

SDRSG Minutes – 19 January 2017

The Chair opened with an update on CSDR timelines;

- Final CSD authorisation standards sitting with European Council and Parliament, no surprises are expected at present.
- OJ for authorisation standards expected end of Q1
- SDR standards with Commission. There could be possible push backs in either the Council or Parliament.
- Expect entry into the OJ for SDR standards for for Q2 with a 24 month phase-in, which would indicate the SDR going live in Q2 2019

1) Approval of minutes of 17 November 2016 and matters arising

Minutes approved and the following items noted;

- EUI SDR webpage to be updated and operational bulletin to be send before next meeting (ACTION 1)
- As previously discussed, minutes will only record the names of the Chair and Sponsors.

2) Update on Settlement level gap analysis and task force composition:

- Draft TOR would be distributed shortly.
- The taskforce (TF) met in December comprising of SEWP members where a number of corporate action issues were discussed. The Last Date of Transfer (LDOT'S) for Gilt redemptions being an example of the extent of impact that the standards will have. Useful feedback received and will be a topic of conversation going forwards. The taskforce is not fixed and will remain fluid depending on subject
- Work is ongoing to form a centralised penalties engine with group.
- Meeting held with Quoted Companies Alliance (QCA) alongside the Trading level sponsor to provide overview of regime. Next meeting planned for March
- Further analysis on fines - £140,000 to £150,000 of fines moving on average on daily basis covering small cap stock as expected.

The SDRWG noted that reporting is key - who would be leading, ECSDA? CP would need to advise (ACTION 2)

It was also noted that the Trading and Clearing level sponsors should be included in TF for complete visibility (ACTION 3)

CR noted that the TF should not solely focus on SEWP and that a structured plan of action was needed to address all areas. There should be a clear view on requirements and the people needed. Fluidity in terms of drawing in issue specific experts was a good idea, but the TF would also benefit from a having consistent core members. Other SDRWG members should come forward if they wished to be involved. The chair agreed that the TF should be aware of T2S requirements and any benefits of sharing data but should always ensure that the UK & Irish markets had access to the data and analysis needed to tailor the SDR proportionately and effectively to the individual contours of these markets.

The chair also agreed that the reporting will be key and encouraged EUI to lead. The TOR should reflect this. These should consider: are the affected parties involved and advised?; what are the mechanisms that will need to be implemented at settlement level; and what mechanisms need to be built between settlement and the trading, clearing, and participant levels? This would be a particular issue in terms of coordination between the clearing and settlement level. EUI should consider the implications of a group penalty engine in serving the UK and Irish markets. It would also be essential for the TF to review EUI's gap analysis to align it with the comprehensive state of development exhibited by the clearing level TF. (ACTION 4)

CP agreed but noted that there is common ground between the clearing and settlement levels. Both parties will follow the same standards, same message types and process the same fees. There should not be any significant issues. Delta and communications to be understood but harmonisation is needed. CR noted that this would be welcome but should be confirmed through a thorough assessment.

CR enquired again to see if CP had been successful in definitively identifying Irish securities against UK securities so that the settlement efficiency profiles could be observed by securities settlement system. CP noted that this was proving difficult, and had engaged with Irish SG members to try to refine an approach based on using those securities that are listed on the Irish Stock Exchange. Regulators noted that as Irish securities were processed according to the Irish Uncertificated Securities Regulations (USRs) through a separately designated securities settlement system overseen by the Central Bank of Ireland, they expected that the securities should be capable of easy identification. The regulators requested that CP re-double his efforts to provide comfort that this was possible and report back on progress at the next SG meeting. (ACTION 5)

3) Update on clearing level gap analysis and task force composition

- A consolidated impact assessment had been compiled and was under review. It will be circulated to the BoE upon completion. (ACTION 6)
- The TF is comprised of Eurex, EuroCCP and X-Clear, with engagement from AFME
- TF participation is productive with good engagement. It discussed future operational requirements
- Bilateral meetings need to be arranged with EUI to discuss reporting structure

