

## ISSA Symposium 2014

- This issue is devoted to the 17<sup>th</sup> Symposium.
- Following the CEO's introduction, read about the major discussion topics.

## Adaptation of the Business Model to Compliance Standards

- Regulatory / compliance decisions impacting omnibus account structures.

## Today's Regulatory Challenges and Trends

- Read the message from a Regulator.

## Practical Application of Technology to Solve Regulatory Challenges

- Industry utilities as a possible way to pool the costs of meeting increased regulatory demands.

## Infrastructural Regulatory Challenges

- Challenges caused by CPSS / IOSCO Principles 14 and 19.

## Collateral Management

- Deep-dive discussions on certain aspects of ISSA's Report published in March 2014.

## Out-of-Network Assets

- Deep-dive discussions on possible next steps following the publication of ISSA's Report in April 2014.



## ISSA Symposium 20 - 23 May 2014

Dear ISSA Members and interested parties,

From 20 to 23 May 2014, some 80 senior delegates of custodian banks and financial market infrastructures took part in the 17<sup>th</sup> biennial ISSA Symposium, held at the Wolfsberg Conference Centre in Ermatingen, Switzerland. This year's agenda focused on how the value chain is responding to the regulatory challenges and the implications for the industry. The conference theme met with great interest and prompted lively debate.

As has become tradition at ISSA Symposia, the issues were presented by prominent experts and the key questions subsequently discussed in panels and in various breakout sessions. Given that a total of 48 institutions from 26 countries were present, the composition of the audience yielded quite some diverse views and recommendations. It is now the task of ISSA's CEO Office and Operating Committee to take concrete decisions on which topics to select for further assessment and pursuit in working groups. We hope to be able to inform our community in more detail by the end of July 2014.

The major discussion topics are summarized overleaf. A more detailed «Account of Proceedings», written by Dominic Hobson, to whom ISSA is very grateful, can be found under [this link](#).

The Symposium is also the place to hold the biennial general meeting of ISSA. The members present unanimously approved the proposed amendments of the Articles of the Association. They were mainly a consequence of establishing a CEO office as an integral part of the governance structure. The general meeting confirmed as well unanimously the nominated Board Members representing the sponsoring institutions.

With the approval of the amendments of the Articles of the Association an important transition in our governance structure could take place. As a consequence, Stephen Lomas officially became the Chairman, Thomas Zeeb the Vice Chairman and myself, the CEO of ISSA, as of May 23, 2014.

I am looking forward to working together with you in my new role and I remain with my best personal regards.

Josef Landolt, CEO ISSA

## Major Discussion Topics

### Adaptation of the Business Model to Compliance Demands

The impact of recent regulatory / compliance decisions on the widely practiced omnibus account structures in the securities services industry were discussed. The background was communicated in the Issue Paper [«Transparency in Securities Transaction and Custody Chains»](#) worked out by a small ISSA working group before the Symposium. In addition, the [presentation of Mark Gem](#), Clearstream, and the [presentation of Jens Gebhardt](#), Standard Chartered Bank, gave further profound input.

In a case cited in the above documents, Clearstream Banking paid a substantial USD amount to settle potential civil liabilities arising from the fact that it had served as the channel by which the Central Bank of a sanctioned country held securities in the United States. The principal issue, named by the Office of Foreign Asset Control (OFAC), was that the securities were held in an omnibus account structure which meant that their beneficial ownership was not transparent to Clearstream. Omnibus account structures substitute intermediaries for beneficial owners and commingle fungible interest in securities. Such accounts are widely used not because custodians wish to conceal beneficiaries, but because they are operationally efficient.

Next to the advantages offered by omnibus accounts, they also mean that sub-custodians lack visibility into the owners of the securities they hold in custody. At present, they take comfort from the fact that intermediaries are regulated and expected to conduct Know Your Customer (KYC) screening. Until recently, regulators did little to disturb the view that it is sufficient to rely on these assurances, yet recent regulatory developments suggest continuing reliance on the regulation and KYC procedures of intermediaries may be misplaced.

The paper and the breakout sessions discussed recent regulatory motions to increase transparency along the custodian chains and identified a number of best practice and technical solutions that could be pursued.

### Today's Regulatory Challenges and Trends – A message from a Regulator

Mark Branson, the recently appointed Director of the Swiss Financial Market Supervisory Authority FINMA, gave a pronounced keynote speech on the evolution and trends of financial regulation. Supervision, he noted, is not the same thing as regulation. It is the focus on rules of conduct and «supervisory intensity» that is aimed at altering the behavior of banks and bankers. Explicit regulation is following a more predictable pattern, in which existing regulation is overhauled. Previous unregulated sectors are brought within the purview of the regulators and international regulatory bodies are increasingly influential and aim to prevent regulatory arbitrage.

