

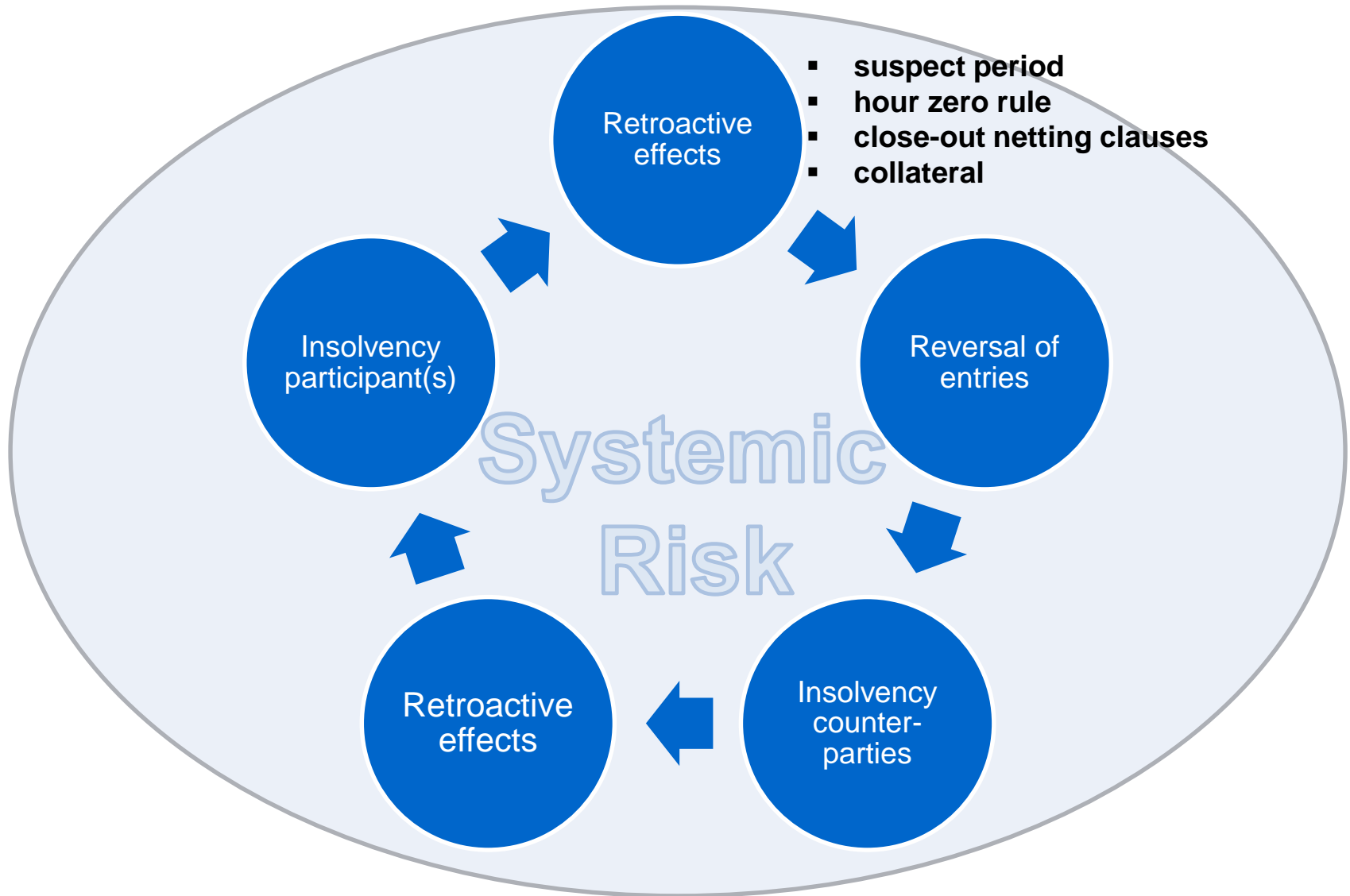
Settlement Finality after Brexit

Global Custody forum London

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Why Settlement Finality?



