

**Spain: Oversight and Supervision of Financial Market Infrastructures Technical Note**

This paper was prepared based on the information available at the time it was completed on May 2012. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Spain or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services  
700 19th Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623-7430 • Telefax: (202) 623-7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) • Internet: <http://www.imf.org>

**International Monetary Fund  
Washington, D.C.**

FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

SPAIN

OVERSIGHT AND SUPERVISION OF FINANCIAL MARKET  
INFRASTRUCTURES (FMIs)

TECHNICAL NOTE

MAY 2012

Contents	Page
Glossary .....	3
Executive Summary .....	4
I. Introduction .....	8
II. Description of the FMI Supervision/Oversight Framework .....	9
A. Overview of Financial Market Infrastructures .....	9
B. Overview of the Supervisory and Oversight Framework .....	12
C. Main Reforms Since the 2006 FSAP .....	13
III. Main Issues at Stake .....	16
A. Effectiveness of the Oversight/Supervision of the Systemically Important FMIs .....	16
B. Cooperation Between Domestic Authorities .....	22
C. Financial Risk Management and Corporate Governance of the Spanish CCPs .....	23
D. Crisis Management .....	25
Table	
1. Main Recommendations on FMI Supervision and Oversight .....	7
Figures	
1. MEFF Collateral Details at End-November 2011 .....	31
2. Meffclear Collateral Details at End-November 2011 .....	32
Boxes	
1. 2006 FSAP Recommendations for IBERCLEAR .....	14
2. Follow-up of the 2006 FSAP Main Recommendations for IBERCLEAR .....	20
Appendixes	
1. Overview of the Trading, Clearing and Settlement Organization in Spain .....	28
2. European Initiatives in the Field of Securities and Derivatives .....	29
3. Risk Management Framework in MEFF and MEFFClear .....	31

## GLOSSARY

AIAF	Private fixed-income securities market
BdE	Banco de España
BME	Bolsas y Mercados Españoles
CADE	IBERCLEAR Book-entry System for fixed-income securities
CCPs	Central Counterparties for financial instruments
CPSS	Committee on Payment and Settlement Systems
CLS	Continuous Linked Settlement
CNMV	Comisión Nacional del Mercado de Valores
CSD	Central Securities Depository
DVP	Delivery versus payment
EBA	Euro Banking Association
ECB	European Central Bank
EMIR	European Market Infrastructure Regulation
ESCB	European System of Central Banks
ESMA	European Securities and Markets Authority
EU	European Union
FMI	Financial market infrastructure
FX	Foreign exchange
ICSD	International Securities Settlement System
IOSCO	International Organization of Securities Commissions
ISDA	International Swaps and Derivatives Association
Latibex	Latin-American securities market in euro
MAB	MTF for equities issued by small and medium-cap issuers, and SICAV
MEC	Ministry of Economy and Competitiveness
MEFF	Spanish Financial Futures Market
MEFF RF	MEFF Renta Fija
MFAO	Exchange and CCP for futures contracts on olive oil
MoU	Memorandum of understanding
MTF	Multilateral Trading Facilities
OTC	Over the counter
PVP	Payment versus payment
RTGS	Real Time Gross Settlement System
RCCP	CPSS/IOSCO Recommendations for CCPs
RR	Register reference
RSSS	CPSS/IOSCO Recommendations for SSSs
SCLV	IBERCLEAR Securities Clearing and Settlement System for securities traded on the stock exchanges
SENAF	MTF for repos on Spanish public debt
SLBE	Banco de España Settlement System
SMA	Securities Market Act
SNCE	National Electronic Clearing System
SSS	Securities Settlement System

## EXECUTIVE SUMMARY

**The way Spanish authorities supervise and oversee financial market infrastructures (FMIs) is an essential issue in promoting and maintaining domestic financial stability.**

Because well-functioning FMIs can vastly improve the efficiency, transparency, and safety of financial systems, but also can concentrate systemic risk, their appropriate supervision and oversight is critical. In particular, central counterparties for financial instruments (CCPs) are playing a greater role in the financial architecture emerging from the recent financial crisis. They are concentrating counterparty risk, which is seen as most relevant as far as financial stability is concerned. Therefore, the note reviews the oversight and supervision framework for systemically important FMIs in Spain and discusses the CCPs' financial risk management and corporate governance as well as crisis management.