CR noted the strong progress being made by the TF, and highlighted that it was essential to draw on expertise widely as the regime must fit all needs. The consolidated gap analysis was best practice, and should be adopted by the other TFs. Sponsors should also send their risk logs to Citi to incorporate into the Risk Register. (ACTION 7)

4) Update on trading level gap analysis and task force composition

- Work has been conducted on actions to better understand the buy-in process and potential gaming regarding price inflation of securities.
- Clifford Chance is assisting in order to consult on various possibilities for rules changes i.e. limits on share price, cash out percentage level, and market abuse protection
- TF met in late November – next date tbc
- Discussions were had on buy-ins and the approach for small and large cap firms. Large cap securities should not be a problem as lending facilities could be leveraged. However, small cap securities could pose a liquidity issue while price inflation will increase cash out price. They were working on a possible paper to the FCA on this.
- The difficulties of the regime for market makers were again noted. One option that they were investigating was whether issuers could lend their own stock as a facility to help cure fails. While this could be beneficial, a number of issues had been identified, e.g. the economics of the return vs. the cost of setting up a facility, or the legal limitations that may prevent an issuer from lending its own securities. Furthermore, where the fail may be as a result of short selling, it would not be in the interests of the issuer to help the failing party who was shorting their stock.
- CP had assisted the TF, which was now working on data from EUI.
- An update was provided on EuroCCP advisory committee – this had a Eurocentric, single approach which was less focused on the individual features of the UK market.

CR noted that some analysis from BATS was needed on non CCP trades (ACTION 8)

Market abuse thoughts should be fed into FCA, CBoI and ISE (ACTION 9)

All sponsors should consider stock lending implications within their TF

5) Update on analysis conducted so far on projected impact of penalties under the new regime – Non-FMI SG members

An Irish SG member estimated that fines would potentially increase by up to 15 times current levels. They highlighted possible problems for Irish stock lending as it was generally less liquid or harder to borrow.

One custody bank SG member noted a potential 80% increase in stock lending costs, and a 50% increase in fines. However, on further examination, they identified that simple changes in housekeeping such as internal processing changes could significantly help. They confirmed that concerns raised internally.

Another custody bank SG member confirmed that there could be a potential 10 times increase for their business. Their UK and Irish operations teams were now aware and they were looking to engage with other European markets teams on this.

Another Irish SG member estimated the impact to be a potential 5 times increase in fines. However, they had an automation program close to delivery that would reduce fails so they were less concerned.

BNYM/Investec/HSBC/Citi/Blackrock have not yet completed their analysis and will report back to the SG once this is done. (ACTION 10)

CP advised that recent analysis showed a growing trend of back-dated trading subsequently leading to fines. Participants will be required to review their internal books closely to address this.

CR noted that good progress was being made. It is important that the regime also incentivises efficient internal processes. The good examples provided by SG members on reviewing and adjusting internal processes to improve them to reduce fails were best practice. Analysis on the penalty process was well underway and that buy-ins should also be looked at closely. All member analysis should be added to risk log. (ACTION 11)

6) Discussions on the implications of the mechanics of reporting in the regime

The chair asked the group if this was a low impact area.

The group agreed that this was potentially the case, but only if it is harmonised. Most message types are established but there are obvious concerns for any new message types. The fails present a complicated chain of participants. CP noted that it is more straightforward for non-CCP's as CCPs were had more complex relationships with the addition of clearing members. More work was needed on communication and data feeds with all CCPs clearing for the UK and Irish markets.

CR noted that there are complexities concerning the different participants and mechanisms and that as EUI was the common denominator it should lead in this area and assess the problem. (ACTION 12)

This challenges posed by reporting appear to be deceptive – it should be treated as a key area for 2017. All sponsors should be aware and address it in their gap analyses. This would require them to identify associated articles that make up the components of the overall reporting mechanism - this is not just about Article 13 RTS alone.

CP noted that transactional information flows will be reviewed to identify what currently exists, what is new, and where there are the gaps. The data source, how is it transmitted, and what cost involved would also need to be identified. (ACTION 13)

7. Review and reconcile open actions table

Open actions were reviewed and the table will be updated accordingly.