Any expectations that over-regulation will be mitigated by reliance on regulatory equivalence are likely to be disappointed. Regulators in the US and the EU have developed extra-territorial ambitions which are now being imposed on banks that wish to trade in their markets. In any event, national regulation that does not aspire to international standards means near-uniformity is more the norm than equivalence.

Regulators have certainly not lost sight of the possibility that the next crisis will come from a completely different and unexpected direction. Indeed, one of their primary concerns is that financial markets are still a long way from returning to normality. The banks that are active in the securities services industry are immune to none of the regulatory trends and will bear their share of the costs.

### Practical Application of Technology to Solve Regulatory Challenges

Kelley Mavros and Richard Carl Drisko of Booz&Co (now: strategy&) gave an enlightening presentation on the [«Practical Application of Technology to Solve Regulatory Challenges»](#). The cost incurred to meet the increasing compliance burden is significant, whereby the investments to be made in technology are projected to rise at an annual compound rate of 6.9% between now and 2017. There is a further hidden cost in the loss of focus on new and existing

business, but regulators believe the industry is profitable enough to bear such costs.

Rapid access to high quality data is essential to meet regulatory demands and it poses the severe practical challenge of integrating ageing technology platforms to improve data quality. Many banks are looking to third party vendors to avoid the difficulty of integrating internal systems.

Banks are looking to pool the costs of meeting regulatory demands where these confer no competitive advantage, of which KYC is the most obvious example. Regulators support utilities provided the data they possess is available to all members of the industry. Five functions were identified as susceptible to being serviced by a utility. For the industry to support utilities, however, the banks that fund them need to be convinced of the savings they offer. Among other aspects, the users also need to agree where the liability for errors, omissions and data quality resides.

### **Infrastructural Regulatory Challenges (CPSS / IOSCO Principles 14 and 19)**

In April 2012, the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) published 24 Principles for the management and operation of financial market infrastructures such as CSDs and CCPs. Two of them, namely

- Principle 14 on the need to segregate customer assets and collateral and make them portable to a new broker or bank in the case of counterparty default
- Principle 19 on the need to look through clients to the clients of clients

are proving particularly challenging for CSDs and CCPs around the world to meet, especially on an internationally consistent basis.

Most markets meet the notions of segregation and portability in spirit if not always in practice. Practices range from compulsory segregation and portability, through voluntary segregation and limited portability and a

choice of segregated or commingled, to partial segregation and partial portability. Yet, the intent of protecting customer assets is clear in every case. Obliging markets at different levels of development, and with different levels of activity, to adhere to a single standard would probably be prohibitively expensive.

To make Principle 19 effective, both CCPs and CSDs would have to monitor counterparty exposures in real time. Some CSDs and CCPs are already able to do this, but even they will be dependent on the ability of clearing brokers and custodians to do the same.

### **Collateral Management**

The need to manage collateral efficiently emerged before the financial crisis, because collateralized exposures attracted capital relief. Since the crisis, collateral management has become even more important because central banks lend only on a collateralized basis, the CCPs whose remit regulators have extended to OTC derivatives insist on collateral, and central bankers and regulators are implementing measures to contain the collateralized lending subsumed in the title of «Shadow Banking».

ISSA's [Report on Collateral Management](#) issued in March 2014 informed how the many changes in collateralization are creating a new post trade landscape for many ISSA members. It formed the basis for various issues dealt with in the breakout sessions, such as the less than anticipated rapid growth anticipated some years ago, as for example the expected collateral shortage did not materialize. Presently, cross-border settlement costs outweigh the benefits of more efficient management of collateral. CSDs could play a larger role in making collateral available and moving it across borders efficiently.

It became also evident on numerous occasions that ISSA's report should be disseminated to a wide audience and that all ISSA member institutions should make it available to their in-house specialist units.

## Out-of-Network Assets

Custodians have struggled in recent years to keep up with the range of asset classes acquired by their buy-side clients. Today, they are expected to settle, safekeep and service not only cash, equities, bonds and futures and options, but also holdings in funds of funds, private equity funds, real estate, bank loans, a variety of OTC derivative structures and collateralized interests of various kinds.

As identified in the joint [AGC / ISSA Report on «Out-of-Network Assets»](#) published in April 2014, custodians tend not to control these assets in the sense of keeping them in custody within their own network of sub-custodian banks. This presents them with the risk of assuming liability without taking control.

Besides, these Out-of-Network Assets are operationally complex. For some categories, infrastructure solutions have been successfully built and are being used. The principal obstacle to improvement of the infrastructure is that, although the volume and value of Out-of-Network Assets are rising, and so are the costs and risk of supporting them, the problems are not yet large enough to force market participants to insist on meaningful reform. Yet there was quite some consensus with regard to the suggestion in the above report to encourage custodians and CSDs to discuss how they can work together to address the challenge of verifying and transferring the ownership of assets that cannot be held within a conventional custody network.

### **We welcome your feedback**

We would very much welcome your comments whether the contents of this newsletter suit your requirements.  
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Many thanks in advance!  
*The ISSA Secretariat*