**While systemically important payments systems are European or international based, there are currently four domestic securities settlement systems (SSS) and three domestic central counterparties (CCPs) in Spain.** IBERCLEAR is the main SSS that settles all securities traded in Spain, with the exception of the regional government securities, which are settled in three regional SSSs. There are three active CCPs: MEFF for listed financial derivatives; MEFFClear for Spanish debt repos; and MFAO for olive oil derivatives. All these FMIs, except MFAO, are part of Bolsas y Mercados Españoles (BME).

**The European integration of post-trading systems requires the Spanish clearing, settlement, and registry system to undertake substantial changes, which cannot be delayed.** Since the last FSAP, payment systems have undergone significant changes and are currently well integrated at the European level. The focus is now on improving the European integration of post-trading systems. The current Spanish clearing, settlement, and registry system has proven to be particularly robust, however its particularities make it difficult to adapt to the European integration process without a significant redesign. Spanish authorities have therefore launched a comprehensive reform to this end and securities and derivatives systems have entered in a transition period. Although the overall risk in IBERCLEAR was considered low in the 2006 FSAP, improvements were recommended, which have only be partly addressed. Some of them are not feasible before the reform is completed. Discussions on the securities clearing, settlement, and registration reform began in 2007, but were delayed because of the financial crisis. It is now planned to be implemented by end-2014: the reform should stick to the agreed timetable.

**Overall, authorities' responsibilities with respect to FMIs are clearly defined in the law, but further transparency on Banco de España's (BdE) responsibilities with respect to FMIs other than payments systems is recommended.** Primary responsibility to regulate and authorize FMIs is entrusted to the Government, through the Ministry of Economy and Competitiveness (MEC). The oversight of payment systems is the responsibility of the BdE, in the broader context of the European System of Central Banks (ESCB). The National

Securities Market Commission (*Comisión Nacional del Mercado de Valores*) (CNMV) is the supervisory body for all other FMIs except the local SSSs supervised by their respective regional government. However, the BdE carries out complementary oversight activities over post-trade FMIs, which are not backed by its statute. In practice, cooperation seems to work generally well although some ambiguity remains as to the scope of responsibility of the central bank. It is therefore recommended to revisit the regulation in order to clarify the roles of the CNMV and the BdE with regard to the oversight of FMIs other than the payment systems. In addition, both authorities may want to complement their memorandum of understanding (MoU) with respect to the FMIs oversight and supervision, and publish the revised MoU, for the sake of transparency toward domestic and international markets.

**Within the Euro-system framework, the BdE is entrusted with implementing the common policy stance adopted by the Euro-system on systemically important payment systems and retail systems.** The central bank has the necessary tools and resources to discharge its payment system oversight responsibility and has been successful in inducing changes in the Spanish payment system landscape over the past decade. Since 2005, the BdE has been disclosing its oversight policy and annual reports on payment systems.

**The CNMV exercises close and continuous supervision over FMIs other than payment systems, but does not conduct regular assessments against the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS/IOSCO) Recommendations.** The law provides the market supervisor with specific powers consistent with its responsibilities, including the ability to obtain information and induce change. Since 2007, the CNMV has increased the transparency of its actions. One of its commitments is to ensure that the main Spanish FMIs comply with the CPSS/IOSCO Recommendations, but although the CNMV supervises on an ongoing and tight basis the main sources of risks inherent to FMIs and the fulfillment of main aspects of the current CPSS/IOSCO Recommendations, it does not conduct regular assessments to draw a clear and comprehensive picture of their observance of the international standards. In the next three years, CNMV's supervision methods will need to be adapted to the new European regulatory and operational framework and the future domestic FMIs' organization.