Settlement Finality Protection



Transfer order finality: Insolvency protection of transfer orders / netting

Art 3 SFD: transfer orders / netting legally enforceable and binding on third parties even in the event of insolvency proceedings against a participant (protects surviving participants against insolvency one or more of them)

Transfer orders unilaterally irrevocable

Art 5 SFD: Moment as from which instructions entered into the system can no longer be unilaterally revoked

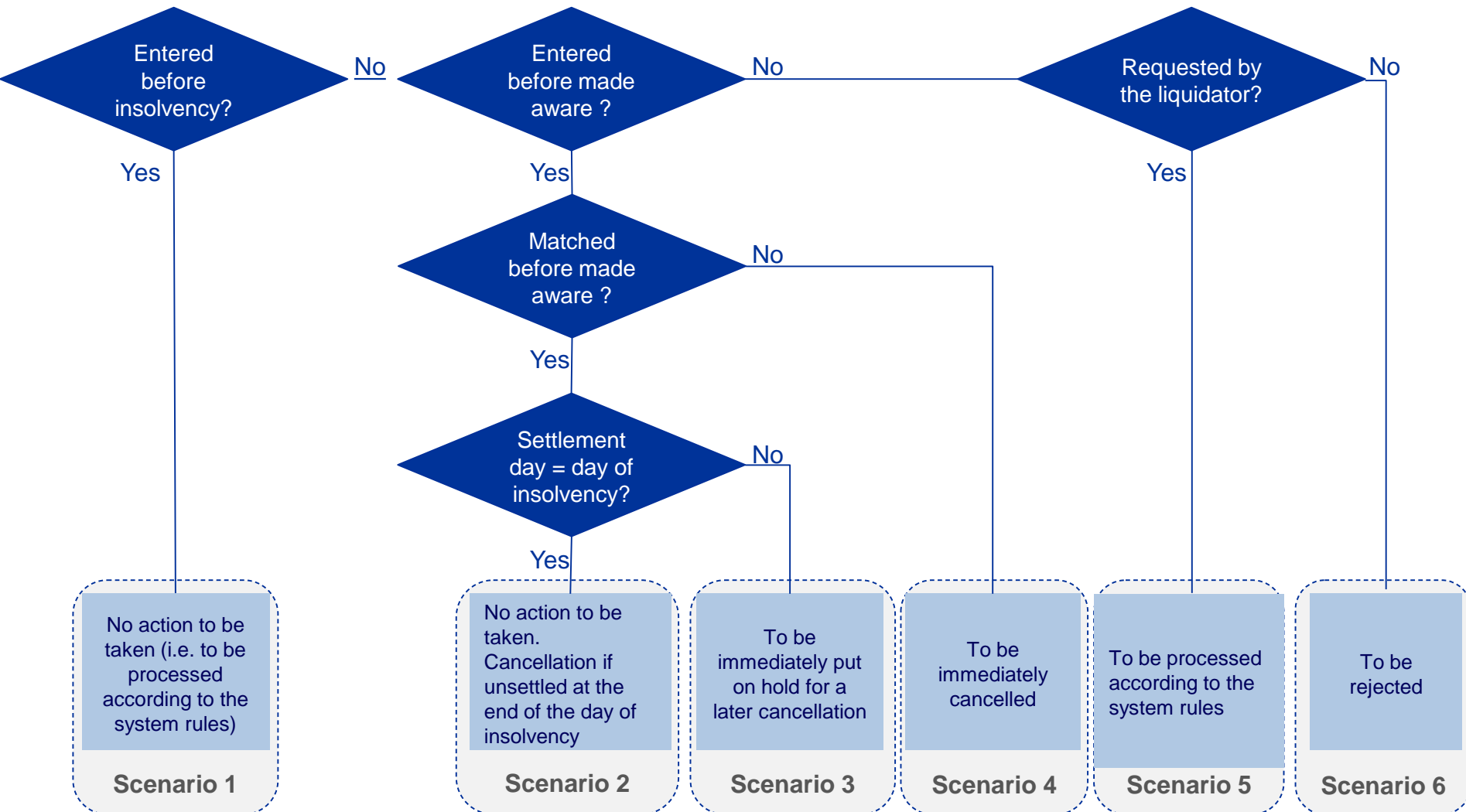
Finality of transfers; Irrevocable & enforceable

