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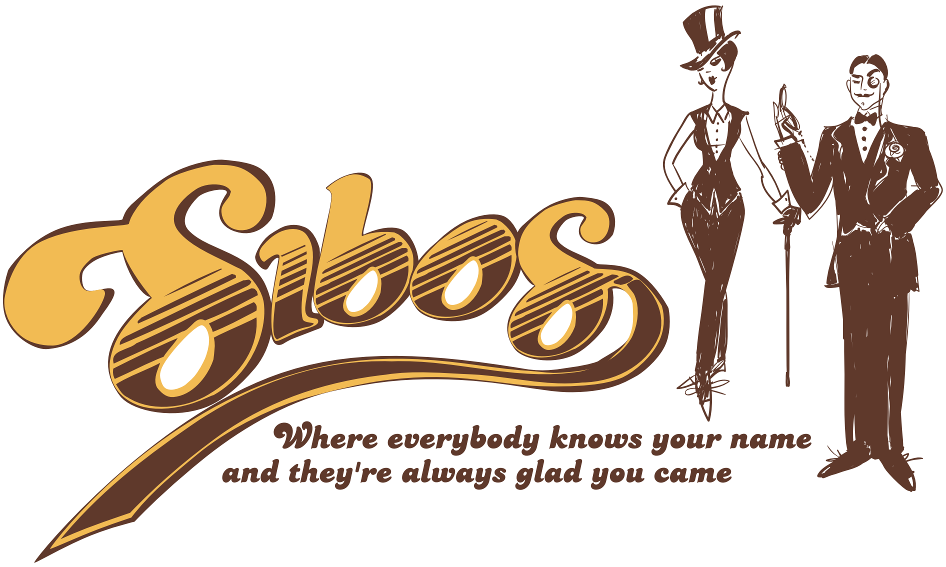

Corporate Actions - *Panellists discuss T2S*

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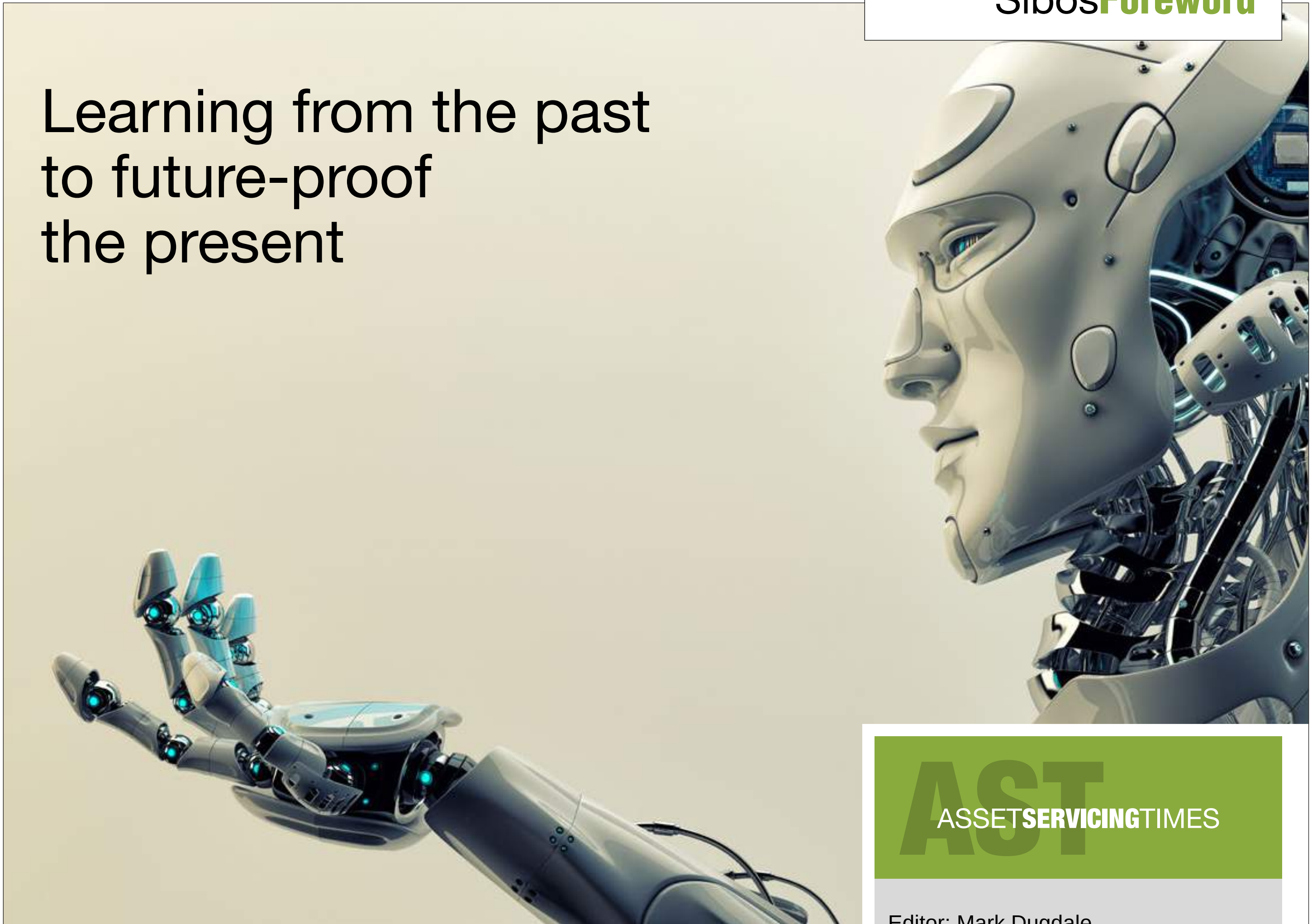
What Next? - *Specialists tackle regulatory updates*

Connecting Asia - *Automating the back office is only the beginning*



Learning from the past to future-proof the present

The financial industry is in the midst of an evolution.

As Darwin dutifully noted, evolution does not happen overnight, but, after everything went wrong for Lehman Brothers, 2008 acted as a catalyst for regulatory change and survival of the fittest has never been more accurate.

For that reason, I could not think of a better city to host this year's Sibos conference. Surrounded by the deep-thinkers of Harvard and the technological know-how of MIT, Boston sets the scene for a conference filled with the latest updates in creating a harmonised financial future.

Boston, and on a wider scale the US, has been home to a number of regulations (the Dodd-Frank Act and the Foreign Account Tax Compliance Act, to name a few) that have had repercussions across the globe. Europe too has contributed its fair share of change, with the Alternative Investment Fund Managers Directive and the European Market Infrastructure Regulation a recurring theme among the pages of Asset Servicing Times.

A flick through this edition will give a taste of how the industry is handling regulations around the world. From the technology used to deal with requirements to the translation of global into local legislation, it would seem that firms have taken up the challenge to make what they do safer, without hitting the bottom line.

I would like to take this opportunity to thank all of our contributors for allowing us a look at the industry through their eyes, and I hope you found this edition as insightful as I did.

As ever, Asset Servicing Times is open to comments and suggestions. If you don't catch me on my wanders around the conference, do drop me a line.

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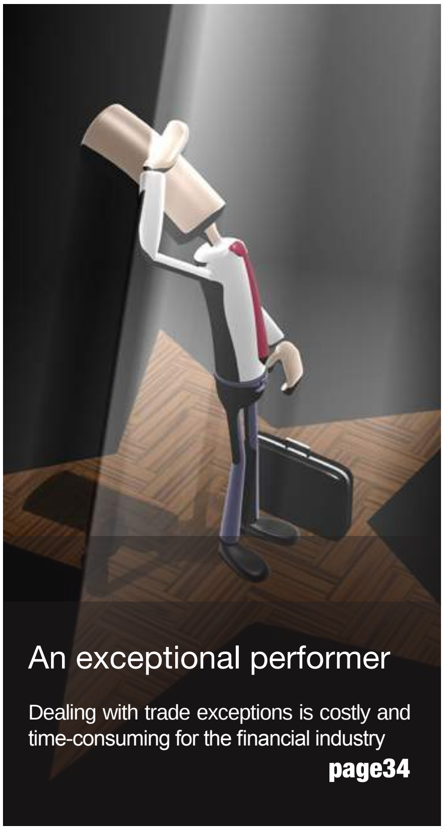

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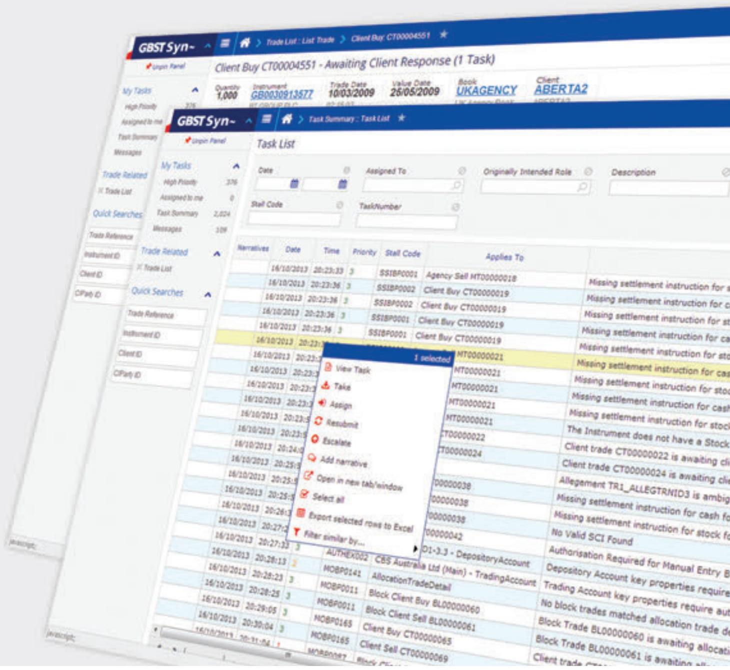

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Connecting Asia

Automation of Asia's back-office is only the beginning of a series of changes that will bring domestic and global growth to the region

CATHERINE VAN DE STOUWE REPORTS

Asia is possibly the largest and most diverse region in the world. From the high-rise Singapore, to the high-speed Japan, to the highly relaxed Vietnam, banking in this region is going from strength to strength, and over the next few years the industry will be subjected to much change.

Depending on where you are standing, both in terms of geography and business function, post-trade processing environments vary considerably. Focusing on automation, Steve Murphy, regional manager for greater China at SmartStream, believes that firms across the Asia Pacific region "have the appetite to automate but their motivations are different".

There is a growing pressure for automation in Asia in order to process cross-boarder transactions and support the vast range of markets. Akhter Khan, general manager of Asia Pacific, global technology and operations solutions at Broadridge, explains: "There is also an increased appetite for firms to extend the range of asset groups that they handle and to process them on a single unified solution instead of using discrete operational and IT silos."

For the most part, automation is not the problem, but having the technology to do so is. Khan says: "Asia's incumbent technology lacks the flexibility and underlying architecture to meet their strategic needs for multi-market and multi-asset operations." This lack of sophisticated technology could be holding markets back.

Japan

As one of the largest territories in the post-trade space, Japan has been a leader in the automated field since fully automating its proxy voting system in 2005. Working with the Tokyo Stock Exchange (TSE) and Japan's Securities Dealers Association, Investor Communications Japan, Broadridge's ProxyEdge solution created a "radical improvement", says Patricia Rosch, president of investor communication solutions international for Broadridge.

She added: "Efficiency to the cross-boarder investor community, extending voting deadlines up to meeting date-1 was a major advance from the meeting date-10 cut off that many international investors had been forced to work with under the prior volumes."

To date, 466 Japanese companies are now using the shareholder communications and voting service, which Rosch says "includes almost all of Japan's leading blue-chip listed companies, representing 80 percent of the market capitalisation of the TSE first section". By having a high percentage of companies aligned with the proxy voting automation, timeliness and accuracy of cross-boarder voting has improved for foreign investors of the 466 companies.

Looking beyond Japan, automation and the benefits of it for post-trade processes are largely aligned to the volumes, the diversity/complexity of markets and products traded and narrowing settlement cycles. In some countries, there is not enough volume for automation to be "too much of a concern".

However, Murphy explains that, as the markets become more interlinked and volumes increase across the region, securities operations will be expected to achieve consistent, transparent performance in execution or settlement with concessions only being made to less automated countries for so long.

If you consider many Asian markets' adoption of T+2 settlement, and the constant search for efficiency, risk mitigation and regulatory compliance, institutions and markets with lower levels of automation levels will have to discard manual processes in order to compete and stand up to scrutiny among peer firms that have already made considerable investment in automated processing, such as those in Australia or Singapore.

Regulations

With global regulations interlinking markets more than ever before, their effect is being felt in Asian financial operations as well as their Western peers. Any significant level of investment exposure to Europe and the US demands institutions in Asia need to keep up and comply with the regulations in those geographies. "The Foreign Account Tax Compliance Act, Dodd-Frank Act, legal entity identifiers, know your customer; they are all very much front and centre for Asian institutions," explains Murphy, "with the biggest regulatory demand arising from Basel III".

Similar to the European Market Infrastructure Regulation and the Markets in Financial Instruments Directive, Basel III is a regulatory standard on capital requirements and maintaining proper leverage ratios. "The liquidity coverage ratios, the reporting, and the means to be able to report on demand is an imperative that everyone has to be able to meet," says Murphy.

He adds: "We've gone from a situation where the regulator would ask if an institution has adequate liquidity to cover their positions; they could say 'yes we have' and the regulator would be happy. But now, under Basel III, this is no longer the case, institutions are under a lot more scrutiny and the regulators want to see evidence, in real-time, that institutions have the necessary liquidity at their disposal."

Alongside global regulations, Murphy explains that certain markets in Asia have the added pressure of complying with their own domestic financial regulations. As well as Hong Kong licensed banks' obligations under the Monetary Authority's Basel III provisions, non-bank institutions regulated by the Standards and Futures commission must comply with its financial resources rules.

By keeping compliant with regulations and increasing focus on corporate governance and transparency, both Khan and Rosch agree, they "will also play a role in attracting foreign investment funds and, through that, growth". Adopting these "international standards" will benefit not only the cross-boarder consistency and alignment, but will add to benefits on "an individual market level".

Stock connect

On 1 October 2014, the Shanghai-Hong Kong Stock Connect (SHSC) will go live, which, according to Alistair Murray, regional head of asset managers sector at HSBC Securities Services, "is receiving a huge amount of interest from global investors".

For some, as Murray explains, the SHSC is seen as an alternative to the traditional China market access routes, such as the qualified foreign institutional investor and the RMB qualified foreign institutional investor.

The SHSC is the first channel for mutual market access between mainland China and Hong Kong for a broad range of investors. The SHSC will give participants easy access to hundreds of companies' shares. A spokesperson for the Hong Kong Exchange (HKEx) says: "The SHSC will pave the way for further opening up on mainland China's capital account and RMB internationalisation … resulting in new investment opportunities and more choice for participants."

The exchange is open to all participants and members of the stock exchanges in Hong Kong and Shanghai, but the SHSC is not mandatory to join. The initiative may not fit into strategies or business models of some firms, or they could take a 'wait and see' approach to how the market reacts to the SHSC. "It is a decision of the individual investors and brokers," says the HKEx spokesperson. "If they want to join the scheme later, they are welcome to do so at any time."

With a "scalable and replicable" design, the HKEx spokesperson says the future could see similar exchanges "expanded to cover other markets and/or asset classes on mainland China and elsewhere." For now, the exchange remains exclusive to Shanghai and Hong Kong, although the introduction of passporting in the next two years will ease cross-boarder trading for the rest of Asia.

In the future

The year 2016 will see the implementation of the Association of Southeast Asian Nations (ASEAN) and the Asia Pacific Economic Cooperation (APEC) fund passports. A similar style to the European UCITS, the passporting will reap huge benefits to the smaller, emerging Asian markets. The passports will work in conjunction with UCITS, allowing fund managers access to markets that Murrays says "are not currently available to their UCITS funds".

"If the passporting schemes are successful," says Murray, "then fund managers will be able to benefit from economies of scale, attract a larger population of investors and give them access to new markets that they would previously have been unable to enter."

A recent release from the ASEAN Exchanges has suggested that steps are being put in place to create an ASEAN asset class. Speaking on behalf of ASEAN Exchanges, Magnus Bocker, CEO of Singapore Exchange, said: "The collaboration action amongst ASEAN Exchanges has been a vital force in moving things forward to achieve our goals and this is most evident in the significant progress we have made over a relatively short period of time."

"Each of the exchange members has embarked on their own in-market engaging activities with the market players to market and create greater visibility of ASEAN products to investors."