**Spanish CCPs benefit from robust financial risk management frameworks, which could be complemented by regular liquidity stress-tests and access to central bank liquidity.**

In particular, legal provisions, operational procedures, financial resources, and coordination arrangements are in place to deal with the default of an FMI's participant. However, liquidity risk management could be further improved by regular liquidity stress-tests and access to central bank liquidity as soon as the on-going reorganization of clearing activities is completed. In addition, Spanish FMIs should conduct regular (at least annual) default management stress-testing exercises with the involvement of participants and relevant public authorities, to allow all stakeholders to check their state of readiness to handle crisis situations.

**CCP governance arrangements will need to be changed to comply with the new European regulation (EMIR) and CPSS/IOSCO Recommendation for CCPs (RCCP) 13 on governance.** The MEFF Board does not include independent members and it covers both trading and clearing activities. In addition, the current MEFF's risk committee is composed of the MEFF CEO, the two deputy CEOs and the CCP managing director, which does not fulfill RCCPs' requirement that there should be a clear separation between the reporting lines for risk management and those for other operations of the CCP. Therefore, the MEFF has to adapt its governance arrangements, by ring fencing the clearing activities, hiring independent members for its Board and completely changing the composition of its risk committee.

**In addition, the orderly exit of the BdE from the BME's capital should be planned, choosing the right moment to do so and avoiding sending a wrong message to the market by clearly explaining the reasons of such a move.** With 5 percent of the BME's capital, the central bank is one of the main shareholders of the stock exchange group. Although this practice has existed for some time without apparent adverse consequences, it could present oversight and reputational problems for the central bank if the BME should adopt inappropriate measures or if the BME should experience operational or other difficulties. In addition, it would create a conflict of interest if and when the BME gets access to central bank liquidity for its CCP activities.

**The authorities should consider developing coordinated contingency plans to deal with a potential failure of a CCP, in line with the outcome of the ongoing discussions on this issue at the international level.** Defining contingency policy and approach in advance will allow the authorities to intervene with greater speed and communicate with the market even more quickly and effectively in the event of a crisis, and ultimately avoid a spillover effect. In particular, the authorities should identify in advance what resolution arrangements will apply to CCPs and in what manner. These would either allow the critical services of the CCP to be sustained or for the CCP's winding down in an orderly manner. This crucial issue is not specific to Spain and international discussions are still on-going to define appropriate ways to deal with it: the Spanish authorities intend to act according to their outcome and the related Euro-system's stance.

**Table 1. Spain FSAP Update: Main Recommendations on FMI Supervision and Oversight**

<b>Recommendations and Authority Responsible for Implementation</b>	<b>Priority</b>	<b>Timeframe 1/</b>
<b>Effectiveness of oversight/supervision</b>		
Regular assessments against the CPSS/IOSCO standards should also be conducted for FMIs other than payment systems (CNMV, BdE)	High	Near-term
The securities clearing, settlement, and registration reform should stick to the agreed timetable (MEC, CNMV, BdE).	High	Near-term
Supervision methods of CSD and CCPs will need to be adapted (CNMV).	Medium	Near-term
<b>Cooperation between domestic authorities</b>		
The roles of the CNMV and the BdE with regard to the oversight of FMIs other than the payment systems should be clarified in Spanish regulation (BdE, MEC)	Medium	Near-Term
The MoU between CNMV and BdE should be complemented with respect to the FMIs oversight and supervision, and published (CNMV, BdE).	Low	Near-term
<b>Risk management and governance of CCPs</b>		
Liquidity risk management could be further improved by regular liquidity stress-tests and access to central bank liquidity (CNMV, BdE).	High	Near-term
MEFF governance arrangements will need to be changed to comply with the new European regulation (EMIR), which will allow RCCP 13 on governance to be fully observed (CNMV).	Medium	Near-term
The orderly exit of BdE from BME's capital should be planed (BdE).	Medium	Near-term
<b>Crisis management</b>		
Spanish FMIs should conduct regular (at least annual) default management stress-testing exercises with the involvement of participants and relevant public authorities (CNMV, BdE).	Medium	Immediate
Coordinated contingency plans should be put in place to deal with a potential financial failure of a CCP (MEC, CNMV, BdE).	High	Near-term

1/ "Immediate" is within one year; "near-term" is 1–3 years; "medium-term" is 3–5 years.