Art. 39 CSDR: deliveries of securities / cash become both irrevocable and enforceable Should be real time or intra day and in any case no longer than COB on settlement day

Art 39 CSDR Real time DvP: Delivery of securities is final and irrevocable if and only if the corresponding cash debit is final and irrevocable and vice-versa

- Art 7 SFD: Protection of rights and obligations of participants in relation to their participation in the system against retroactive effects insolvency events
- Art. 9 SFD: Insulation of the rights of holders of collateral security provided to them in connection with a system from the effects of the insolvency of the collateral provider

SF1 protection: ECB decision tree for T2S



Conflict of law rules under the SFD

Art 8: Insolvency proceedings:

law of the system

In the event of insolvency proceedings being opened against a participant in a system, the rights and obligations arising from, or in connection with, the participation of that participant shall be determined by the law governing that system.

Art 9: Collateral security:

lex rei sitae

The determination of the rights of participants as holders of collateral security in relation to collateral security provided in connection with a system shall be governed by the law of the Member State where the collateral is recorded on a register, or account

What is the issue?

SFD protection is a favor
because exception on the
equality of creditors

Have to be
designated by
MS and
notified to
ESMA

Have to be of
systemic
importance

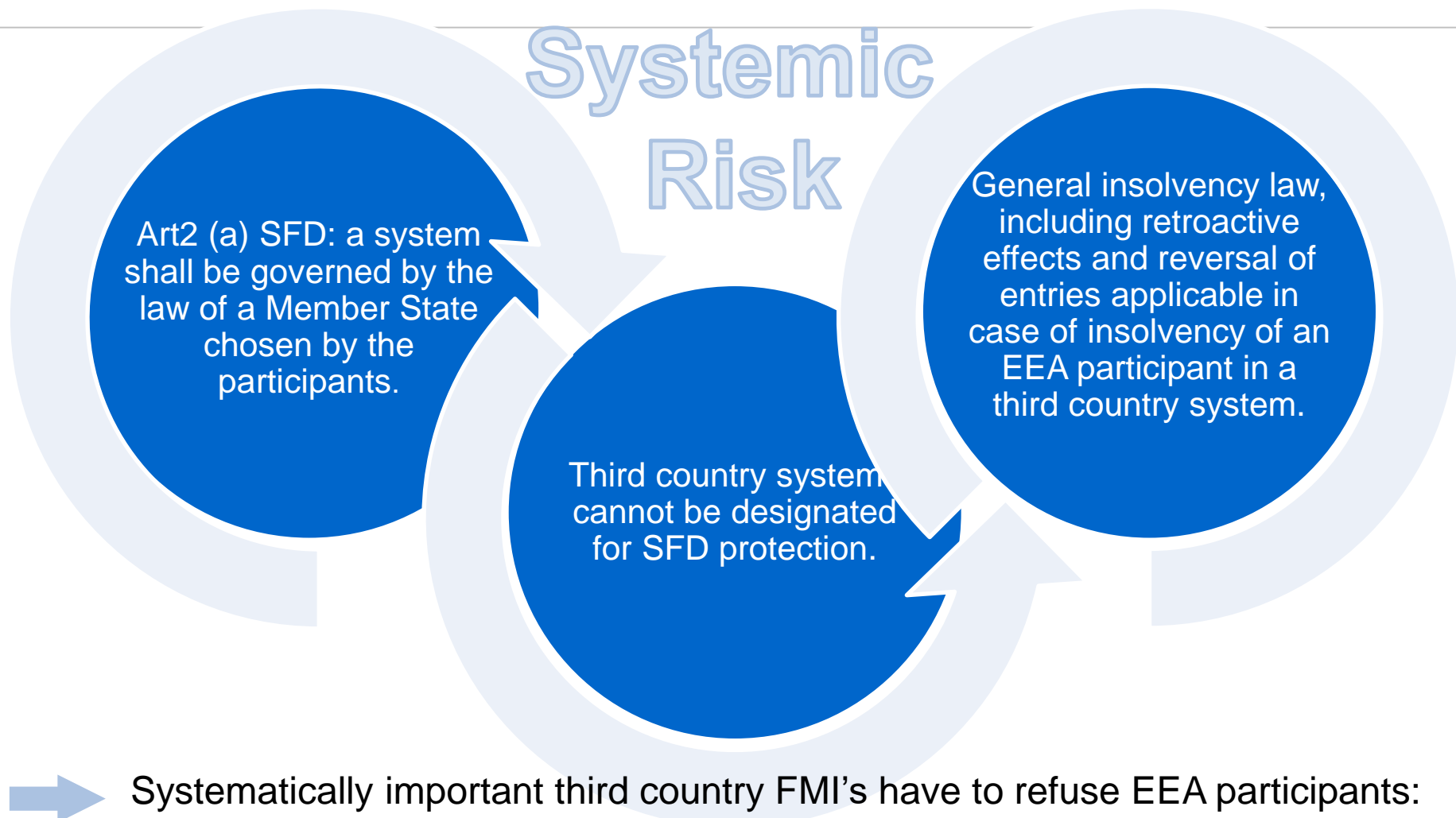
Participant
requirements

Only assets
that are MiFID
financial
instruments or
cash (not
commodity
spot)

System rules
have to be
adequate

Only available
for FMI based
in the EU

Exclusion of third country FMI from SFD protection in the EU.



- ➡ Systematically important third country FMI's have to refuse EEA participants: no clean legal opinion and not allowed by their supervisors.
- ➡ The SFD is the only SF legislation in the world with this restriction.

Impact of Brexit

- UK based FMI with EEA participants will become third country FMI after Brexit.
- Many important third country FMI with EEA participants have chosen London for their EEA establishment in order to benefit from SFD protection.
- For many of these FMI there is no alternative (e.g. CLS), so if they would refuse EEA participants this would be a major problem for the financial sector in the EEA.