While Japan continues to enhance its proxy voting process, Broadridge sees interest across the region is spiking to move to electronic voting. Combine that with impending passport schemes and automation proving significant to Asian market, growth is likely to come both in domestic terms and in proving the Asian markets to be global players. AST

Asset management integration

Yasutoshi Kaneko of the Nomura Research Institute tracks the trend of asset managers in Japan turning towards BPO and BCP services

The Japanese asset management industry has reached significant milestones and continues to grow. As a result, fund managers in Japan must find a way to catch-up with their peers across the globe, while still maintaining efficiency and managing costs.

The industry is facing pressures from the competitive landscape introduced by foreign asset managers in the unique Japanese market, the push to further enhance fund performance and from the complex requirements introduced through the various stakeholders, including regulators, investors and the parent companies of various financial groups involved.

In response to these pressures, many foreign managers in the region are rethinking their operations and have shifted the traditional views on business process outsourcing (BPO) and business continuity planning (BCP) services and are examining how best to work with providers located in Japan.

Unique regional framework

The asset management industry in Japan boasts a unique framework that has previously been very attractive due to market size, but not very cost efficient for participants. However, the environment is constantly evolving, significantly affecting the business choices made by foreign managers as a result of recent market changes. For example, the Government Pension Investment Fund (GPIF) in Japan, the largest pension fund in the world, is reforming its system to increase its reserve. GPIF surprised the market by electing to allocate solely foreign investment managers for bottom-up research and management of active funds when selecting mangers in the spring of 2014. This shift was a landmark change for the industry, as Japanese asset managers believed that they had competitive edge of Japanese equity products.

Regulatory changes continue to impact the industry as well, especially after the financial crisis, as regulations imposed upon banks now affect subsidiary asset managers. These mandates are calling for stronger governance while investors are simultaneously requesting better transparency on banks' investments.

Despite these region-specific characteristics, the Japanese capital market is very open for interested foreign players to enter. If an asset management firm does not have an office located in Japan, they are still allowed to participate in opportunities within the region, such as cross-border funds or sub-advisory services. This participation is often beneficial for asset managers in terms of cost savings. For example, cross-border funds are not required to adhere to UCITS standards, which would otherwise be much higher in cost for the fund.

Additionally, Japanese investors have strict standards for their investments and demand a high quality service from their asset managers, making business and operational accuracy a critical component for success.

Global focus on BCP and BPO services

Even though foreign managers without Japanese subsidiaries can easily access the market, there still exist remarkable reasons for them to have entities in Japan in terms of client services. However, as foreign managers begin working in Japan, it will be important to carefully review how they position their offices in the region. As the institutional investment industry increasingly operates on a global scale, asset managers are more often subject to regulatory pressures from foreign entities. Many asset managers in Japan are working under a larger financial group's umbrella, such as a bank or broker-dealer. Similarly, foreign asset managers in the country are usually part of a larger global asset management firm or a large western financial group's asset management arm.

Regulatory changes put in place as a result of the US financial crisis have also affected asset managers in Japan, especially regarding outsourcing and BCP. Asset managers are required to have much tighter governance over the third party firms they work with, including IT and BPO services, and business sustainability must be taken into account for those firms, as well.

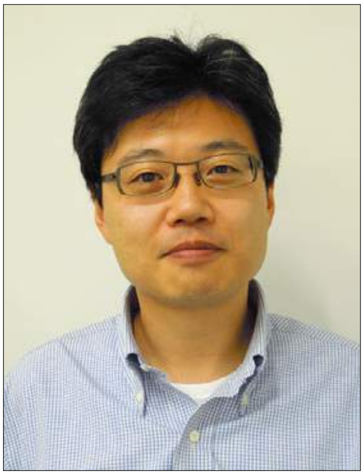
For the smaller independent asset management firms in the US, this regulatory pressure may not apply as they operate in domestic markets and may fly under the regulatory radar. Larger, globally focused US asset management firms should take heed, however. Global financial institutions continue to heavily influence the operations of the non-banking industry and shadow banking, and asset managers will likely have more influence on the market overall.

As such, asset managers in Japan that are putting a high priority focus on BPO and BCP practices could prove to be industry leaders in this space, providing a best practice framework for US-based firms operating in this region. The Japanese market has the largest pool of assets under management in Asia and the labour fee in Japan has not risen in past decades, which could entice investors and foreign managers to execute more business in the region and bring more focus to the business practices there. These managers that may find themselves in the spotlight are starting to rely on the expertise of dedicated BCP and outsourcing offerings so that they can reallocate their resources back to their core business operations and focus on client services, while effectively managing their overall costs.

BCP is becoming an important discussion point for firms focusing on enhancing their client services and reliability, and BPO services are the key components for taking successful action in that direction. By utilising BPO, asset managers can effectively achieve their BCP goals through a more efficient, simplified process.

In order to sufficiently engage with the complicated Japanese asset management industry, foreign managers are looking to enlist business partners located in Japan to help manage the cost effectiveness, regulatory changes and unique local nuances of their business operations.

More recently, BCP and BPO services have piqued significant interest for foreign managers within Japan. By providing these services through firms located in the country, foreign managers benefit from expertise generated by past experiences that have served to build better and stronger solutions. **AST**



Yasutoshi Kaneko
General manager
Nomura Research Institute

Avoiding costs

Guido Wille and Karla Amend discuss Clearstream's latest study into T2S and what harmonisation will mean for CSDs

CATHERINE VAN DE STOUWE REPORTS

What were the key results from this year's study on TARGET2-Securities?

Guido Wille: Last year, we worked with PricewaterhouseCoopers to estimate the overall benefits that TARGET2-Securities (T2S) can unlock for the market as a whole. The objective for the study that we commissioned with Oliver Wyman was twofold. Firstly, to break down the benefits for the market into benefits for market players. Oliver Wyman calculated various ranges of euro savings for a generic international broker-dealer, a global custodian, and a European bank. While each real bank has its individual profile, these ranges give an idea to each organisation of the benefits they can extract. Secondly, we wanted to provide more insight into the specific drivers that enable these savings. The study breaks the drivers into four clusters, each with three to four dimensions, and explains the dynamics that create these costs today or will create them in future.

What is important to stress is that many of the costs are either widely absorbed today or are costs that will only materialise in the near future and therefore are often poorly understood. Let me explain this with two examples.

In terms of widely absorbed costs, think of fails that arise because of realignments to move securities from the place of settlement and safekeeping to the place of financing. For domestically traded assets this is a daily process as, today, the large triparty agents do not operate settlement services within the European central securities deopositories (CSDs), as these tend to be the domain of the domestic agent banks. As a consequence, domestically traded assets such as equity and Southern European market fixed income are moved manually between the settlement agents and the sub-custodians of the financing agents, and naturally, fails occur in this process.

While most people understand this reality, few have viewed this as a cost to reduce as there has been no alternative solution to this issue. What the study says is that T2S will offer an alternative, as it will enable the triparty services offered in the international CSD market to be extended to domestically held assets through the investor CSD route facilitated by T2S. This will enable a significant reduction in the fails cost that, today, is unavoidable.

My second example concerns future costs. Many market players rely on uncommitted and unadvised intra-day credit lines for their settlement and very often there are no interest charges for intraday usage of these lines. At the same time, market commentators suggest strongly that regulatory pressures will change this.

First, organisations that offer intra-day credit are under pressure to manage their credit provision more tightly and they will face capital charges where credit facilities are provided on a formalised basis. Second, clients as the users of credit are under pressure to agree these more formal arrangements for their credit lines, because of business continuity considerations and regulatory pressure to assure stability in their liquidity arrangements.

There are now two possible ways to deal with this situation. The simple way is to say, "hey, great, intra-day credit is for free", and carry on with the current credit model. The second, which the study assumes will become more commonplace, takes a more nuanced and forward-looking approach. It says, "the industry believes that it is likely that, in the future, there will charges for intra-day credit lines, so, if you take no action, you will face future costs, and you can calculate them fairly easily with some basic knowledge of your business and an educated assessment on potential future intra-day interest charges—T2S can help you avoid these future costs".

Were they the results you expected?

Wille: In broad terms yes, as it has been long been our belief that direct access to CSDs and central banks and the consolidation of cash and securities pools that T2S enables can bring significant benefits to market players. But, of course, it is impressive to see them calculated for realistic business profiles item-by-item, because the level of transparency is much greater now.

What do these results mean to banking?

Wille: They mean that every organisation has a choice. The first option is to look at T2S as something that forces you to migrate to a new series of processes that your provider will adapt as the markets migrate to T2S, and to limit change to these mandatory migrations. Pursuing this option mean that your organisation remains fully functional with a given network and correspondent set up but will continue to face most costs that come with fragmentation, plus those additional costs that will arise because of the market changing in response to regulation.

The second option is to embrace the opportunity and redesign your European securities processing chain, leveraging the potential that T2S provides. Choosing this option will mean that your organisation will, with T2S fully live, conduct business in a significantly cheaper way than with the legacy structure. Oliver Wyman has estimated the difference it makes for each organisation based on three generic cases:

- A broker-dealer with €100 billion trading assets and liabilities across major T2S markets could save up to €70 million;
- A global custodian with €400 billion in assets under custody across major T2S markets could save up to €50 million; and
- A regional bank with €140 billion in securities deposits across major T2S markets with a home market bias could save up to €30 million.

Given these large numbers, it appears that taking no option is a significantly worse option. We expect the large majority of banks will reassess their European post-trade structure, to avoid falling behind competitors who do just that and, in the process of doing so, significantly increase their competitiveness.

T2S has just moved into its user testing phase. Could any implications arise in this phase that could set back the 'go live' in 2015?

Karla Amend: The size and complexity of the project, the high number of stakeholders with different business and user profiles, and the interaction between all involved parties could lead to larger testing issues, even those that might set the go live in 2015 at risk.

Therefore, stability and efficiency of the T2S environment and T2S platform right at the beginning of user testing will already be a key factor for a smooth and successful user testing period. Later on, efficiency in handling problems as they occur also represents a key success factor. Procedures need to be in place that efficiently manage all the involved parties and allow quick decision making when required.

It remains a key imperative for all parties to avoid a delay scenario by all means, as the associated cost would hurt everyone. The staggered approach of migrating in several waves provides some flexibility needed in case of test issues. In addition, the migration approach provides slots for stabilisation of the platform between each migration wave. **AST**

Guido Wille
Executive director and head of market development
Clearstream

Karla Amend
Senior vice president, operations T2S governance
Clearstream

Looking Strate ahead

Strate's Monica Singer explains how South Africa is meeting collateral requirements while being under pressure from local regulators

CATHERINE VAN DE STOUWE REPORTS

How did South Africa's regulator interpret the CPSS-IOSCO principles, specifically those relating to PFMIs and CSDs?

The adoption of these principles is being strongly encouraged in most international markets by practitioners and regulators alike. As Strate is one of South Africa's financial market infrastructures (FMIs), it voluntarily completed a self-assessment shortly after the Committee on Payment and Settlement Systems-International Organization of Securities Commissions (CPSS-IOSCO) published its Principles for Financial Market Infrastructures and Assessment Methodology. Strate worked closely with its regulator, the Financial Services Board (FSB), to finalise the assessment against the principles. No areas of material concern were identified.

According to the CPSS-IOSCO, FMIs were a 'source of strength' during the financial crisis, able to settle obligations when due, giving market participants the confidence to continue transacting. Central security depositaries (CSDs) can use their adoption of the principles to promote confidence within their respective markets.

Having completed its review, the FSB confirms that Strate is recognised as 'observing' 14 of the principles and 'broadly observing' a further three. The remaining seven principles are not applicable to Strate at this time.

As an active member of the Africa & Middle East Depositories Association (AMEDA), Strate is also extensively involved in sharing information and its experiences relating to the CPSS-IOSCO principles.

What does it mean to Strate to be recognised as an FMI?

Strate has always played the very important role of being a financial market infrastructure, providing efficiencies and mitigating risks within the South African market since it was established more than 15 years ago. We recognise ourselves as a national asset and one of the important institutions in South Africa's financial markets.

This has been evident over the past few years, as South Africa continues to be placed on top of the leader board in the Global Competitiveness Report's financial market development category, which has been published by the World Economic Forum. In the 2013-2014 report, South Africa maintained its financial market development rank of third out of 148 countries, scoring 5.8 out of seven points.

We continue to look at ways to increase investor protection and asset safety in the market by offering value-added services and benefits to our custodian banks and their clients, while still focusing on our core services of clearing and settlement.

The demand for collateral is still a hot topic. How has the Liquidity Alliance been tackling the issue?

The nature of CSDs as FMIs ensures they are well positioned to provide solutions to the global collateral shortage through optimisation of collateral pools. It is in this spirit that the Australian CSD ASX, the Brazilian CSD Cetip, the international CSD and CSD Clearstream, the Spanish CSD Iberclear and Strate in South Africa were the initial CSDs to announce the formation of the Liquidity Alliance.

This association of industry peers gives members an opportunity to exchange information, identify common needs and extend global collateral solutions, while encouraging development of informed research.

Each member has partnered with Clearstream to use its technology as a common platform across multiple jurisdictions. It has been developed to provide CSDs, such as Strate, the ability to offer collateral solutions to local market financial institutions to meet their collateral requirements by assisting them with the mobilisation and optimisation of their collateral.

While the collateral management service offered in South Africa currently meets local collateral requirements, it will eventually address cross-border collateral requirements, too.

How important are cross-border partnerships, such as the Liquidity Alliance, to overcoming differences in local regulation? In turn, how does this improve access to collateral?

The financial landscape has evolved over the past five years with the heightened expectation that market infrastructures will further refine their risk management models and focus on asset safety.

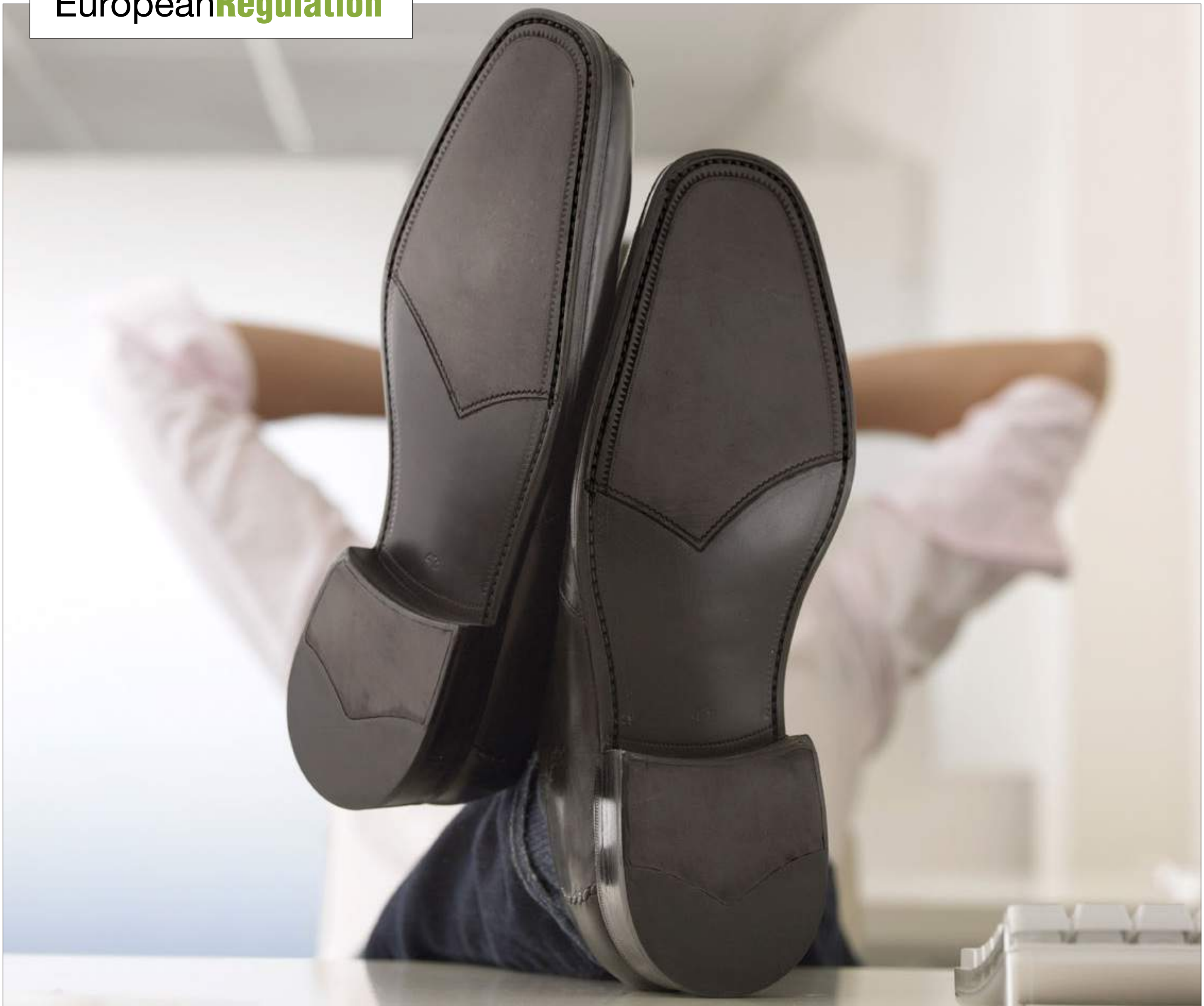
The lessons from the global financial crisis have taught the industry that the need to restore stability and confidence is a market imperative for the greater good of not only the financial system itself, but also its reputation as a whole. Increasing demands are placed on local market infrastructures to meet the wave of regulatory, technological and operational changes required to restore confidence in the system.