## I. INTRODUCTION

1. **The way Spanish authorities supervise and oversee post-trade financial market infrastructures is an essential issue in promoting and maintaining domestic financial stability.** Because well-functioning FMIs<sup>1</sup> can vastly improve the efficiency, transparency, and safety of financial systems, but also can concentrate systemic risk, their appropriate supervision and oversight<sup>2</sup> is critical to the public policy goals. In particular, CCPs are playing a greater role in the financial architecture emerging from the recent financial crisis. They are concentrating counterparty risk therefore being most relevant as far as financial stability is concerned.

2. **Therefore, the note reviews the oversight and supervision framework for systemically important FMIs in Spain.**<sup>3</sup> The analysis focuses on the effectiveness of oversight and supervision of the main SSS and CCPs; it is based on the relevant recommendations of the current CPSS-IOSCO standards.<sup>4</sup> Building on this analysis, the note addresses a number of issues that are relevant in the current Spanish and international context. The remainder of this note is structured as follows: Section II provides an overview of the Spanish FMIs, describes their oversight and supervision framework, and outlines the main reforms undertaken since the 2006 FSAP; and Section III discusses the following main issues: effectiveness of the oversight/supervision of FMIs, cooperation between domestic authorities, financial risk management and corporate governance of the CCP, and crisis management.

---

<sup>1</sup> In this note, FMIs cover payment systems, securities settlement systems, and central counterparties.

<sup>2</sup> As defined in the CPSS report on “Central Bank Oversight of payment and Settlement Systems” Bank for International Settlements, Basel, 2005, “oversight of payment and settlement systems is a central bank function whereby the objectives of safety and efficiency are promoted by monitoring existing and planned systems, assessing them against these objectives and, where necessary, inducing change.”

<sup>3</sup> This note was prepared by Christine Sampic, Senior Financial Sector Expert from the IMF’s Monetary and Capital Markets Department, for the 2012 Spain FSAP Update. Her analysis was based on the authorities’ answers to the Fund’s questionnaire, background documentation, as well as meetings with the relevant authorities (Treasury, BdE, the CNMV), the industry (BME, MEFF and MEFFClear, banks, saving banks and securities firms associations, Banco Popular and BBVA as participants in MEFFClear, Santander and Altura Market as participants in MEFF), and lawyers (Uria y Menendez).

<sup>4</sup> CPSS-IOSCO Recommendations for Securities Settlement Systems (RSSSs) and CPSS-IOSCO Recommendations for CCPs (RCCPs).

## II. DESCRIPTION OF THE FMI SUPERVISION/OVERSIGHT FRAMEWORK

### A. Overview of Financial Market Infrastructures

#### Payment systems

3. **Systemically important payments systems used by Spanish financial institutions are European or international based.** Indeed, the euro area benefits from a well-integrated wholesale payment infrastructure, thanks to a number of changes implemented before and after the launch of the euro. The euro area is served by two main euro large-value payment systems, TARGET2 and EURO1, and by the worldwide foreign exchange (FX) settlement system, Continuous Linked Settlement (CLS), all of which classify as systemically important payment systems.

