This will have the goal of protecting the system from a possible insolvency of a participant and to facilitate the clearing processes according with the CCP procedures.

With the aim of carrying out the settlement of the trades, once these are cleared, the CCP must send to the CSD the corresponding orders for changing the beneficial ownership of securities and cash. To this end, the CCP must be a participant in the CSD.

The CSD will have to set up its own rules about the settlement finality of orders entered in the system. The CSD could define different settlement finality moments depending on the nature of the transfer orders received (coming from the Exchanges, MTFs, OTC, etc). To that end, there are different moments in which the settlement finality can be set (when orders are matched, in the matching of orders once the funding of assets is already checked by the participants or when the orders are settled). It is important before choosing a time for finality to bear in mind the particular operational framework of each system, as well as the interoperability agreements established between each other.

One of the analysed risks is the event of insolvency proceedings against a participant between the novation at the CCP level and the settlement in the CSD. In order to minimise this risk, it is important to get a time period as short as possible between the novation in the CCP and the settlement in the CSD.

Some issues regarding the links between the CCP and CSD have been examined in connection with finality. Some legal risks could arise from the fact that there are different moments of settlement finality in the interoperable systems. Furthermore, the fact that the concerned systems could be submitted to different regulations may raise more complex problems. In order to avoid legal risks derived from different settlement finality moment for the same trade it is necessary that the agreements between systems take this issue into account in their procedures. The amendment of the Directive 98/28/EC, in 2009, recognises this circumstance. Therefore, the agreements between interoperable systems could establish specific moments for settlement finality for orders to be processed, different to those set up for other kind of orders.

With regard to the registry and the delivery of RR after settlement, different alternative scenarios are being considered to elaborate an initial working proposal, once the main legal consequences in this field have been pointed out.

Further work

The working groups will continue with the development of pending issues while some already completed topics will be revised with the objective of providing at the end of this initial stage of the reform with a guidance, to include the main needs of the reform model and which could be used as a baseline to continue with the legal design in further stages.

In the following meetings the institutional design and issues related with corporate governance of the CCP will be treated.

With regard to registry and settlement finality, operational questions about the determination of the time of settlement finality will be finalised and several alternatives of compatible registry system with the resulting settlement model will be studied.