In these fast-paced times of change, staying abreast of regulatory reforms, market developments and ensuring their implementation, can be a challenge for any market. I have always maintained that Strate's success has been built on collaboration and key strategic partnerships. Since Strate's inception, we have been able to create one of the most advanced and highly rated CSDs in the world.

It has been through collaborating with global market experts, such as Tata Consultancy Services, SWIFT and now Clearstream, and becoming a member of the Liquidity Alliance, that has placed Strate and the South African financial markets where we are today.

Historically, the CSD industry has always been a collaborative one with an active number of international forums and regional associations. These forums have been broadly used to share and gain knowledge of other markets, including operating models, future initiatives and trends. **AST**

Monica Singer
CEO
Strate



Here to stay

The next 12 months will see financial institutions tackle a medley of regulations. Marko Niederheide of Deutsche Bank explains how preparations are going

CATHERINE VAN DE STOUWE REPORTS

The industry has seen too many regulations to name here come its way. How are they progressing, and how much more regulation is there coming down the path?

The European Market Infrastructure Regulation is a work in progress. A couple of the regulatory milestones have been reached, and there are some more to come: collateral reporting, the definition of FX-derivatives versus spot, and clearing obligations.

The Central Securities Depositories Regulation (CSDR) has not been finalised but work on the second level has already begun with a 90-page discussion paper from the European Securities and Markets Authority (ESMA), and we will see further consultation on draft regulatory and implementation standards.

Securities Law Legislation has been a hot topic for decades and still no dedicated proposal has been published. The European Commission has tried to put bits and pieces into other regulatory initiatives but the big picture is still missing.

Basel III is high on everybody's agenda right now. The Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR) are the acronyms to know here and those will highly affect the way banks can and will do business with their clients.

And there is more to come: structural reform in Europe inspired by the Liikanen report, the German Separation Law, and the Volker Rule in the US all try to establish rules around which businesses banks should be doing in the future and which should be separated from investment banking.

There are also significant additional reporting requirements on the horizon such as Securities Financing Regulation and the Financial Transaction Tax in Europe. There is no doubt that regulatory pressure will remain high across the financial sector for years to come.

What are custodians doing to prepare for T2S, and how has the euro crisis affected their preparations?

Deutsche Bank has been an active participant in TARGET2-Securities (T2S) since the beginning of the project and indeed throughout its different stages since. In so doing, we have voiced concerns on behalf of the market and our clients to ensure that the platform meets the requirements of all stakeholders.

The 2008 financial crisis has put additional pressures on budgets but T2S is a strategic project for Deutsche Bank and we will be delivering it regionally.

A lot of IT resources are spent, not only by central securities depositories (CSDs) and the eurosystem, but also by custodians preparing their infrastructure for T2S. We have invested millions to build a competitive product, which is ready from day one. A number of important decisions had to be made such as the connectivity option one wants to employ.

We are now in the final stages of our preparations and looking forward to the first testing phase for the first wave of migration in June 2015, where reality will show if the European platform meets market needs.

How is pressure on the clients of custodians affecting mandates?

Active dialogue on regulatory topics with our clients is ongoing and in the custody space we have created a dedicated team to look in particular at regulatory changes and how they affect our clients and the bank.

One of the current regulatory trends is investor protection, and we see clients asking for more segregation of assets throughout the custody chain despite final rules on this yet to be defined and so it is not fully clear at which level a segregation of assets will be required.

In this context, we believe being able to offer different parts of the asset management business from within the same firm will be essential to gain large mandates in the future.

What kind of clients are European custodians keen to pick up, and what are they doing to attract this business?

We believe that focusing only on one client segment would not be prudent from a risk perspective. Our business model and service offering has elements that suit broker-dealers as well as large global custodian banks or retail banks.

In particular, our regional offering in the context of T2S will offer our clients a one-stop-shop model to access all T2S regions through a central hub. This helps clients to benefit from most of the opportunities offered.

In addition, being able to understand and explain the regulatory impact of relevant developments is a key differentiator to clients in being able to steer in times of uncertainty.

How do you view the market shape changing within the CSD space?

While it was anticipated that T2S would push CSDs into consolidation, we have actually seen new CSDs being established ahead of T2S going live. Whether all the CSDs will remain once T2S is up and running remains to be seen.

T2S and the CSDR will serve as a catalyst for further competition among CSDs. But it is not only CSDs that compete with each other. Some CSDs use T2S and CSDR as an opportunity to also look for additional revenues and start competing with custodians.

Before venturing into those fields it will be important that no business expansion endangers the proper functioning of the core activities of the CSDs, eg, the settlement of securities transactions in their systems. So to what extent banking services will add to their risk profile needs to be considered.

In light of the current discussion on recovery and resolution of financial market infrastructures, it will be essential to define functions which are economical critical and required for the orderly functioning of the market and which functions could actually be resolved as they are not a core function of a CSD.

What are the consequences of inefficient settlement, and how can the obstacles be solved?

In this context, the question that needs to be raised is: what is considered inefficient settlement? Based on some statistical analysis done by the European Central Securities Depositaries Association about two years ago, settlement efficiency in Europe is already quite high.

Within Deutsche Bank, we believe that T2S will act as a catalyst to further enhance settlement efficiency in Europe. Here we see in particular a standardised settlement day across Europe and a harmonised set of matching fields. This helps to sort out non-standardised communication and settlement across CSDs, which have caused some friction among participants in the past.

The CSDR, with its proposed settlement discipline regime, will provide further incentives to avoid and reduce settlement fails. However, any future regulation in this area should be developed in close cooperation with relevant industry participation in order to account for different settlement and custody models. This eventually would ensure that settlement inefficiencies will be addressed at the source and not at the intermediary level.

What are your predictions on the future for derivatives clearing?

Clearing will bring a number of currently uncleared derivatives onto clearing platforms, thereby reducing the currently existing counterparty default risk.

However, it should be noted that the number of central counterparties (CCPs) active in the field of derivatives clearing would be limited.

To date, only five CCPs have been authorised to clear derivatives and only one has been authorised to clear credit derivatives.

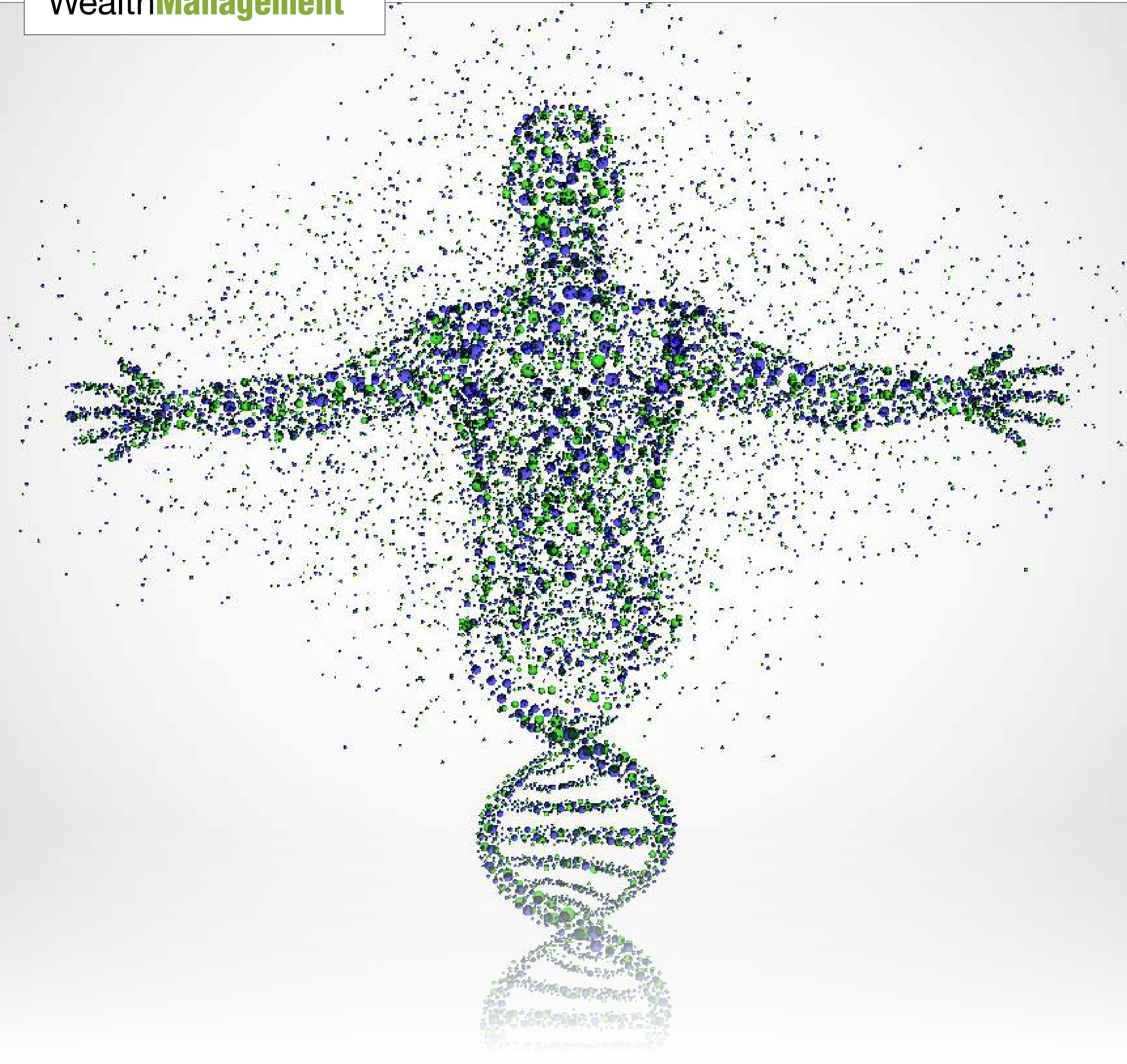
It is currently unclear which derivatives will ultimately have to be brought to CCPs and a number of derivatives might be too complex or illiquid for CCPs to effectively perform a proper risk reduction function.

Given the significant concentration of clearing business on very few financial market infrastructures, it will be important that the future standards on recovery and resolution that are currently being developed make sure that the infrastructures have the right procedures in place to avoid a spill-over effects from the default of clearing participants.

How many trade repositories do you think Europe needs?

Given the broadening scope of reporting requirements we might actually see further trade repositories specialising in certain products. However, we believe that reporting should be centralised, thereby favouring a global data warehouse that can process all of the different regulatory reporting with which banks have to comply. **AST**

Marko Niederheide
Market advocacy of global transaction banking
Deutsche Bank



Managing an evolution

Societe Generale Securities Services UK introduces its new wealth and investment management outsourcing solution

The wealth management industry in the UK has been subject to an unprecedented level of change over the past five years. Aimed at mid-tier wealth and investment fund managers, Societe Generale Securities Services (SGSS) has launched a fully integrated wealth and investment management outsourcing solution for the UK to complement its existing securities and funds services businesses, spanning the full post-trade value-chain, from global execution to global custody.

With increasing regulatory change such as the Retail Distribution Review, Foreign Account Tax Compliance Act and a heightened focus from the regulators on suitability and client assets, it is sensible to expect there to be some significant changes to the way that wealth managers do business now and in the future. The increased regulatory pressure is forcing managers to reform their front-office processes, segment their client base and, more significantly, it has given rise to a need for more efficient business operations to support different levels of client service and to implement better controls.

It is easy to view these challenges as a negative cost and burden on the wealth industry but the truth is the wealth management segment is fast growing with wealth and institutional managers securing significant new investment when compared to traditional long-only funds.

"SGSS is delivering a solution that will allow managers to adapt their operations to cope with scale through future proofing their operating and front-office, while minimising their cost base throughout their middle-and back-office functions"

Michael Le Garignon, head of business development sales and relationship management in the UK
Societe Generale Securities Services

Investor needs are fundamentally changing, driven on the retail front by the looming retirement of the biggest demographic wave in history, and on the institutional side by a combination of worsening pension deficits and a significantly different approach to evaluating and paying for performance.

This is taking place amid an uncertain market environment that is breeding enormous levels of anxiety among investors.

Mid-tier wealth and investment fund managers are increasingly faced with the costs associated with constant regulatory change and operational developments. To remain competitive, managers are increasingly looking to outsource their operational functions, leverage providers to reduce costs associated with maintaining back-office systems and integrate web and front-end functionality to future proof their services.

As a result, SGSS has developed a true front-to-back-office wealth management solution in the UK to provide a unique best of breed portfolio management platform in partnership with JHC Systems, specialists in IT solutions for investment managers and stock brokers.

A beneficial solution

Wealth managers will benefit from access to a 'tailored turnkey solution' from wealth to fund services and associated banking services. The service and unique proposition comprises a consolidated service provision supporting integrated execution services and liquidity support, middle- and back-office services, segregated portfolio processing, master books and records, clearing and settlement processing across multi-products, global settlement and local custody with multi-currency capabilities, and fund administration services.

Additional ancillary services include foreign exchange services, liquidity and securities lending, asset servicing and reporting services, as well as risk and regulatory reporting.

Mid-tier wealth and investment managers, private banks, direct dealing/broking firms and advisory firms will benefit from a reduction in key operational, cost, risk and an increase in time benefits by subscribing to this outsourcing solution. As a result, they can be more end-investor orientated and focus budgets and management time on client facing duties and functions, enhancing their competitive positioning as a result.

These managers use fund and non-fund structures, but increasingly the underlying end-investor records are required to be held in the form of segregated or managed account structures.

"The new way in which money is managed has altered significantly, aligned with the new definition of performance that incorporates risk management, income generation, and alpha/beta separation, increasingly retail investors are becoming much more institutionalised," comments Michael Le Garignon, head of business development, sales and relationship management in the UK at SGSS.

Those investment managers that expand the definition of 'asset class' by marketing specific outcomes, such as target retirement dates, tax minimisation and income generation, will become tomorrow's winners. Average annual growth rates among 'outcome-oriented funds' have been twice that of traditional long-only funds in recent years.

The structures these managers utilise are not that different to traditional long-only funds, however, one specific area of note is the use of pooled vehicles to amass client investment. Typical types of investors are pensions, charities, trusts, foundations, as well as private HNW individuals and family offices.

"We aim to be a key partner to our clients," comments Le Garignon. "SGSS has designed a fully integrated, white-labelled front-to-back solution with a competitive and client-aligned pricing strategy to ensure it represents good value, a partnership that enables growth for our clients. By doing so, we provide our clients with important operational efficiencies as well as significant new business opportunities to stay ahead of the competition as the industry continues to evolve in response to regulatory and structural changes."

"By combining the platform capabilities with the securities services and fund services capabilities globally, SGSS is delivering a solution that will allow managers to adapt their operations to cope with scale through future proofing their operating and front office, while minimising their cost base throughout their middle- and back-office functions."

Compelling solutions

To complement buy-side solutions, SGSS is in the process of launching a range of new solutions with a specific focus on the wholesale sell-side industry, ie, independent institutional brokers. These firms have to deal with a developing range of industry, regulatory, capital and operational challenges.

Today, these firms can source a range of services, such as research, execution, agency clearing and settlement, hosted back-office systems and full middle-back-office outsourcing, from a multitude of third party providers. This is known as the 'broker-dealer outsource' model.

By bringing together the strengths of SGSS, Societe Generale Corporate & Investment Banking and Newedge in the recently set-up Societe Generale Global Banking & Investor Solutions division, SGSS aims to develop scalable innovative solutions for mid-tier brokers, in effect delivering mid-tier firms the benefit of a global financial organisation and a significant investment programme while being able to support their business on a purpose built platform coupled to a strong commitment to service.

"Partnering our clients, delivering integrated solutions and enabling our clients to grow their business goes beyond investment in our teams, technology, and our organisation. It is about investing in our clients and the key relationships that are at the core of what makes the industry so strong," says Jason Nabi, head of the financial institutions and banks segment and broker-dealer outsourcing at SGSS.

In addition to its existing services within the UK, SGSS has also set up a trustee and depositary services business. The business will work with asset managers to help them manage regulatory change and ensure a smooth transition to the Alternative Investment Fund Managers Directive and UCITS V regimes.