4. **TARGET2-Banco de España is the Spanish component of the TARGET2 system.** It is the successor of the former Spanish Real Time Gross Settlement System (RTGS), the so-called Banco de España Settlement System (SLBE), which was part of the first generation of TARGET. TARGET2, a RTGS system owned and operated by the Eurosystem, is the core payment system in the euro zone, where payments between banks are settled throughout the day, through which monetary policy operations are processed, and through which most of the other payment systems and FMIs settle. In RTGS, transactions are continuously settled in central bank money and on a gross basis. This eliminates settlement risk since payments are final as soon as they are settled by the system. It fully replaced the previous, more decentralized generation, TARGET in May 2008. TARGET2 is based on a single shared platform, which has been developed and is operated by three central banks of the Eurozone.<sup>5</sup> TARGET2 is therefore a centralized system that offers harmonized services to European users, while keeping business relationships between national central banks and users decentralized. It is one of the three largest payment systems in the world, along with the FEDWIRE system and CLS, with average daily transactions amounting to a value of more than €2,380 billion<sup>6</sup> (of which €367 billion for the Spanish component).

5. **EURO1 is the only private sector alternative to TARGET2 for euro large-value payments.** It was launched in 1998 by the Euro Banking Association (EBA), which is a cooperative undertaking between EU-based commercial banks and EU branches of non-EU credit institutions, to provide a cost-effective net settlement infrastructure, with immediate finality for large-value payments (both credit and debit transfers) in the single currency environment. When the euro was introduced, there were four other euro large-value payment systems, which were country based (Germany, France, Spain, and Finland). Since then, the

---

<sup>5</sup> The Banque de France, the Deutsche Bundesbank, and the Banca d'Italia (the main IT platform is duplicated in two identical hot sites located in Germany and Italy).

<sup>6</sup> 2011 daily average.

first three have ceased operations, and the Finnish system has been reclassified as a retail payment system. EURO1 processes large-value cross-border and domestic transactions in euro between banks operating in the European Union for a daily value average of €249 billion.<sup>7</sup> The average payment amount is far lower than in TARGET2, as EURO1 tends to specialize in processing smaller large-value payments, typically commercial payments.

**6. CLS offers payment-versus-payment settlement of foreign exchange transactions in 17 currencies, including the euro.** Launched in September 2002 to mitigate FX settlement risk, CLS is a worldwide foreign exchange transactions system. It settles both sides of a foreign exchange deal simultaneously for trades executed in a number of FX instruments: FX spot, forward, swap, and option exercises. The CLS payment-versus-payment (PVP) settlement model ensures that one payment leg of a FX transaction is settled only if the corresponding payment leg is also settled. CLS participants fund and defund their net settlement positions through the RTGS systems of the eligible currencies—i.e., in central bank money. Hence, TARGET2 processes all euro payments to and from CLS. With a share of about 20 percent of all transactions settled in CLS (i.e., €600 billion in daily value average), the euro is the most important currency settled in this system after the U.S. dollar, whose share is slightly over 40 percent.

**7. In addition, there is one interbank Spanish payment system, the National Electronic Clearing System (SNCE), for small-value payments, which does not classify as a systemically important payment system.** The SNCE is managed by Iberpay, a private company owned by the participating credit institutions. This system processes retail payments: credit transfers, checks, direct debits, bills and various other transactions (for example, nonstandardized documents, commissions and fees on loans or documented batches, and foreign currency exchange). The settlement of SNCE takes place in TARGET2. It settled transactions for an average daily value of €6.3bn in 2011.

#### **FMI's other than payment systems**

**8. European clearing and settlement infrastructures are less integrated than payment systems and there are currently four domestic securities settlement systems and three domestic CCPs in Spain.** They currently only process euro transactions and use central bank money for settling through TARGET2: Appendix 1 provides an overview of the trading, clearing and settlement organization in Spain. Except for the commodity derivatives CCP, all the clearing and settlement systems are integrated into the holding company, called the BME, a publicly traded company listed on the Spanish Stock Exchanges, as follows:

- La Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A. Unipersonal—which operates under the trade name of IBERCLEAR. It

---

<sup>7</sup> 2011 daily average.

holds and settles securities admitted for trading on the four Spanish Stock Exchanges, on the Public Debt Book-entry Market, on the private fixed-income securities market (AIAF), and on the three Spanish multilateral trading facilities (MTF).<sup>8</sup> IBERCLEAR manages two settlement platforms—the Book-entry System (CADE) for fixed interest securities (public and private) and the Securities Clearing and Settlement System (SCLV) for securities traded on the stock Exchanges. In the first 11 months of 2011, IBERCLEAR settled transactions for an average daily value of € 189bn, which placed it at the fourth position in Europe, behind Euroclear Bank, Euroclear UK/Ireland, and Euroclear France.