DRAFT EUROPEAN PARLIAMENT LEGISLATIVE RESOLUTION (TLAC Package)

- In the context of the review of the BRRD (proposal for Directive amending the total loss-absorbing capacity (TLAC), BRRD and SFD Directives).
- Parliament proposal provides that a third country FMI is included in the scope of the SFD if:
 - (a) at least one EEA participant, and
 - (b) For FMI clearing and or settling financial instruments: ESMA is satisfied as to the adequacy of rules and legal framework; or
 - (c) For FMI processing payments: a cooperative oversight arrangement has been established between at least one of the central banks of issue of each EEA currency processed in that system and the authorities supervising that system in the third country.

TRIALOGUE 30 November 2018

Proposal of the Parliament was not accepted during the trialogue. (ECOMP.1.B), because:

- Brexit related
- Complex time consuming procedures, involving ESMA and collaborative arrangements with third countries: would jeopardise the deadline for the review of the BRRD
- The European Parliament accepted the Council's general approach: A review clause is added, whereby the Commission will assess the existence of any gaps to be repaired 24 months after entry into force of the BRRD.

=> Systemic risk remains, and the Commission encourages the Member States to implement the contingency solution of recital 7.

Contingency solution: Recital 7 SFD

Individual Member State level

Recital 7 SFD:
“Member States may apply the provisions of this Directive to their domestic institutions which participate directly in third country systems and to collateral security provided in connection with participation in such systems”

Reciprocity: only the creditors of insolvent participants of that Member State will be disadvantaged by SFD protection, not those of the other participants.

Conflict of law rule: If law of the system applicable, the finality protection of law of the system (third country law) is applicable, not the SFD

Who will designate the third country system, decide which system is systematically important, has the right participants and assets, and adequate rules?

➡ Not implemented in many Member States (the Netherlands, Luxembourg, Sweden, France,, ...,)

➡ National recital 7 Implementations are often inconsistent and incompatible.



Thank you for your attention.

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