Both regimes represent a step change for the asset management industry and the aim of the new business is to work in helping UK managers adapt to these new regimes with proactive regulatory guidance, leveraging a range of innovative products from within the existing global business. **AST**

TARGETing corporate actions

A panel of experts assesses the potential effects of TARGET2-Securities on corporate actions in Europe, and what Asia is doing to catch up

Pierre Colladan
Senior advisor, strategy for market infrastructures
Societe General Securities Services

Philippe Ruault
Head of product for clearing, settlement and custody
BNP Paribas Securities Services

Paul Phillips
Business development manager, EMEA
SunGard's XSP

Stephanie Colaric
Global custody product head
Bank of America Merrill Lynch

With less than a year to go before the implementation of T2S, how much of a driver has the platform been for corporate actions?

Pierre Colladan: Implementation of corporate action standards is led by two drivers in Europe: one is the action of major players in the securities industry; and the other is the advent of TARGET2-Securities (T2S).

First of all, major stakeholders of the securities industry are committed to the implementation of the European Corporate Actions Joint Working Group (CAJWG) standards endorsed in 2009. Custodians have an industrial stake as they deal with multiple events for multiple clients. Central securities depositaries (CSD) face a similar concern and will meet the demands of their participants.

Local market implementation groups (MIG), directly monitored by the Broad Stakeholders Group, the European MIG and the CAJWG, lead this part of the implementation. This organisation is more or less followed by the European Commission.

Progress is limited by budget considerations, but it should be noted that main corporate events have something to do with settlement. Indeed, a settlement or 'corporate actions on flow' may be triggered when a seller does not deliver securities on time to a buyer that wants to participate in a given corporate event.

From a cross-border perspective, these settlement flows linked to a corporate action imply the adoption of a common European language with a shared definition of concepts, terms, dates and even processes. This is why T2S stresses the implementation of standards with the support of two T2S governance bodies.

One is the T2S Corporate Actions Sub Group (CASG). The T2S CASG has defined a set of technical rules adapted to the T2S environment to manage corporate actions on flows, these technical rules complying with the CAJWG standards. It also monitors the implementation of its standards in the participating T2S countries and reports to the second body, the Harmonisation Steering Group (HSG).

The HSG monitors the implementation of a wider range of items, including the European corporate actions standards. It gives priority with regard to T2S migration constraints and issues an annual report underlining the compliance level of each market. It puts any potential non-compliance, and the consequences thereof, in the perspective of the T2S migration of the market concerned.

Through their respective missions, these two bodies put pressure on the whole T2S community to comply with the standards for corporate actions before, or very soon after, any migration to T2S.

The composition of these structures demonstrates the importance of the corporate actions standards and harmonisation topics. For instance, Societe Generale Securities Services has at least one or more experts who is a member, sometimes a chairperson, of every group that defines, validates standards, or monitors compliance with them.

Philippe Ruault: Everyone agrees that there were myriad reasons why Europe needed to tackle the domestic differences preventing corporate actions processing to be harmonised across its markets. These included differences such as the complexity of cross-border events, multi-listed securities, and the sheer absence of norms in some cases.

Whereas T2S is not much of a force behind the standardisation of corporate actions on stock, without a clear deadline for each market, it is fair to say that the efforts to harmonise corporate actions on flows would have suffered from a tunnel effect. So, yes, without a doubt, T2S has been a major driver for the harmonisation initiatives across the board.

T2S is a response to the Giovannini report but it was not at all meant to be the main driver behind the standardisation of corporate actions. Because payments were due to go through T2S, it would have implied a standardisation of the settlement of their proceeds, but above all, what T2S did is that it served as a catalyst to standardise corporate actions on flows across the T2S markets by the time of their migration wave. It is fair to assume that had there been an initiative to harmonise cross-border corporate actions without T2S on the horizon, it would have inherently failed.

To put it bluntly, custody projects without clear deadlines stall. This is why one can wonder what will become of the CAJWG standards that do not have a strong dependency on T2S, such as the inception of SWIFT communication between the CSDs and their participants for announcements, instructions and payments. One likely scenario is that some 'good students' will implement them and some countries will not, sometimes for good reasons such as the implementation cost of these standards.

Despite the fact that, by signing the T2S Framework Agreement, local CSDs do not commit to implement the CAJWG standards for corporate actions on flows, the pressure applied by the European Central Bank has increased as the first wave is getting closer. Through its 'name and shame' policy that singles out countries not sending positive signals, it intends to speed up progress in countries failing to address issues it deems essential for the project.

To further exemplify how T2S facilitated the harmonisation of corporate actions processes by setting deadlines, one can point out the case of the UK where—partly because it will not be part of T2S in the foreseeable future and partly because it requires a change in the local regulation—no one can tell when we will see the implementation of the recommended sequence of key dates. It is hard to imagine that such an internationally oriented market will not adapt its rules to avoid the risk of being seen as a solitary case in Europe, but still, this is an example of a lack of visibility that was avoided in markets driven by their T2S migrations.

Stephanie Colaric: The driver behind the T2S platform is to provide borderless, commoditised, and harmonised delivery versus payment (DvP) securities settlement in central bank funds across all European securities markets. While asset servicing was not directly part of the remit, the platform has certainly been a catalyst for change in a number of ways. For example, as market participants, CSDs and sub-custodians have taken on the development work necessary to reshape their service structure to meet the demands of T2S. Many have also taken the opportunity to reform areas of post-trade activity, such as asset servicing, in order to support their new business models and better position themselves for the evolving competitive landscape that T2S will encourage.

Specifically, T2S is assisting the operational harmonisation initiative because a prerequisite for a market joining T2S is to become compliant with the market standards for corporate actions processing that were drawn up by the CAJWG and CASG, which are responsible for defining rules for corporate actions on pending transactions or flows. Each market is required to report on their progress towards meeting these standards, with their progress being assessed by a team of market practitioners from within the European MIG. It is fair to say that T2S has really provided the impetus for change.

Paul Phillips: It can be reasonably argued that the pending deployment of the first phase of T2S will have an impact on how the determination of the eligibility to participate, and to that extent, how market claims resulting from active corporate actions are managed by CSDs through the utility. It cannot, however, be considered that T2S has proved to be a key driver in organisations looking at how they process their events or in making any necessary changes in their processes to benefit from its introduction in 2015.

In the current fragmented environment, local settlement procedures differ significantly. Custodians tend to maintain separate back offices in order to interact with each CSD or they employ a local subcustodian to carry out the activity on their behalf. The objective of T2S is to harmonise the pan-European settlement process through efficient use of CSDs. This will make it much easier for custodians to consolidate these separate back offices into a centralised back office and achieve a higher degree of automation and efficiency. The reduction in back-office costs is one of the key benefits resulting from a harmonised borderless settlement.

The corporate actions process can be complex, with many interactions between buy- and sell-side organisations to determine what is happening, when it is happening, what the impact of the change is and who the change directly affects. Settlement plays a significant part in determining who is affected, and how an entitlement is distributed through the complex current settlement infrastructure network to ensure that the legal recipient of the entitlement is correctly identified and compensated.

By utilising a CSD with access to T2S, it should prove possible to significantly reduce the potential for position breaks, due to settlement failure, across the ex-date, effective and record dates of any corporate action. This alone will considerably reduce the risk of processing incorrect positions. With CSDs (through T2S) settling using central bank funds, you not only reduce the risk of settlement failure, but you also reduce the risk of counterparty failure.

By utilising T2S, it is not only possible to efficiently move and settle the corporate action on flow, but also the associated claim linked to any failed transaction within that flow. This makes the whole claims process much more efficient and has the potential to significantly reduce the overall time taken to resolve and receive or return entitlements to or from the market via these claims.

How closer are we to a common set of standards for corporate actions in Europe, and what still needs to be done?

Colaric: Although the high risk involved in handling corporate events has always been well understood by market participants, and various European-based industry groups have been driving the harmonisation and automation agenda forward for many years, progress has been slow.

There are a variety of reasons for this. For example, there is a lengthy chain of intermediaries involved in the corporate action process from issuer through investor, many with their own specific set of challenges. In some cases the need to make legal, regulatory, and market practice changes has been an obstacle, for example, CSDs may need to change their processes and rulebook, and some markets do not legally recognise the concept of record date. However, historically one of the biggest issues has been that corporate event inefficiencies have not generally been as visible as settlement inefficiencies, so competing priorities always took precedence.

T2S introduced a degree of urgency and focus that was not there before, especially because each market has to comply with the standards in order to join the platform. While it has taken regulatory change to drive these harmonisation efforts forward, positive momentum has been created. This momentum could help the industry working groups and participants themselves to really drive the process towards full end-to-end harmonisation and automation of securities settlement transactions across all intermediaries.

Phillips: We are making slow progress toward a common set of standards that could truly unify a complex process across all of the recognised event types.

The transport mechanism for the movement of corporate actions information across the industry, between active buy- and sell-side participants, has reached a point of maturity in Europe with ISO 15022 now being utilised or the very least useable across almost all participants. The advent of ISO 20022 will, in time, push this even further with the use of XML/XBRL. However, it is anticipated that ISO 20022 will predominantly be utilised in the US and Asia Pacific and China region, where the adoption of the ISO 15022 standard has not been as widespread.

The Depository Trust & Clearing Corporation transformation initiative is leading the charge in the US as it will be eliminating the use of proprietary message types for notifying participants on corporate actions events and replacing them with ISO 20022 message formats by the end of 2015. The Australia Exchange (ASX) in Australia and JASDAQ Securities Exchange in Japan are also leading the ISO 20022 charge in their respective markets.

So, standardisation of the information transport mechanism for the majority of mandatory events, where market interaction other than collating and determining an account of the terms and conditions of the event promotes a high degree of straight-through processing (STP) if an enabling technology is employed within an organization to utilise the information effectively.

> “Phillips: For the election process, there is a still a lack of clarity and consistency around how the sell side distributes option information as part of the ISO standard”

For voluntary and choice events, standards need to go a step further.

For the election process, there is a still a lack of clarity and consistency around how the sell side distributes option information as part of the ISO standard. The industry is still seeing a lack of synchronisation around sequencing of options where one organisation can distribute a series of options in a completely different sequence to another. So, when the instruction is required to be executed to a multitude of sell-side organisations, there is a need to rationalise and reorganise the elections into the correct sequence that it was received.

All of this added risk and complexity could be removed if the market strictly adhered to the option types and sequencing submitted by the issuer.

More could be done to formalise how the issuer informs the market of the terms and conditions of the events that it wishes to be executed in the marketplace. The industry has still not found a way of taking the information directly from the issuer and making it possible to quickly confirm that the market is made aware of the finalised terms and conditions of the events being executed. This final, rationalised information can only come from the issuer and is often misinterpreted by the data-vendor community and distributed accordingly.

Finally, more work needs to be done to better define the claims process. With the advent of T2S (the first phase) in 2015, we have reached a point where we can effectively rationalise both held stock record (corporate actions on stock) and open transactions (corporate actions on flow) to assist in the defining, accurate claiming, tracking and settlement of market claims through participating CSDs.

> "Colladan: To the extent that European countries do not share the same list of core principles, obstacles to standardisation will remain, whatever the technical and resources involvement of stakeholders"

Colladan: The common set of standards regarding corporate actions exists. CAJWG, where two SGSS experts have been mandated since 2010, representing the French and Italian markets, has issued a set of around 140 standards covering definitions and operational processing for all categories of corporate actions, including transaction management, ie, the process needed in case of corporate actions on flows. These were endorsed in 2009 by all the European constituencies of the securities industry and released in 2012.

At a national level, MIGs are working on local implementation. They meet together every six months in a European MIG to share experiences. These groups have regular exchanges with the CAJWG experts playing the role of the guardians of the 'European bible of standards'.

As for the T2S community, it aims to comply with these standards too, with priority given to the technical specification made for T2S by the CASG, more specifically for transaction management.

As SGSS experts are direct participants in CAJWG, CASG, MIGs, European MIG and HSG, we can state that implementation is on track. A difficult job is being carried out, requiring a high level of involvement, but two kinds of difficulties may occur:

- Purely technical brakes in a challenging environment with many projects; and
- Obstacles due to core legacy principles.

Corporate actions standards imply a wide adaptation of information systems and organisations. However, these organisations are facing major regulatory challenges with new regulations, directives, etc.

This is a turbulent environment, with limited resources available. 'Prioritisation' and 'choices' are commonly heard words when attributing budgets where meeting clients' needs remains the primary goal.

On the prioritisation battlefield, complying with regulatory requests comes top. T2S adaptation itself demands important efforts, at least from CSDs that are generally setting the pace for implementing standards. Corporate actions standards come at the end of the priority list.

The postponement by Euroclear (ESES markets) of its releases known as Stream 5, now positioned for March 2015, and 6, now positioned for September 2016, is a good illustration of this reality.

When looking at leading countries of each T2S wave, there is a big risk that they will not comply with T2S CASG standards before joining T2S, and sometimes months after. This shows how complex the matter is, and this complexity is not only a technical issue. The most important obstacles are mainly those based on core existing historical and cultural principles.

Furthermore, these are generally reflected in the local legal frameworks. By definition, standards are based on a pure technical approach and by definition a technical approach should be led by core principles to find solutions that respect them, not the opposite.

To the extent that European countries do not share the same list of core principles, obstacles to standardisation will remain, whatever the technical and resources involvement of stakeholders.

Ruault: From the point of view of the CAJWG standards, and in relation to T2S, one cannot say whether markets are close or far without putting each case in perspective. Indeed, some markets might not implement the recommended standards for a few years yet and not before their migration to T2S. However, these same markets might already be prepared to put them into practice, they might have already solved potential regulatory, IT, and legal issues and are simply choosing to synchronise the move to the new standards with their T2S migration. Other countries may very well be almost entirely compliant to the CAJWG standards, but they are far from implementing the remaining standards for a number of reasons.

What we can say is that there are isolated cases of genuine concern about the readiness of some markets due to some implementation issues, such as the problematic consideration about the record date in some cases and the ex-date in others. The favoured payment method outside of T2S is, and I quote the T2S whitepaper on corporate actions: "Using the same payment mechanism for distribution of cash proceeds of [corporate actions] as the one used for the settlement of cash transactions by the issuer CSD."

However, these cases are being discussed at the highest levels of the T2S governance and solutions will have to be found in due time to ensure smooth processing of corporate actions on flows.

Yet, the glass is more than half-full and we are very close, we just need to remind ourselves that the standards have been endorsed by everyone. This, in itself, is a considerable achievement. Unfortunately, there will be steps backwards as new interpretations will shed light on issues that have not been identified before (eg, the issue with the legal period of subscription rights trading on the French market). This is where the involvement of all key stakeholders in the established governance is crucial in order to find common solutions, even if they are that—for sound reasons—the standards may not be immediately applicable.

On a similar note, no matter how close every market is to adapting to the CAJWG standards, let's remember that they are merely a toolbox, albeit a very sophisticated one. They are a set of solutions given to us (sometimes even created by us) to ensure smooth corporate actions processing, to reduce cost and risk. They are not a ready-made roadmap to definitely eliminate differences between European markets.

But never say never. Hopefully, European markets will tend towards complete alignment. There have been and always will be historical local practices, intricate domestic laws, and exceptional corporate actions types in the foreseeable future.

What pressure has T2S placed on service providers in this area?

Phillips: T2S is ostensibly designed to facilitate smooth settlement across the different markets in the eurozone and to promote healthy competition across CSDs subscribing to the service across the four phases, with a view to reining in the settlement cycle to two days.

> "Ruault: What we can say is that there are isolated cases of genuine concern about the readiness of some markets due to some implementation issues, such as the problematic consideration about the record date in some cases and the ex-date in others"

Accurate and timely settlement, which T2S promotes, is a fundamental requirement in the cor-

rect determination and application of stock record which is the current, settled (actual) and the open, traded balances across the security, on the ex-date, effective date and record date, and across the trading period of a corporate action. Accurate stock record drives the entitlement calculation process, the election process and the claims process.

Participating CSDs will be under increasing pressure to settle in-house orders within the two days and also to collaborate with other CSDs effectively to settle transactions where the buyer and seller operate in different markets with different CSDs. Failure to achieve this, particularly for trades active across the ex-date and record date of events will fuel an increase in market claims. That in turn will result in an increase in message traffic and put added pressure on the CSDs, and also the associated custodian banks to resolve not only the transaction, to remove any chance of a position break, but to also resolve the associated entitlement claim due from the failed transaction.

For voluntary events, failure to reach settlement in time can potentially expose the seller by preventing the buyer from making an election. Custodians that offer contractual settlement services, and would therefore directly settle any transaction from inventory, are then required to manage the election process through one, or multiple CSDs. This adds even more risk to the process of efficiently and correctly managing elections.

While T2S is aimed at promoting a more efficient, fluid settlement process in Europe, it also presents considerable challenges to the middle - and back-office of organisations to ensure everything that was typically done manually in three days is now done manually in two. This includes determination and reconciliation of failing transactions, which is a significant contributor to corporate actions processing risk.