- The SSSs of the Barcelona, Bilbao and Valencia Stock Exchanges settle transactions for securities that are listed only regionally (mainly public debt of the Autonomous Communities). They are operated by their respective Stock Exchange and are regulated and supervised by the Autonomous Communities. Since 2006, their activity has decreased by 33 percent and they settled a total value of €64 billion in 2010.
- The MEFF acts as a market and clearing house for futures and options on market indices (IBEX-35), equities and dividends, as well as on derivatives on energy. The MEFF cleared 70.2 Million contracts in 2010. These trades had a notional value of €789 billion.
- The MEFF Renta Fija (MEFF RF) has traded futures and options on bonds and settled its contracts through its own clearing house since 1990. In September 2003, the MEFF RF established a CCP known as MEFFClear, which provides clearing services for (repo) public debt transactions contracted in SENAF, an MTF for repos on Spanish public debt ( ) and those negotiated bilaterally by participants in the public debt market. The CCP currently does not perform multilateral netting of the transactions: MEFFClear is not a central clearing counterparty, but rather a central counterparty that guarantees gross transactions. Since 2003, the derivatives activity of MEFF RF has been negligible and its main activity has been the CCP for repos under the MEFFClear commercial name.<sup>9</sup> Since mid-2010, activity in MEFFClear has increased significantly, due to a highly sensitive environment to counterparty risk and its opening to OTC transactions.<sup>10</sup> However, value of cleared transactions is still

---

<sup>8</sup> The Spanish MTFs are Latibex, the Latin-American securities market in euro, MAB for equities issued by small and medium-cap issuers, and SICAV, and SENAF for repo on public debt (and some AIAF securities).

<sup>9</sup> MEFFClear commercial name is in the process of being changed to MEFFRepo.

<sup>10</sup> In the first half of 2010, interbank financing was severely reduced in the whole Euro area due to the loss of market confidence. Hence, European banks turned to CCPs to manage counterparty risk. MEFFClear benefited indirectly from the acceptance of Spanish sovereign debt for repo operations in LCH Clearnet (the London and Paris based CCP) through the banks and saving banks that were members of both CCPs.

small. In 2010 MEFFClear processed repo trades for a value of €278 billion, ending the year with approximately €27.7 billion of outstanding positions.

9. **MFAO is an exchange and CCP for futures contracts on olive oil.** MFAO began transactions in 2004 and is unique in the world, trading olive oil as underlying. It is a private company whose main shareholders are the Regional Government of Andalusia and seven saving banks located in Andalusia. Its activity is quite low and done among members and their clients, all of them related to the market for the underlying asset. MFAO is not considered systemically important by the authorities. MFAO cleared 75,023 contracts in 2011 (until December 20), with a notional value of €124 million.

## **B. Overview of the Supervisory and Oversight Framework**

10. **Primary responsibility to regulate and authorize FMIs is entrusted by law to the government.** The primary regulatory competence is assumed by the MEC through the treasury. This competence can be delegated to the BdE and the CNMV to develop technical provisions. As a result, the ministry actually determines the general principles of the regulation, and the BdE and the CNMV develop them into technical provisions. The MEC is also competent for the authorization of FMIs, in most cases, based on the BdE and the CNMV's opinions.

