ISSA Working Group update – Regulatory impact on the securities services chain

Florence Fontan, ISSA Working Group Leader and Global Head of Public Affairs at BNP Paribas Securities Services, presented the ISSA Working Group Report on the „Regulatory Impact on the Securities Services Chain.“ The objective of the report was to identify key regulatory trends and their impact on various industry actors. The overview of regulatory changes was divided into „5 Buckets“:

- banking
- shadow banking
- investor protection
- market organization and
- tax and other authorities

as well as geographic regions. An interesting addition was the discussion of potential opportunities, just before the concluding observations summarized overarching impacts.
# Agenda

1. Objective of the group
2. Key regulatory trends
3. Impact on the various actors
4. Conclusion
# General overview – Major regulatory trends

## Financial crisis
- G-20 new requirements
  - Identification of sources of systemic risks
  - Regulation of non-regulated products and actors
  - Coordination between authorities to face exceptional situations
  - Prudential measures to face extreme situations

## Major regulatory trends

### Europe - USA
- Reinforcement of regulation of financial markets and institutions

### Asia – Latin America
- Opening and organisation of financial markets within a stricter framework
- Development of financial markets according to new G-20 standards

## General overview - Regulatory changes

### Banking Rules
- **Prudential requirements**
  - SIFI framework / living wills
  - Enhanced implementation of capital regulation
  - Asset protection / segregation / collateral

- **Banking model**
  - Vickers
  - Resolution

- **Accounting rules**
  - IFRS

### Investors Protection
- **Investor Information**
  - Conflicts of Interest

- **Distribution Rules**

### Market Organisation
- **OTC derivatives**
  - New York middle market

- **Trading organisation**
  - Regularisation of trades (Asia +3)

- **Infrastructure regulation & org.**
  - CNS/TPC

- **Standardisation**
  - MOT/TPC

### Tax and Authorities
- **Europe**
  - New European Treaty
  - Financial Transaction Tax

- **USA**
  - Dodd Frank Act
  - Asean Bond market forum (ABMF)

- **Asia**
  - Asean +3 (China, Japan, Korea)
3 major regulatory trends are particularly critical for our industry

- **Banking rules - BASEL 3**
  - Increased capital requirements on risks
  - Liquidity ratio
  - Custody, which provides client cash balances may be seen as more attractive
  - Increased need for market financing to finance the economy

- **Market organisation in particular for OTC derivatives**
  - Use of infrastructures pushed by regulation (EMIR, Dodd Frank)
  - A tiered market organisation where Financial Intermediaries should remain the risk absorber
  - Increased need for High quality collateral
  - Squeeze on collateral may impact volumes and creates opportunities for intermediaries and FMIs

- **Investor protection and transparency**
  - Increased risk to be taken by Financial Intermediaries to protect investors
  - Increased demand for transparency and reporting towards investors & regulators

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Impacts for financial intermediaries

**Liability**
- Increased liability
  - AIFM, UCIT V: restriction obligation
  - SID, EMIR: Assets segregation
  => Change in services offers (and countries)
- Impact on ROE
  - Increased capital requirement
  - Resolution plan

**Banking rules**
- Impact on ROE
  - Increased capital requirement
  - Resolution plan

**Market regulation**
- Impact on IT and adaptation costs
  - MIFID: custody as investment service
  - T+2: New settlement discipline framework
- Impact on services portfolio
  - MIFID: ban of inducements
  - AIFM: constraints on combined depositary and prime brokerage services
  - EMIR: constraints between custody services and financial services as counterpart

**Conflict of interest rules**
- Impact on It costs
  - FATCA, FTT
  - Impact of profitability of transaction services
  - FTT: cost for P/E, FX swaps...

**Tax**
- Impact on It costs
  - FATCA, FTT

**Risk absorber**
- Financial Intermediaries
  - Custodians
- Buy side

**Access to infrastructures**
- OTC Derivatives (EMIR, ORR, JFATCA, FTT)
- Increased need to access market infrastructures (CSD, and TR)

**Centralize and mutualize risk**
- Take on risk currently managed bi-laterally
- Mutualize risk to reduce industry costs

**Service Portfolio**
- Centralize and mutualize risk
  - Take on risk currently managed bi-laterally
  - Mutualize risk to reduce industry costs
- Update services for market and tax changes
  - T+2
  - FATCA
- Settlement Discipline

**Counterparty risk**
- Risk shifts to FMIs exposure
- Increased reliance on and exposure to FMIs

**Market Rules/Tax**
- Update services for market and tax changes
- T+2
- FATCA
- EMIR
- Settlement Discipline

Impacts for market infrastructures

**Increased regulatory requirements**
- Increased compliance and investment
  - CPSS-IOSCO Principles for FMIs
  - EU regulatory reforms for CSDs
  - FSB guidelines for TRs and LEI

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**Financial Market Infrastructures**

**Collateral**
- Higher collateral demands by FMIs as they centrally manage risk
  - Need to optimize collateral management

**Governance**
- As FMIs increase their role, participants will focus on governance practices

**Participants**
Impact on custodians and clearing agents

- **Increased costs and risks**
  - Cost of regulatory compliance and IT adaptation (FATCA, T+2, EMIR...)
  - Cost of new liabilities (AIFM...)
  - Cost of capital
  - Knock-on costs of FMI reforms - capital and margin

- **Opportunities for services and products**
  - Outsourced services
  - Collateral optimization and transformation
  - Access to market infrastructures
  - Products to enable clients with Trade Repositories
  - Transparency services

- **Probable Outcome**
  - ROE of major custodians already low (approx. 8% for US “pure plays”)  
  - Impact will vary firm to firm depending on how they are positioned
  - Focus on cost reduction
  - Will attempt to pass along increased costs to clients

Impact on FMIs

- **Increased costs and responsibilities**
  - FATCA
  - T2S: settlement revenues move to ECB
  - T+2 and LEI implementation costs
  - CPSS IOSCO principles (compliance costs, capital and liquidity requirement)

- **Increased competition**
  - EU CSD regulation to spur CSD competition

- **Opportunities**
  - OTC derivatives clearing for those well positioned
  - Trade repositories and LEI
  - Pan-European CSD services
  - Collateral management and transformation

- **Probable outcome**
  - Increased regulatory reliance on infrastructures
  - Impact will vary greatly depending on how positioned
  - Large number of European CSDs unlikely to survive in current form
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Conclusion

• Cost of regulation will be high for all actors in the chain

• Infrastructures will play a greater role in financial markets but not all will benefit from this trend. Competition and rationalisation is expected. Potential new entrance as well.

• Financial intermediaries will face important challenges. Strong focus on cost is expected especially in current low growth environment. Regulation is also source of business opportunities and business model may evolve.

• Some overall benefits to ISSA core constituency
  – Improved and more efficient processing (dematerialization and buy-in procedures in Europe, T+2 in Europe and potentially US)
  – Improved transparency - OTC derivatives data
  – Increased use of central clearing for OTC derivatives

• Potential Risks and Challenges
  – Regulatory arbitrage
  – Balancing short term cost of regulation versus efficiency, profitability and financial stability
Appendix

WG1- Working Group Members
Regulatory impact for the actors in the securities chain

- Florence Fontan, BNP Paribas Securities Services – Chairman
- Bruce Treff, Citigroup
- Ioannis Tzouganatos, Citigroup
- Neil Henderson, DTCC
- Jo Van de Velde, Euroclear
- Henry Raschen, HSBC
- Jong-Hyung Lee, Korea Securities Depository
- Richard Young, Swift
- Urs Staehli, UBS