Colaric: It is well understood that the introduction of T2S is a game changer for the industry. While some of the largest players have made their intentions known, many buy-side participants such as global custodians and brokers are likely to be adopting a watch-and-wait position. It is clear that T2S presents a threat to the business models of CSDs and sub-custodians. As the settlement function becomes totally commoditised, the provision of value-added services such as asset servicing will become essential to both CSDs and sub-custodians if they are to continue to be economically viable.

The challenge for CSDs is how they will develop this expertise, as it is not an area in which they have traditionally been involved. Will market participants be prepared to take the risk of entrusting their asset servicing and value added activities to an untested provider? Sub-custodians on the other hand, have the advantage of many years proven expertise in supporting the institutional investor community, not only for asset servicing but for their value-added services as well.

Ultimately, the winners are likely to be the providers who can adapt their model according to client needs and offer multiple options for ac-

cessing their services on a bundled or unbundled basis whilst meeting the regulatory and working standard requirements. These will likely be those regional sub-custodians and ICSDs that already provide multi-market eurozone service offerings, and in fact they are already far along in developing their solutions for the new environment.

Ruault: The inception of T2S and its influence on the harmonisation efforts in the area of corporate actions can, indeed, be seen as an added pressure for all stakeholders. This is mainly because it has set deadlines for market infrastructures and other market players to implement 100 percent of the standards that have strong dependencies with T2S, for example, corporate actions on flows.

Again, instead of allowing all markets to move at their own pace, T2S set clear milestones for each local stakeholder to reach before their own migration waves. Custodians, for example, have faced an increasing financial pressure to enhance their systems as well as time constraints to ensure that their own internal processes would be in line with the standards of each market while taking into account the timing of these markets' migrations and the standards they would be implementing.

One of the difficulties has been, for instance, to keep a crystal clear, short-to-long term mapping of the adaptation plans of each CSD. Should custodians be unable to keep track and keep up with the pace imposed by local markets, they would face a dangerous situation where they would create a break in the chain of custody by not applying the appropriate markets rules. Not only that, but they would also set themselves apart by bifurcating from the other custodians' practices, leading to confusion, especially for all investors that might rely on several different providers established in the countries where the CAJWG standards will apply.

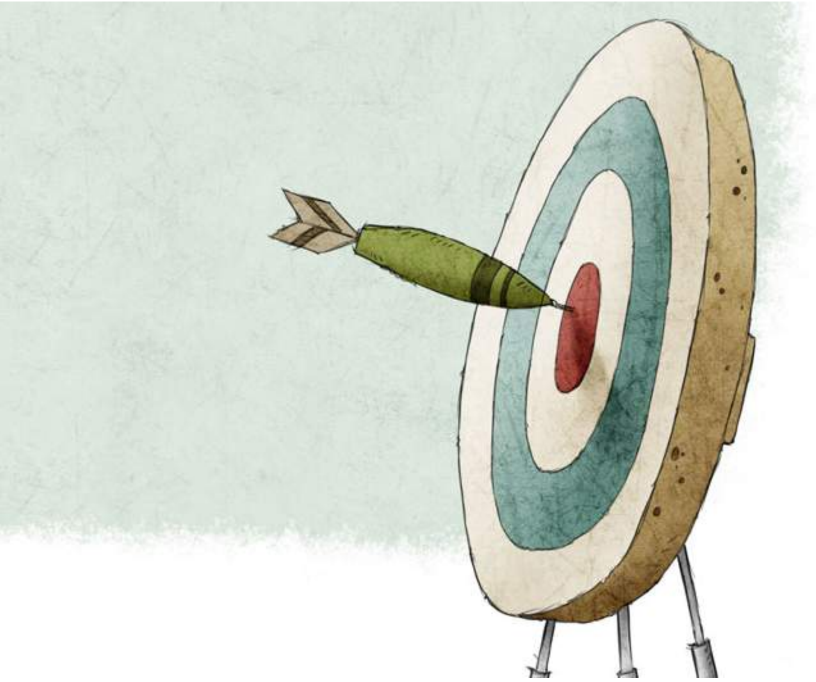
This being said, another way to look at these correlated initiatives is to embrace the fact that, for once, the stars have aligned for custodians that can seize this opportunity to harmonise processes, for true regional providers to shine and offer versatile yet consolidated solutions based on the same set of standards and practices.

Going further, T2S is making custodians rethink their traditional offers. Indeed, some large financial institutions that have traditionally relied on local custodians to handle both settlement and asset servicing are starting to look at ways to connect directly to T2S and internalise their settlement activity. While this is made possible thanks to T2S, they will still need the assistance of a provider who will be able to handle corporate actions, tax, and proxy voting, with each activity being subject to all manner of local particularities. By allowing institutions large enough to see benefits in handling their own settlement activity, T2S has therefore pushed custodians to rise to the challenge and think of new ways to service such clients.

At the core of our business, another window of opportunity for custodians lays with the investors, small and big, that are in serious need of clear, practical, detailed and yet comprehensive information about these projects. Those that have actively taken part in the definition of the future standards, both for corporate actions on stock and on flows, will have a chance to capitalise on their deep knowledge of the rationale behind these new standards and communicate all the more efficiently with their clients.

Colladan: For the securities industry, T2S will generate technical, organisational and commercial shock waves that will also impact the corporate actions area.

Technically speaking, there is global pressure on service providers to adapt their information systems to corporate actions standards requests. In France, a strict marketplace organisation has been set up to ensure that all providers will be



able to meet these standards, considered by French players as a prerequisite to T2S.

Furthermore, T2S introduces new concepts such as 'investor CSD', which is more or less a custodian in the skin of a CSD being a participant in an 'issuer CSD'. In the scope of corporate actions, this concept opens an electronic highway between issuers, agents and investors passing through an issuer CSD, its participants and their clients.

Any link in the chain of intermediaries not complying with European corporate actions standards will cause a break in the processing of any event. Imagine the consequences of a securities redemption paid in T2S when counterparties are waiting for a T2S dedicated cash account payment?

The second shock wave is revamping organisations in order for a service provider to draw maximum advantage from T2S implementation. T2S offers a technical flexibility to provide client access to multiple CSDs via a single point of entry. This flexibility leads to different organisational questions such as the location of clients' securities holdings.

Should it be close to the source of information and benefit from immediate announcement and better market deadlines, implying the need to locate assets in each issuer CSD accounts? Centralised in a single CSD to benefit from economies of scale? Disseminated in a local agent network to benefit from deep local knowledge? Or should it be a mixture, with the potential support of local agents in specific matters such as tax processing?

The last shock wave is commercial. Boundaries between key participants will be redrawn. A convergence of roles will emerge, with a confusion of roles between investor CSDs and custodians. Few custodians will look at establishing CSDs.

In this world, the application of corporate actions standards will become a basic common service. Providers unable to offer this basic service will disappear, while those just capable of offering it will only have the fees parameter to make the difference.

However, corporate actions will still be an area of local specificities, for instance, on the taxation front. Providers able to offer deep knowledge and the ability to deal with these specificities will make the difference.

That is the reason why SGSS has adopted a 'Glocal' approach based on our multi-local custody offer coupled with our European global access facilitated by T2S. Clients will be offered a single point of access, balanced by direct custody with deep local knowledge and the capacity to deal with local specificities.

T2S is simply the beginning of the story. It is just a pipe and the most important things are at each end and what goes through it, not the pipe itself.

Turning to other jurisdictions, what has Asia got to do to catch up with Europe and the US?

Ruault: The US and Europe are two very different cases. The American market is, by nature, a single consolidated marketplace where diversity lies with the various types of events and tax regimes rather than local specificities. Now, considering the diversity of markets, investors, and providers across Asia, a comparison with Europe does make sense. European institutions themselves wanted to create a set of rules that would make Europe as attractive as the American market to worldwide investors.

However, this is where the comparison between Asia and Europe has its limits. Asian countries still have some way ahead when it comes to adopting common standards, and are yet to generate the momentum to launch a coordinated initiative.

Asia is a fragmented market today and the Asian markets are building the foundations before putting in the finishing touches. Current efforts include more fundamental aspects of corporate actions activity such as increasing the STP rate. For instance, some local CSDs have entered workshops with local custodians in order to improve the STP integration of announcement messages. This will allow for an overall reduction of operational risk but also a much faster transmission of corporate actions details to custodians. Custodians that are a part of these workshops have an opportunity to help build standards and leverage on this first-hand experience to increase the service they offer to their clients.

It will probably be a while before Asia sees an initiative similar to the CAJWG and will depend on where regional harmonisation efforts will be on each country's priority list. Without a coordinated regional initiative, it is difficult to envisage Asia implementing a common set of standards across the markets in the immediate future. In the meantime, it is the responsibility of custodians to implement processes that allow investors to experience corporate actions in a harmonised way on all the markets where they appoint the same provider, for example, harmonised structures of narratives, harmonised swift setups and competitive deadlines.

Still, observers can see positive signals coming from Asia. Without being directly linked to this activity, a number of markets have been very active in their discussions about T+2. The Australian and the Singaporean stock exchanges have initiated talks about reducing the settlement cycle to two days. India is already in line with T+2.

In order to harmonise know your customer (KYC) norms for foreign investors within their market, India has standardised KYC guidelines by implementing a common questionnaire on a risk based approach.

To conclude, there are a number of initiatives being taken in Asia, but for the moment, they are limited to their individual markets rather than launching a regional coordinated initiative.

Phillips: With an increasingly aggressive attitude toward winning new business from traditional western silos, coupled with there being little burden of legacy technologies, Asia has traditionally been an early adopter of new technologies and is usually innovative in its approach to process.

China has been particularly assertive in its expansion in the financial services sector and has shown many innovations in product development and its use of enabling technologies to meet a growing demand for tailored financial services. At an infrastructure level, China is adopting ISO 20022 for its payments systems while Thailand is looking to completely overhaul its own financial services infrastructure to be able to easily adapt to new standards.

Japan's central depository, JASDEC, is leading the way with its adoption of ISO 20022 and market participants in Japan are required to become compliant in their use of the standard by 2018. Considering how slow it seemed for the global marketplace to first adopt, refine and finally use the ISO 15022 standard, to see Japan straightforwardly adopt the new standard is a testament to the attitude prevailing across Asian markets to maintain parity with and, in some cases, lead the industry.

> "Colaric: Australia, Japan, and Singapore are good examples of where the industry participants themselves—such as the stock exchanges and CSDs—are being very active in engaging with the various intermediaries and participants and taking meaningful steps, especially around the adoption of SWIFT's ISO 20022"

As always, there is something of a 'wait and see' attitude but in the case of harmonised standards for settlements, it is markets in the west that are looking to Asia to determine the potential success or failure of initiatives such as T2S where reduced settlement cycles in Asia have already been established. In Europe, the Single Euro Payments Area is proving to be a success and Asian markets are keen to replicate this success. New listings of companies across Asia remain strong, particularly in China, even though secondary funding for such enterprises is proving difficult and the proliferation of IPO events is forcing the direction of thought around automation of the corporate actions process.

Europe and the US look to Asia for some aspects of development of standards while Asia looks to Europe and the US for others. All markets are looking to harmonise standards and cross-border collaboration with their significant trading partners wherever possible with a view to streamlined processes, making the act of doing business more efficient, simpler and more cost effective for all involved.

Colaric: The capital markets environment across Asia is very diverse, ranging from the well developed and sophisticated markets such as Japan, Australia, Hong Kong, and Singapore, to emerging markets with a variety of foreign investor barriers such as entry eligibility tests, currency restrictions, documentation, and investor ID processes. This, together with no common regulatory regime or single currency and a lack of market linkages, means it is not realistic to compare these markets to Europe or the US.

What we are seeing, however, is very positive progress in the more developed markets. Australia, Japan, and Singapore are good examples of where the industry participants themselves—such as the stock exchanges and CSDs—are being very active in engaging with the various intermediaries and participants and taking meaningful steps, especially around the adoption of SWIFT's ISO 20022. One of the many positives about Asia is that once a market decides to make an infrastructure change, it tends to happen pretty quickly.

After automation, what's next for corporate actions, or are we not there yet?

Ruault: This question is twofold as it touches two topics that are essential to further improve corporate actions processing down the road.

As far as automation is concerned, let's face the fact that corporate actions are worlds apart from, let's say, settlement. Indeed, even though we can learn from the achievements in the area of STP processing of settlement messages, it seems utopian to think that corporate actions messages could reach such automation rates.

To be more precise, successes in automation need to be assessed slightly differently depending in whose shoes you are. For local custodians, automation of incoming messages has not been achieved yet due to their direct interactions with first-hand material received from multiple sources that do not use standardised communication methods. This is where asset servicing providers at a local level play an important role in dealing with this variety of message formats such as faxes, SWIFT messages and PDF files, by processing narratives more often than not and, overall, by enriching announcement and payment messages to guarantee that the entire chain of custody receives the appropriate information right from the start.

For global custodians, on the other hand, automation is more achievable thanks to their own individual harmonisation efforts one of the many benefits from BNP Paribas Securities Services's network integration, for instance. But to do so requires solid information from their local custodians, this is why global custodians that can, whenever possible, rely on their own networks of local custody, have an advantage because they control the format of messages in and out and can therefore aim at more than 80 percent STP integration in these cases.

Corporate actions require manual intervention today and while some events are starting to be processed without as much manual work, the increasing complexity and diversity of some events make it that the industry is making progress on one side and taking a step back on the other.

This is partly due to the fact that issuers tend to have needs that are more and more specific and competition is fierce among paying agents whom the issuers will appoint. To win mandates, agents customise the engineering of corporate actions to the maximum, which, in a way, is a contradiction with the global harmonisation efforts led by the industry.

So, in order to move to the next level, a full incorporation of the issuer community as well as the issuing and paying agents is necessary. Without rallying them and without their strong commitment, the efforts to align processes, to reduce operational risks, to guarantee smooth processing of cross-border corporate actions events, will be to no avail.

Phillips: With the growing volumes and increasingly complex corporate actions events, global financial institutions are constantly faced with challenges in processing corporate actions. The automation of data management, event management, entitlement processing, election management and communications through the use of currently available third-party technologies help facilitate the consistent and accurate processing of these events.

High levels of STP are being achieved for mandatory payments and stock adjustments and the adoption of standards and development of common cross-border practices helps ensure that events are processed consistently wherever they may be executed.

However, automatic compilation and update of stock records, the management of position differences between the client and their depository (position breaks) and the management of market claims not automatically compensated through the auto-compensation process are areas that would benefit significantly from further thought and development of both standards and technologies.

T2S will go some way to addressing the challenges with both the position and claims processes while widespread adoption of ISO 20022 with enabling technologies will considerably reduce the financial overhead and risks associated with manual processing.

The industry has made real progress and while we continue to make great strides in this complex process, there is still a significant amount of manual effort involved for many financial institutions, especially those in developing markets. As depositories and exchanges, such as the Australian Securities Exchange, the DTCC and JASDEC migrate from old proprietary formats to the new ISO 20022 formats, firms will need to address how their systems will handle these messages. Systems will also need to be upgraded to support the growing complexity of new event types to ensure that STP levels are maintained and improved upon. Firms may also look to leverage corporate actions solutions that can interface with books and records systems to help further maximise operational efficiencies. **AST**

When there's a will

MYRIAD's Simon Shepherd discusses the role of network management in living wills

Recently, a large client of ours mentioned that the MYRIAD platform is now a major part of its 'living will' planning and that without the platform, putting in place a coherent resolution plan, should the bank in question get into difficulty, would have been much harder.

My reaction to this was twofold: pleased that here was another use that the platform can accommodate, but also an acknowledgement that we need to push these different angles a little harder when talking to clients and prospects alike.

It set me thinking on a subject: what is the extent to which the middle office and specifically the network management function should have input in living wills? Often characterised as 'the link between the front-office and the back-office', the role of network management in particular, in any workout situation, must be crucial. After all, where do all the records sit that identify where all the assets are? It is clear that providing part of the solution for a living will is becoming a bigger part of the overall decision and having a system that genuinely underpins a living will is enormously supportive of a business case.

As a consequence, the announcement in the first week of August that US regulators had rejected the living will plans of 11 too-big-to-fail banks might not be such a big surprise. Doubtless, bank executives and their legal teams focused heavily on the headline departments—trading, sales and the back-office—and too little on what really makes each bank run smoothly and effectively. Two of the five actions highlighted by the Federal Reserve board were:

- Ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process; and
- Demonstrating operational capabilities for resolution preparedness, such as the ability to produce reliable information in a timely manner.

The point is that the Federal Reserve board is now very focused on seeing that each bank's thinking has moved beyond a better apprecia-

tion of risk and onto the provision of coherent operational systems and processes, which persist in the event of a resolution.

At Sibos 2009, McKinsey coined a great phrase: “High intensity but no depth.” The phrase had nothing to do with living wills at the time. It was more a comment made in the height of the crisis about a lot of activity around risk management, without big banks actually having the systems and processes in place to manage the unfolding risk situation, as the banks lacked depth in terms of robust operational systems. Part of the message then was that in the absence of systems that persist and provide near to real-time or even instantaneous access to data—there is really very little management can do but to wait for a crisis to blow over before dealing with the fallout.

Banks and other financial institutions that do not understand and appreciate the depth of their operations—and the lack of depth in their systems—will at some point struggle to pin down the right course of action and might therefore open themselves up to all sorts of unnecessary risk and unfortunate fall-out.

This is ‘passive’ management rather than ‘active’ management, which would normally get to grips with any particular developing situation. A living will has been requested of the too-big-to-fail banks precisely because they do not have the systems in place to deal proactively with a crisis and, in the absence of such, the regulators anticipate the need for a workout or a winding down from someone at some point in the future.

A living will is supposed to demonstrate how a large bank can continue its operations in the event of a new crisis or following a shock, or in the words of the Financial Times, “without creating havoc”. It does not necessarily mean the bank will shut down. Those drafting living wills, which have been rejected, have doubtless looked at the high intensity activities that get all the attention, without drilling into the real depth of how a workout might actually work and what might be needed to make it work.

The key—and this is the importance of having a system in place—is that information is available and can be readily interrogated and that procedures are at hand with which to continue the effective running of the firm, pending disposals or the arrival of new capital or liquidity or the appointment of new management. The network management function must be central to this and having the right systems in place now helps to run the bank, as part of business as usual, and underpin any living will or resolution plan.

Now put yourself in the position of an auditor or consultant actually tasked with executing a living will. This is not the case at Lehman Brothers in Administration (LBIA), because Lehman Brothers did not have a living will in place, but the problem remains absolutely the same: what accounts do you have where and with whom? The person in whose head this information resided probably left the bank on the first day of the crisis, but the problem remains the same. Not having a robust, durable and persistent system in place will always compromise the day-to-day running of a major financial institution before a crisis, in the same way that it would hinder any resolution plan for the same institution, should the need ever arise, after a crisis and during a transition.

Asking the question now about which systems and procedures an auditor would most like to have in place to underpin a future workout might be very informative on how to overhaul current capabilities: a comprehensive database of all accounts ever opened? Check. A list of all related documents, including old or expired versions? Check. Current fee schedules and associated reconciliations? Check. The ability to pull a report that, if not quite comprehensive or detailed enough, can be re-defined at a whim and re-run? Check.

All of these would be basic facets of a system that would be most useful to people in operations in a workout situation. It would be interesting to know how many operations and network management staff have been retained at LBIA as part of the resolution of the Lehman Brothers estate.

This would provide a good guide for the shape and content of a major part of living wills. It is a worthwhile pointer to the 11 banks that have just had their living wills rejected that if they haven’t consulted with the administrator at LBIA, this might be a pretty good starting point.

The regulator’s focus is still on getting banks to clean up their balance sheets and the imposition of living wills is a stick with which to beat the banks. The political value of using one to drive the other should not be overlooked, but the operational value of having to put in place a living will should also not be overlooked.

The value of a living will should encourage banks to take a long, hard look at how they actually run and what, in essence, would be required to work things out if they or their executive successors had to wind the institution down.

A look at the Federal Reserve board’s 2013 Model Template for §165(d) Tailored Resolution Plan highlights a lot of ‘what’, but leaves much of the detailed planning—the ‘how’—to the banks themselves. One suspects that this is where many institutions fall down. Not being able to demonstrate which systems are in place and how a workout might be effected could well be key criteria where the authorities can mark these institutions down.

Understanding who you work with, what it costs and how those relationships work is a critical element in a living will. It is doubtful that many of the 11 banks whose living wills have been rejected really went to the time and trouble to lift the lid, not just on how their balance sheet might be compromised (and how to avoid it), but how to resolve the situation, should such a compromise have taken place. Understanding the nuts and bolts might help a workout inform how current, pre-crisis operations can be better organised to head off the eventuality.

Moore Stephens, the London law firm, came up with a useful checklist asking ‘are you ready?’ in the context of heightened scrutiny from the UK Financial Conduct Authority and the Prudential Regulation Authority.

The checklist covers off-client agreements and disclosure documentation as well as compliance manuals and procedures and monitoring programmes.

Significantly, it also talks about management frameworks and systems within which risk registers, policies, business continuity planning - disaster recovery (BCP-DR) plans and a plethora of other material can sit.

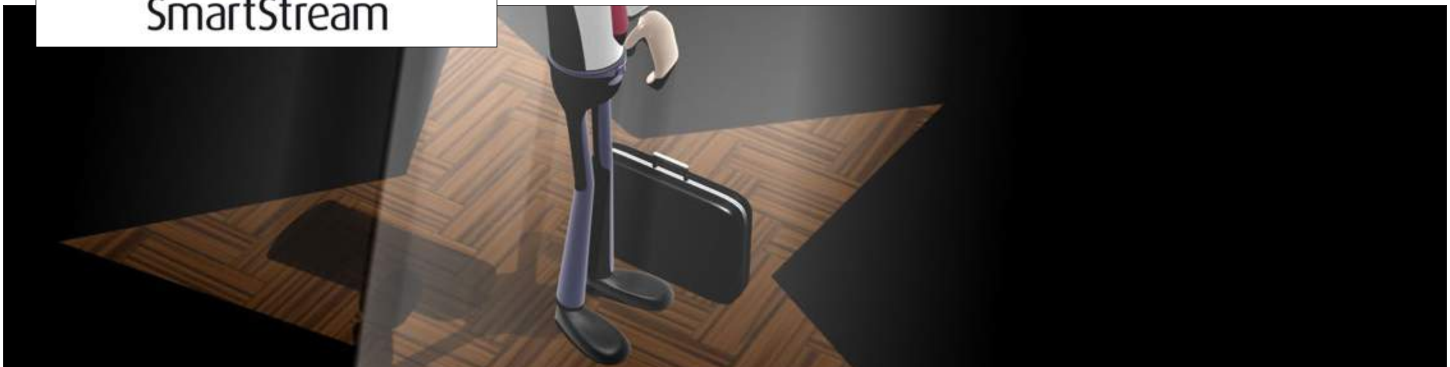
The underlying message is inescapable: you have to do this and if you do not you will be in trouble. It is a simple extension of this thinking and approach to ask the question, why not have it all in place beforehand and make it be part of your current day-to-day activities?

We have written many articles on the move towards more comprehensive, integrated frameworks for information and risk management, in relation to network management. Having a unified, centralised platform in place can help drive and maintain standards, which can consolidate knowledge and mitigate risk is key to future success. If having such an integrated version of the truth helps tick the living will box, then so much the better.

But bank executives grappling with how best to demonstrate their living will capability would be well advised to look at current operational needs and gaps as part of their analysis of what might be required in any workout situation. **AST**

Simon Shepherd
Chief executive
MYRIAD Group Technologies

SmartStream



An exceptional performer

Dealing with trade exceptions is costly and time-consuming for the financial industry. SmartStream's innovative new TLM Exception Management tool offers the industry a smarter, faster and more cost-effective way of resolving exceptions, says Peter Webb

Under pressure to reduce back- and middle-office costs, financial institutions are reviewing their operations, looking for ways of introducing greater efficiency. One area under scrutiny is exception management: resolution times are still too long, exposing organisations to unnecessary risk and expense.

The industry's current exception management process

So why hasn't the industry already made greater progress streamlining the exception resolution process? One problem is underinvestment in the back and middle office. A result of the financial crisis, this has created many operational inefficiencies, currently magnified by the rising volume and increasing complexity of transactions.

Specifically, companies lack a single, consistent view of the exception management process, which makes it difficult to see why an exception has occurred, monitor its resolution, and get a trade back on track promptly. Too few standardised processes are in place and businesses also struggle to prioritise exceptions. Capturing all the information relating to each exception is still a challenge for some organisations.

TLM Exception Management

At SmartStream, we are keen that our customers achieve the very best performance. We go to great lengths to understand the challenges our clients face and to create solutions and services that will enable them to improve their balance sheet, reduce expenses and comply with regulations. In order to support our clients effectively, we look for ways to evolve our technology. Research and development are of fundamental importance to us and a strong culture of innovation underpins all we do. SmartStream's new TLM Exception Management application reflects our commitment to understanding and fulfilling our clients' requirements, as well as to innovation and development.

Built on the latest SmartStream architecture, and equipped with a sophisticated, newly designed, single user interface, the application allows financial institutions to replace inefficient manual resolution processing with automated, proactive exception management. It detects exceptions as far up the workflow process as possible, monitoring and managing them through to resolution. Where an exception cannot be handled automatically TLM Exception Management guides users towards resolution through a series of straightforward steps.

We have designed the new TLM Exception Management solution to provide connectivity to communication platforms, using XMPP standards. Video, voice and text chat services are also available. All activity—however minor—is recorded for future reference, ensuring that a full audit trail is created.

A single view of the resolution process

The lack of a single, consistent view of the resolution process creates many headaches in the back and middle office. At present, to close an exception quickly, a number of personnel usually work on it in different parts of the business. Work is duplicated and repair procedures are sometimes overlooked. TLM Exception Management, which delivers exception management information through a single user interface and is accessible by multiple participants, puts an end to these difficulties. All the information relating to an exception can be managed in one place, allowing a single individual to investigate an exception. Staff across the organisation can simultaneously access the system, ensuring they have a clear and up-to-date picture of the resolution process.

A common exception layer across multiple systems and lines of business

TLM Exception Management integrates with SmartStream's suite of solutions and third party technology (where the necessary APIs or web services can be exposed). It can extend into and process exceptions from other applications, eg, trading or payments systems, creating considerable efficiencies. Automatic connection also removes the need to log on to other applications and re-key data, cutting the risk of errors occurring and making investigations less time-consuming.

The application allows organisations to assign and escalate exceptions in a systematic way. It also ranks exceptions according to urgency ensuring that the most pressing issues are handled first. Innovative features, such as the executive summary function and the exception categorisation capability, make it possible to exercise close control over risk.

We know that managing service level agreements effectively is essential. TLM Exception Management promotes a proactive approach, alerting managers to fluctuations in service quality and prompting them to take action.

TLM Exception Management experience

SmartStream's TLM Exception Management is the result of research, investment and development effort. It provides financial institutions with a highly effective tool in the drive to remove inefficiency, risk and excessive cost from the resolution process. At SmartStream, we are strongly convinced of its benefits: TLM Exception Management is installed at our reference data unit—responsible for processing, normalising and enriching reference data for the financial industry—and has already introduced significant efficiencies there.

Peter Webb
Senior vice president, product management
SmartStream

Ready or not, here T+2 comes

One giant step to T+2, one small step to T+1 and beyond? Denis Orrock of GBST discusses the industry's preparations for the clearing and settlement regime

From 8 October 2014, the capital markets and wealth management industries of Europe will operate a T+2 clearing and settlement regime.

Despite standardised T+2 not being universally accepted as necessary or indeed wanted, the majority of sell-side firms have prepared for the changes by updating software or decommissioning and replacing inflexible, no longer fit for purpose, legacy systems. They have recognised time for change has come.

The same cannot be said for the rest of the industry. There has been a marked lack of interest, investment or action, and the challenge remains for them to fully engage with the required changes. Indeed, many buy-side firms are expecting their brokers to be 'flexible' and continue to allow T+3 settlement.

This relative apathy has knock-on consequences for the sell side, bringing potential for additional risk and regulatory capital requirements.

Through our whitepaper research on introducing T+2 to the Australian equities markets and the combined research with Aite into the US markets, it was observed that smaller firms do not have a consistent cultural, operational or technical appetite for change. Even larger firms were content with T+3 and were struggling to keep up with the operational challenges that arise with a sustained period of regulatory change.

Equally important to remember is the fact that T+2 is not applicable to all transactions and asset classes (ie, exchange-traded funds and American depository receipts), for example OTC transactions and securities lending exhibit different transaction lifecycles. Consequently, despite the T+2 deadline, if settlement systems are unable to cope with this wider range of set-

tlement regimes for asset delivery, settlements may still fail. It is clear that one size no longer fits all and any back- and middle-office process/technology must be able to cater for a wide range of requirements and settlement methods

A long time coming

Thirteen years ago, the Giovannini Group identified a number of barriers to settlement process effectiveness and market efficiency. Today, with mandatory T+2 transition imminent, it would not be true to say that the market as a whole is ready. This is despite all the discussion, seminars, workshops, forums and industry events on the subject, plus all of the significant technology advancements that have happened during this time.

The key concerns identified all those years ago were restrictive technology, non-compliant market practices, non-standard taxation and legal uncertainty. To become more effective, the industry had to change. The changes were needed to provide improved safety, market efficiency and transparency of cross-border transactions, delivering financial and operational benefits as trade volumes, velocity and value increase.

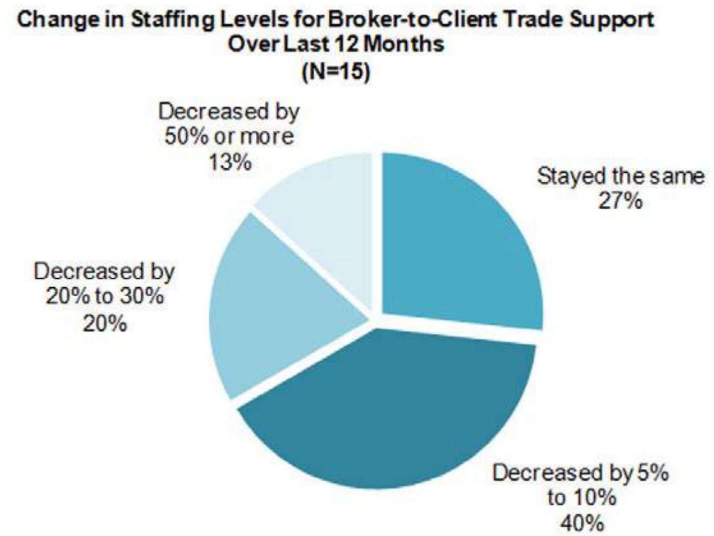
The industry has also been 'incentivised' to comply, with the threat of fines for late settlements. How long it will take for any such sanctions for non-compliance to come into effect is another story.

The compression of the transaction lifecycle is intended to improve integrity of the markets, but it can only be successfully achieved through widespread implementation of appropriate technology.

Ready or not, people are key

The Association for Financial Markets in Europe's Recommendations on Implementation Impacts of T+2 state that where increased trade volumes are expected, sufficient staff should be available through the migration and transition periods, central bank liquidity requirements should be reviewed, and requests for readiness confirmed prior to 8 October.

Figure 1: Change in Institutional Brokerage Firms' Overall Budget for Trade Support



Source: Aite Group interviews with 15 institutional brokerage firms, Q4 2012

However, pressure on heads of operations to continually cut costs (see Figure 1) has meant reducing headcount, with more than 70 percent of surveyed firms indicating 5 to 50 percent staff reductions in trade support functions. Even if this were not the case, increasing headcount, during transition, without the associated process adjustments could actually exacerbate the problem of rising fail rates.

Sell-side firms must be ready to cope with counterparties that are not as prepared as they are for T+2. They will need to work with their providers to ensure the successful transition for all.

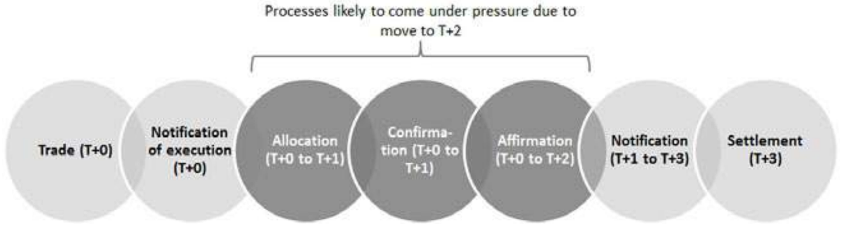
One area to be addressed when moving to T+2 settlement is the elimination of trade failures. With complexity and potential for failure at each stage of the trade lifecycle, successful settlement is contingent on the previous action being completed. With increased time pressure at each stage standardised electronic mediums (such as ISO standard or FIX messages) are essential and provide a clear audit trail.

The manual processes of pre- and post-trade matching and settlement of the past do not fit the nature of today's dynamic markets and the need for compressed settlement times. More efficient capital allocation with less risk has only been achievable through complete market review, investment in technology and (most importantly) action.

At GBST, we believe that implementation of innovative, smarter, cost-effective technology and operational process change is the key enabler and differentiator for effective T+2 participation on a global basis. However, the nature of the capital markets and the ever-pressing need to reduce costs and risk means that T+2 implementation is unlikely to be the end of the story.

These are exciting times with T+2 groundwork in place and take-up of scalable, faster and more efficient processes becoming an accepted norm. We believe that T+2 is likely to be just another step toward an automated efficient settlement standard with global T+1 or even T+0 capability possible in the longer term. **AST**

Figure 2: Steps in the Settlement Lifecycle Under Pressure Due to a Move to T+2



Source: Aite Group

Denis Orrock
Chief executive, capital markets
GBST

Ready for **sibos** *?*

Should have got **MYRIAD**!

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Smooth sailing ahead

A year since joining the multilateral trading facility Turquoise, Robert Barnes explains his team's strategy and the vision for a single European market

Turquoise is the pan-European equities multilateral trading facility that provides users with a single connection to trade shares, depository receipts and exchange-traded funds of 18 countries with an efficient trading and post-trade model that delivers economies of scale. Members include banks, brokers, specialist trading firms and retail intermediaries.

Successful partnerships with customers is key for Turquoise. Every month we show that we have listened to customers by exploring prospects and executing enhancements, such as expanding the number or type of securities available to trade. It is a privilege to work on new ideas with the user community, and thanks to our customers, Turquoise has achieved remarkable growth in the last year. Turquoise is now the fastest growing equities trading platform, across lit and dark, with meaningful liquidity.

Ten years ago, the publication of the Markets in Financial Instruments Directive (MiFID) envisioned for November 2007 the start of greater investor choice in a more harmonised European regulatory framework. This encouraged entrepreneurial projects with large-scale efficiencies in mind to embrace the potential of, collectively, the largest economy in the world, Europe.

Project Turquoise, an idea in 2006, was an initiative of members exploring whether, as users, we could implement a single competitive multi-country lit order book and innovate in some form of smart anonymous block auctioning. In September 2008, Turquoise launched with regulatory approval. London Stock Exchange Group joined Turquoise as majority owner in partnership with the user community in 2010.

One of the benefits of this relationship is the shared service level arrangements. For example, Turquoise now runs on the same low-cost technology platform, MillenniumIT, in use across London Stock Exchange Group. The benefit to members is not just a state-of-the-art and resilient platform, but also the similarity of application programming interfaces across markets that use MillenniumIT.

Turquoise today allows trading on one of two complementary order books. Turquoise Integrated Lit is a traditional lit order book featuring price priority and includes hidden orders such as icebergs and large-in-scale. Turquoise Midpoint Dark matches orders in shares pegged to the reference price of the primary best bid and offer of the respective European exchange.

A key differentiator of Turquoise Midpoint Dark is that it is the only public, open-access dark pool in Europe that prioritises orders by size. Size priority means larger orders jump to the front of the queue. With size priority and user-defined minimum execution size, Turquoise offers two midpoint matching functionalities: Continuous Midpoint matching and Turquoise Uncross, a buy-side friendly mechanism for randomised periodic auction uncrossings.

Whereas the lit order book gives certainty, the dark pool facilitates matching of larger sized orders while minimising market impact. The benefit of offering two types of order books is that it allows Turquoise to offer complimentary liquidity. The two approaches provide better quality matching towards benchmarks that investors are trying to meet. Customers are choosing to trade in Turquoise Lit and Turquoise Midpoint Dark. The result is significant growth in 2014.

Turquoise Uncross is an innovation that allows buyers and sellers to rest anonymously with potential to match at a time determined by randomised function. The key feature, in addition to size priority, is the randomised function. Having a series of auction uncrossings with a randomised feature means the likelihood of matching at a fair price is higher.

LiquidMetrix, the independent analytics firm that specialises in venue performance metrics, reviewed September 2013 transaction data of European dark pools and then again in February 2014. LiquidMetrix confirmed Turquoise's best-in-class quality and concluded participants should feel comfortable placing larger orders for longer in Turquoise Uncross. More firms are opting for this functionality. The result is significant growth in Turquoise Uncross.

Turquoise aims to be the European single market trading venue of choice. We believe Turquoise contributes to quality trading and best execution.

The notion of best execution is a priority for market participants. Pre-MiFID, different countries had different definitions with the most common focus on 'best price'. MiFID harmonised the framework across Europe by re-defining best execution as a process to deliver the best possible result on a continuous basis. This principles-based approach effectively empowers investors and market participants with their respective abilities to evaluate, monitor, justify and decide choice of liquidity venue.

Figure 1

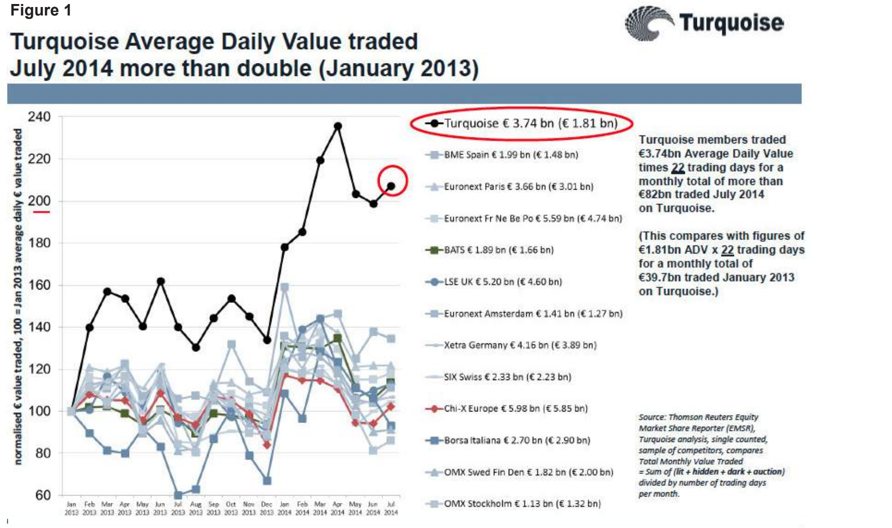


Figure 2

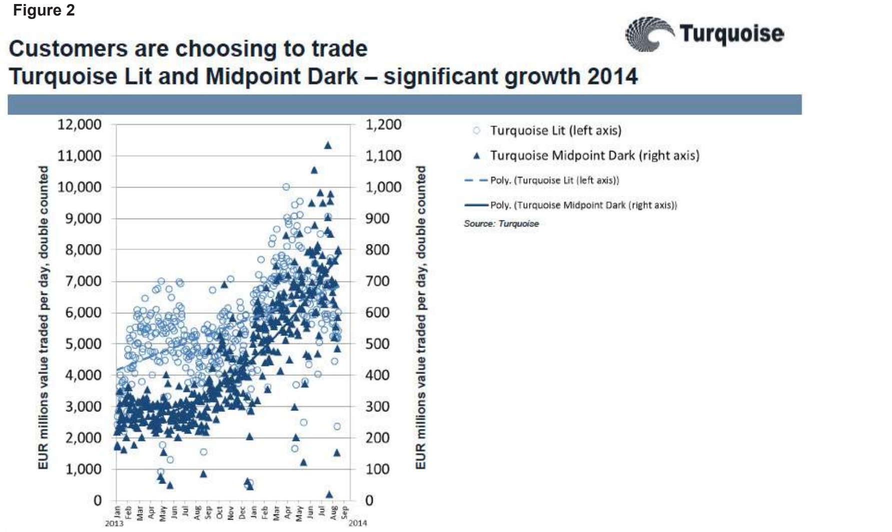
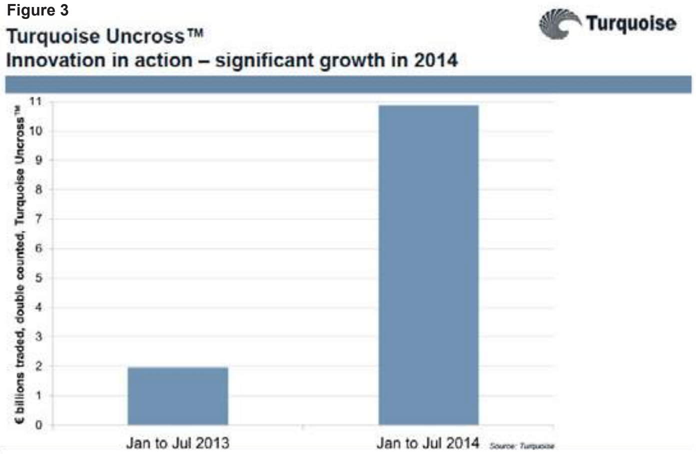


Figure 3



Investment firms traditionally accessing just their respective domestic exchange are increasingly exploring benefits of Turquoise in order to deliver a better execution result for their clients. Turquoise also widens a firm's geographic offering. A single connection to Turquoise enables share trading of 18 countries, 17 more than just those of its home market.

Connection at the trading level is straightforward. Turquoise, along with other multilateral trading facilities, also innovated the post-trade space. Members today have a choice of three fully interoperable central counterparties (CCPs): LCH. Clearnet, EuroCCP, and SIX x-clear. Structurally, each central counterparty nets and facilitates delivery of the European shares for settlement into their respective country's central securities depository. This means a member can sell on a local exchange and buy on Turquoise with a flat position. The commercial benefits of consolidating clearing through a choice of CCP serving multiple markets are economies of scale via volume discounts offered by the respective CCP.

As more retail intermediaries and mid-tier tier firms look to become members and efficiently access pan-European liquidity pools offered by Turquoise, the opportunity is for prospective members of Turquoise and general clearing member firms already connected to the post-trade ecosystem serving Turquoise to cooperate for incremental business.

Turquoise aims to make this as simple and as efficient as possible, while at the same time innovating to deliver not just the best experience, but the highest standard of result consistent with principles of integrity, innovation, partnership, and excellence. This is exemplified through Turquoise Uncross, the innovation for trading larger size with best in class quality, independently verified. AST

Robert Barnes
CEO
Turquoise

Global is local, with a few caveats

Enforcing global regulations into a local market doesn't have to be difficult, explains CIBC Mellon's Alistair Almeida

The financial and regulatory environment has in recent years been the focus of much consideration and activity by global market participants and other stakeholders. From stress tests to enforcing risk management practices to disclosure requirements, regulatory players around the world are taking action on many fronts as they seek to strengthen systemic stability and enhance transparency.

In some regions—particularly the US and the EU—regulators are casting a global eye as they seek to address cross-border and extra-jurisdictional activities that they view as potentially impacting their local markets. Regulations such as the Foreign Account Tax Compliance Act (FATCA) and Alternative Investment Fund Managers Directive (AIFMD) set out global demands and accountabilities. Market participants are as a result expending tremendous energy on assessment, compliance and reporting related to new and emerging requirements. The impact of global requirements is further compounded by a related area: reconciling global requirements with domestic rules in various jurisdictions.

In some cases, regulators and lawmakers in different jurisdictions are unable to come into alignment. For example, under FATCA, market participants are required to identify their clients who are US persons or face a 30 percent FATCA withholding tax. Canadian privacy law, however, bars unauthorised disclosure outside of Canada of certain information about individuals in Canada. As a result, Canadian market participants were faced with conflicting rules for dual Canada-US citizens residing in Canada.

To resolve this, regulators and lawmakers in Canada and the US put in place an intergovernmental agreement and related regulatory guidance that allowed Canadian institutions to report FATCA-related disclosures to the Canada Revenue Agency, which was authorised to then make the relevant disclosures to the US IRS. This strategy enabled Canadian market participants to stay on the right side of both Canadian law and FATCA.

Of course, the expectations and requirements of regulators in various jurisdictions are not always so smoothly coordinated—particularly when market participants are also required to assess the impact of those instruments on their operations. Contract requirements under AIFMD are an example. Canadian regulators direct assessment and reporting focus to the financial health of an institution or segment, rather than requiring the inclusion of specific contractual provisions.

Conversely, European regulators have in some cases called for specific language or terms within a given contract—and some institutions have taken a particularly conservative interpretation of these requirements. To resolve such differing expectations, global market participants active in Canada and their local asset servicing providers must work closely together to find solutions and practices that satisfy regulators on both sides of the ocean—all the while accounting for their own business and risk management needs.

In many cases, success is built on education: a domestic player well-versed in the requirements of a given local market can help educate global players about local requirements and identify possible challenge points in advance, working with their clients to develop a solution that accounts for both local and global regulatory needs.

Complying with regulatory requirements—global or domestic—can require substantial investments of time, energy and financial resources by both asset servicing providers and their clients. To find the right balance, asset servicing providers can assist their clients by helping clients understand where along the spectrum a given set of requirements might fall in terms of cost, challenge and feasibility.

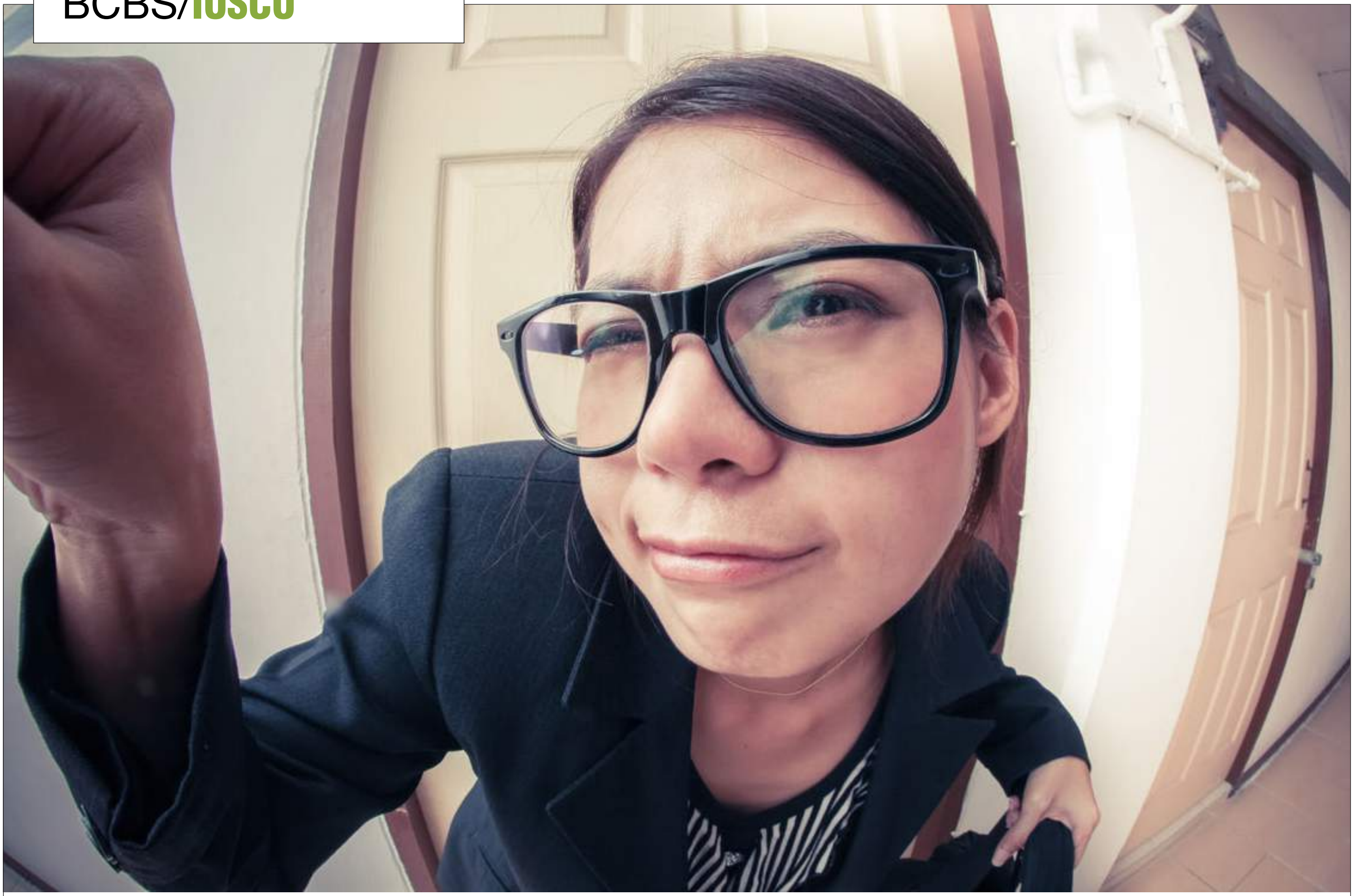
Regulatory requirements can be grouped into three broad categories. First, tasks that an asset servicing provider is already delivering or can reasonably facilitate within its service offerings. Second, regulatory responsibilities that present a substantial additional burden, which can be undertaken when clients share some of the costs. Lastly, there are some responsibilities that an asset servicing provider simply cannot take on from a business or regulatory perspective. Certain filings under FATCA are a Canadian example of this last category, as FATCA requires self-certifications that domestic custodians are not able to give on behalf of clients.

The global regulatory environment will continue to evolve, and asset servicing providers and global market participants can expect to face new and changing requirements from regulators in many jurisdictions. Market participants can position themselves to move forward by seeking to partner with domestic asset servicing providers that can deliver deep insights into local market requirements, and that are positioned to work closely with their clients to help navigate potential areas of challenge between global and domestic regulatory requirements.

Here in Canada, our rules-based business practices, the collaborative approach taken by Canada's regulators, and the strong governance efforts of domestic players across the industry have brought great strength to the Canadian brand and further enhanced our desirability as an investment destination. Effective regulatory practices remain a cornerstone of Canada's value proposition.

For many global investors into Canada, the challenges of navigating our regulatory environment are far outweighed by the confidence and strength they provide. Canada is an exceptional place to do business, and we at CIBC Mellon continue to invite global participants to investigate the many opportunities available to them here. **AST**

Alistair Almeida
Vice president, business development and relationship management, global financial institutions
CIBC Mellon



Knocking on the door

Alex Soane of SunGard assesses the possible impact of BCBS/IOSCO on collateral

First it was Messrs Dodd and Frank and the European Market Infrastructure Regulation that brought in sweeping regulatory reform across the major markets. Later it became apparent that non-standard trades, not subject to mandatory clearing, still posed risk. Given that anything uncleared is by definition non-standard, it could be argued that this is where the majority of risk is situated.

As a result, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) proposed a plan to further mitigate the risk of non-cleared derivatives. In September 2013, they released the final recommendations for margin requirements for non-centrally cleared derivatives and the market began to prepare for yet another regulatory challenge. Further consideration must be given to local regulators defining the governance of this global mandate. All of this has significant ramifications for collateral operations for both the buy and sell sides.

Kick-off is December 2015, when bilateral derivatives will be traded under new collateral agreements and market participants will start putting the preparation for the new requirements in to practice. In order to allow adequate time for all market participants to adhere to the new market rules, the implementation of initial margin (IM) transfer will be phased in gradually to 2019. The BCBS/IOSCO framework has been designed to reduce systemic risks related to over-the-counter (OTC) derivatives, in addition to providing firms with incentives to centrally clear eligible trades and provide assistance in managing the overall liquidity impact of the requirements.

It is important to understand that the impact of this regulation is far reaching, arguably more so than central clearing due to the breadth of liable parties and the non-standard trade types covered. Under the new globally agreed standards, all financial firms and 'systemically important non-financial entities' engaging in non-cleared derivatives trading will have to exchange initial and variation margin with their counterparties.

While the exchange of IM and variation margin (VM) is by no means revolutionary, the mandate covers a large section of the market which historically has not been affected by collateral. This means many trades may not currently be covered by credit support annexes (CSAs), or it may be as simple as an organisation having no existing collateral operation or expertise. Either way, BCBS/IOSCO means that the cost of non-cleared OTC derivatives will increase.

For those that may be new to collateral, as some non-financial organisations will be, two options await:outsourcing or internal investment. It is highly possible that trade volumes may be low enough to manage internally for many, in which case a rapid roll out of a collateral system providing agreement management and margin calculation may well suffice.

What of those who have the necessary wherewithal, what are their main concerns?

Yet another increase in call volumes is expected, with one Tier 1 bank recently forecasting volumes to increase 15-fold. This, added to the multitude of intra-day, multi-currency calls experienced under central clearing, conjures images of entire cities of collateral personnel busily crunching data. Of course throwing people, like money, at a problem is not the answer. Exception-based, straight-through processing (STP) workflows are the ally of the dynamic, future proof organisation. Let the infrastructure you invest in do the work. We are moving from an age of system fed manual labour into an era of intelligent platforms and enhanced collateral utilisation.

As well as 'crippling' call volumes, the new requirements call for new style agreements.

These will include standard eligibility rules and haircut schedules, and will apply to derivatives traded post-1 December 2015. Collateral managers will have to maintain multiple agreements spanning cleared business and the pre/post-IOSCO bilateral business.

It may be prudent to invest in the impending shortfall in legal resources; renegotiating existing CSAs to make them BCBS/IOSCO compliant. The task of introducing asset segregation and currency silos will be lengthy. All of this is in addition to negotiating new agreements with non-collateralised counterparties.

Other features of the IOSCO framework are intended to assist in managing the liquidity impact of margin requirements. The European Supervisory Authority's Regulatory Technical Standard (RTS) includes more asset classes, such as convertible bonds, than originally listed in the IOSCO standardised schedule.

The application of concentration limits promote explicit diversification and prevent counterparties inadvertently becoming exposed to specific assets, issuers or domiciles. The standard schedule of haircuts means that while more collateral may be required, organisations will be encouraged to think strategically about the collateral they pledge.

IM is a central focus of the BCBS/IOSCO framework. It is used in the centrally cleared world to great effect and is seen as fundamental to reducing systemic risk. As with most of the current regulatory initiatives, there is much focus on the apparent collateral squeeze due to increased IM requirements.

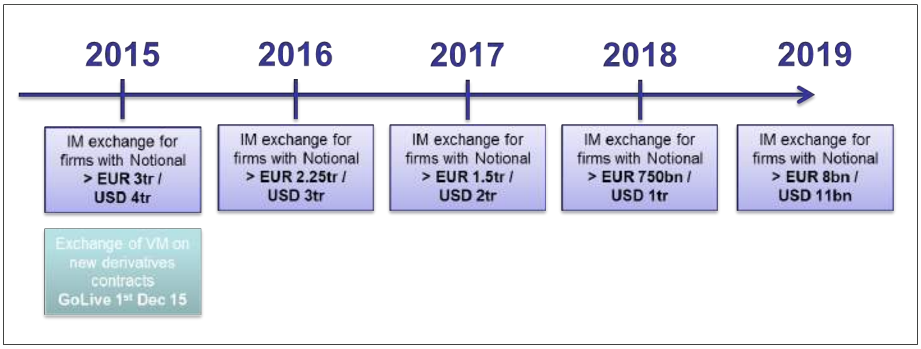
In an effort to combat this, the framework allows an IM threshold of €50 million. Maintaining this across a large organization, with many legal entities may prove difficult operationally. There will be instances where organisations may apply the threshold to their largest, most profitable business, leaving smaller entities to fend for themselves. Maintaining thresholds at a counterparty level, as well as at agreement level is a key consideration for collateral processes.

While VM will be separated into currency silos, movements will be calculated net. IM will be calculated and settled gross. Counterparties within non-netted jurisdictions will be familiar with this method, however, two-way exchange of collateral is not currently common market practice.

The standard schedule for IM, as set out by BCBS/IOSCO, appears simplistic at first glance with the framework setting out a percentage of notional that can be easily calculated by a collateral system. However, on further examination, in addition to calculating the percentage of notional required, the system would also need to calculate the net to gross ratio (NGR) and apply this to the IM requirement, as below:

Net standardised initial margin = 0.4 * Gross initial margin + 0.6 * NGR * Gross initial margin

While this calculation provides a 'simple' way to calculate IM, particularly for smaller market participants, there is much evidence that this method is punitive. It was stated in the key findings of BCBS/IOSCO's second consultative document that initial margin requirements under the standardised schedule are roughly 6 to 11 times higher than model-based initial margin. Moves for a standardised, market-wide IM quantitative model are well under way.



BCBS/IOSCO adherence timeline

The International Securities Derivatives Association (ISDA) has proposed a standard initial margin model. The next logical step may appear to be a market-wide calculation tool but we should be cognisant of other initiatives, such as standard CSA, where uptake was limited due to overly complex rules which effectively penalise buy-side firms. Smaller market participants will not have the same needs as Tier 1 banks.

In a bid to 'lock in' IM, IOSCO set out with recommendations to limit rehypothecation. However, preventing rehypothecation entirely would have detrimental effects on liquidity. As a result, the final framework recognises the possible funding impact by allowing the rehypothecation of collateral for the purpose of hedging positions.

In addition, any rehypothecation of IM can be done only once. Firms must be able to flag rehypothecated assets and ensure that no onward reuse occurs. One simple way of doing this is rehypothecation to a clearinghouse, which would hold those assets without reusing, however, this option is not available to many organisations.

A flexible, global inventory would allow the enhanced monitoring, tracking and reporting of assets needed to manage this requirement. It would also provide the required information for asset reconciliation.

Additionally, a global inventory would provide the facility to link into segregated custodian accounts in order to monitor assets placed as IM. Triparty agreements are widely used, however, all parties will be required to sign account control agreements allowing them to support gross bilateral requirements.

The operational problems faced increase the network or scope of the collateral manager. If we consider a central clearing model, the buy side faces off against clearing members, or brokers that provide collateral services, such as collateral upgrades and allocation. For uncleared derivatives, the buy side will have to choose whether to manage those functions internally or outsource operations.

One key impact to the buy side would come from concentration limits on collateral assets, meant to promote explicit diversification, which pose the challenge of sourcing multiple assets across multiple funds/strategies. Increased activity in securities finance markets to generate funding may be widespread. In many organisations, an integrated trading and collateral system will provide huge benefits.

What do all these requirements mean? The answer is simple. Strategic investment in effective collateral operations is paramount.

Many organisations recognise that existing collateral operations systems are not fit for purpose. This is driving investment in new technology. However, after the large outlay of the past few years this investment should be carefully considered with the aim of providing a future proof solution covering multiple requirements, including collateral trading, inventory management, optimisation, as well as collateral operations.

In a market that demands utmost efficiency and control, organisations need to make the right decision in selecting a new collateral system. **AST**

Alex Soane
Product manager, operations for Apex Collateral
SunGard

Regulation's tightening hold

Counterparty risk management is critically enhanced through the effective sourcing and use of collateral as part of an architecture supporting multiple requirements, says Ted Leveroni of DTCC

Collateral is a fundamental aspect of mitigating risk and the efficient and adequate exchange of collateral has become a matter of prudent risk management.

Managing collateral through effective margining creates two specific operational priorities. Where a firm that has not received enough of the right type of collateral from a counterparty, is exposed to the risk of the counterparty's default. But a firm that delivers too much collateral as margin to a counterparty is also running unnecessary risks—both in terms of exposure to default and through lost opportunity costs entailed by not putting those over-collateralised assets to better use.

New rules governing the margining of non-cleared trades serve to codify best practices for firms seeking to manage counterparty risk. The latest global rules were issued in September 2013 by the Basel Committee on Banking Supervision (BCBS) and the Board of International Organization of Securities Commission (IOSCO).

While European supervisory authorities are consulting on draft technical standards for rules, these and other compliance deadlines may seem a long way off, and many buy-side firms may ultimately not be covered.

In addition, there is still debate surrounding how the guidelines should treat initial margin.

Even though the rule is not yet part of regulatory compliance, implementing the current BCBS-IOSCO recommendation covering variation margin is a matter of prudent risk management. Operational risk management is an increasingly important part of due diligence for investors and perceived weakness in this area can have a material effect on whether a firm wins new business.

Whether receiving or delivering collateral, efficient operational processes are critical to ensure that eligible and adequate assets are selected. Counterparty risk management is critically enhanced through the effective sourcing and use of collateral as part of an architecture supporting daily variation margin (VM) calls, initial margin (IM), eligibility monitoring, concentration limits, haircuts and valuations.

Focus on full collateralisation

Since finalisation of the BCBS-IOSCO proposals for non-cleared margin last September, there have been abundant industry discussions on IM, particularly around calculations (see Box 1 overleaf).

These are important discussions and we expect them to continue. However, outside of the IM calculation question, the remainder of the BCBS-IOSCO framework reflects market best practices for risk mitigation through prudent collateralisation—quite apart from the question of future regulatory compliance.

The proposed European technical standards, which have been developed based upon the BCBS-IOSCO framework, also gives equal emphasis to these best practices.

At the core is the daily exchange of VM.

Key risk principles in the exchange of margin

To ensure controlled risk management, a valuation margin framework should recognise the following principles:

- Failing to receive sufficient VM on a daily basis creates counterparty risk.
- Failing to properly implement and monitor

- eligibility, concentration, haircuts and valuations creates counterparty and operational risk.
- It is essential that operational processes ensure timely receipt of the full amount of collateral that a firm's risk assessment has deemed prudent.
- Posting collateral also creates counterparty risk if too much collateral is posted or it is not properly segregated (see Box 2).
- If firms focus only on minimising operational costs by over-collateralising to limit margin call volumes, they expose themselves to greater potential costs in the event of counterparty default.

Box 1

Initial margin requirements

The current BCBS-IOSCO recommendations require the mandatory exchange of both initial (IM) and variation margin (VM). While VM is intended to cover the daily change in value of the derivative being collateralised, IM is required to cover the potential future change in value of a derivative, including in a period of stress—ie, one consistent with a one-tailed 99 percent confidence interval over a 10-day horizon. Current proposed initial margin requirements require the following:

- By the end of the phase-in period in December 2019, IM requirements will be imposed on all firms whose non-centrally cleared OTC derivatives activity exceeds €8 billion in gross notional outstanding amounts. The threshold above which a firm must start collecting IM from a counterparty is currently set at €50 million. This threshold will be applied on a consolidated group basis to prevent the creation of affiliates and other legal entities to get around the threshold. Where netting agreements are struck with counterparties that are subsidiaries of the same group, the group can decide how to allocate the €50 million benefit among its entities. Home supervisors will be required to judge whether local subsidiaries of a group comply with the thresholds. As with VM, IM transfers are all subject to a minimum transfer amount not to exceed €500,000.
- Calculation of IM may be done either by a firm's own quantitative margin model, which must be approved by the national supervisor, or by a standard schedule.
- IM should either be segregated or otherwise protected to preserve its ability to offset the risk of loss in the event of a default.
- Two-way (gross) exchange of IM.

Key requirements and scope

In particular, the final BCBS-IOSCO report specifies requirements of derivatives parties in a number of key areas which prudent strategy should follow:

- Collateral eligible as margin will be specified by national regulators but should include cash, high-quality government securities, corporate and covered bonds, major (eg, index-featured) equities and gold.
- Haircuts on posted collateral, ranging from zero (cash matching the derivative currency) to 15 percent (gold and major equities). These are relatively high and firms have the option to produce dynamic model-based haircut calculations, which have to be agreed upon with counterparties, adding further operational challenges.
- Individual credit support annexes must be adjusted to protect concentration of collateral in a specific issuer, asset class, sector, or country.
- BCBS-IOSCO rules allow one-time rehypothecation to hedge other positions with the same counterparty. This is on the condition that the collateral is adequately protected and such rehypothecation requires tracking. But European regulations rule it out entirely.
- Segregation of collateral assets to ensure they are speedily accessible in the event of a default.
- Thresholds currently €50 million for IM and zero for VM. Minimum transfer amounts for both IM and VM are €500,000.

Collateral management best practices

Given that the BCBS-IOSCO recommendations provide a best-practice blueprint to manage counterparty risk via efficient collateralisation, the challenge is how to implement them.

A solution needs to consider that counterparty risk can arise in both delivery and receipt of collateral. To mitigate the counterparty risk associated with inefficient collateral use, firms must develop an architecture supporting regular posting and receipt of VM. Effective posting ensures inventory is adequately used, and the operational process that delivers it is efficient enough to prevent over-collateralisation and the risks it creates. Effective receipt ensures supplied collateral is adequate, eligible and doesn't create concentration risk.

Firms need to analyse their own unique business operations and determine whether or not their systems and processes will support their future needs. While businesses may choose to develop a bespoke solution in-house, a range of collateral management systems already exist. These have been developed to support best practice capabilities and should allow for quicker implementation, greater cost effectiveness and easier and faster adjustments to future changes in industry practice.

Leverage the knowledge and expertise of the DTCC, with its robust collateral management platform—Omgeo ProtoColl—to implement automated STP in order to manage margin and collateral calls across the entire trading operation. Automation of the collateral management lifecycle minimises manual intervention, enabling firms to increase operational efficiency while making smarter, more effective use of their collateral and subsequently reduce counterparty risk. **AST**

Box 2

What are the risks in placing collateral?

The risks involved in not receiving sufficient collateral are self-evident, but how does placing too much collateral create risk for a firm? The collapse of Lehman Brothers provides some answers:

- Hedge funds that were over-collateralised in trades with Lehman Brothers waited for years while administrators untangled their assets from the melee.
- Even when assets were held without transfer of title, because they were physically delivered, the trustee put a ring fence around the assets when Lehman Brothers entered bankruptcy, from which many assets did not emerge for five years.
- Even when assets are retrieved in the event of bankruptcy, differences in local insolvency regimes mean that the resolutions of bankruptcies may not allow customer first claim. Under UK (and most European) laws, title transfer retains some rights. In the US, segregation creates considerably less protection: client assets and company assets are co-mingled.

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DTCC


safe_keeping
Your complex investments require specialized knowledge and servicing experience. Count on personalized attention from our dedicated custody and agency team.
baml.com/custodyandagencyservices