11. **The oversight of payment systems in Spain is the responsibility of BdE, in the broader context of the ESCB.** At the European level, the promotion of the sound functioning of payment systems is a task of the national central banks according to the provisions of the European Treaty and of the Statute of the ESCB.<sup>11</sup> The Autonomy Law of the BdE<sup>12</sup> states that the BdE must promote the sound functioning and stability of the financial system as a whole and, in particular, of payment settlement systems. The law also recognizes the BdE with the functions arising from the Statute of the ESCB.

12. **The CNMV is the supervisory body for all other FMIs except the local SSSs supervised by their respective regional governments.** All activities relating to securities markets, including clearance and settlement, and the institutions that conduct them, are regulated by Securities Markets Act 24/1988 (SMA), which was last amended in October 2011. Article 84 of the SMA, related to the CNMV's scope of supervision, includes regulated markets, multilateral trading facilities and systems of registry, clearing, and settlement.

---

<sup>11</sup> Article 105(2) of the treaty establishing the European Community states that "the basic tasks to be carried out through the ESCB shall be [...] to promote the smooth operation of payment systems." Article 22 of the Statute of the ESBC stipulates that "the ECB and national central banks may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries."

<sup>12</sup> Law 13/1994.

13. **BdE has also a keen interest in ensuring the proper functioning of securities and derivatives clearing and settlement systems.** This stems from the importance of these systems for the smooth conduct of monetary policy, from their close links to payments systems and from their relevance for the stability of financial systems in general. Although the law does not explicitly provide BdE with oversight responsibilities in this area, the SMA, in its article 44 bis and ter, assigns it several tasks in the securities market infrastructures field. In particular, reports from the central bank are required before approval of the FMIs Regulation (Rulebook), certain aspects regarding their governance, and the establishment of agreements with other FMIs. Finally, since the Eurosystem is a user of SSSs for its monetary operations, it conducts user assessments of the SSSs it uses and the links between them every two years; in this regard, BdE regularly assesses Iberclear and its links with European CSDs against the Eurosystem user requirements.

### C. Main Reforms Since the 2006 FSAP

14. **In 2006, the FSAP team completed both a CPSS assessment of the predecessor of TARGET2-Banco de España, the national RTGS (SLBE), and a CPSS/IOSCO assessment of IBERCLEAR.** SNCE, the local securities settlement systems, and CCPs were not assessed. The assessment under the CPSS Core Principles found that all principles were observed by SLBE. Nevertheless, a few recommendations were made to improve the system further. The assessment of observance of the CPSS/IOSCO Recommendations for SSSs (RSSSs) found that Recommendation 9 (RSSS 9) on settlement risk and Recommendation 15 (RSSS 15) on cost-effectiveness were broadly observed, while Recommendation 11 (RSSS 11) on operational risk, and Recommendation 16 (RSSS 16) on the use of international communication procedures and standards were partly observed. Although the overall risk in IBERCLEAR was considered low, some improvements were suggested (Box 1).

15. **The launch of the second generation of TARGET has been a major improvement in terms of European harmonization and economy of scale.** Because TARGET2 is based on a shared technical platform, institutions with locations in more than one European country can maintain accounts with the central bank(s) of their choice and manage their liquidity on a consolidated and real-time basis from a single point. This marks a major change from the previous arrangements. It allows banks to manage their business from one place only, allowing them to optimize the organization of their back-offices and to centralize their liquidity management. As a consequence, TARGET2 must satisfy demanding requirements in terms of robustness and business continuity measures. It is based on a two countries/four sites concept.<sup>13</sup> Hence, in an emergency, full processing capacity is expected to be restored within a short timeframe. In addition, contingency procedures are aimed at processing critical

---

<sup>13</sup> The payments and accounting processing services can run in either of the two countries, and each country has two identical sites available for immediate failover.

payments under all circumstances in a timely manner. Finally, TARGET2 has improved cost efficiency, which benefits both users and central banks. In 2010, the Eurosystem started two strategic initiatives to cope with future challenges: the increase of the use of ISO 20022 standards and the development of the interface between TARGET2 and TARGET2-Securities (T2S).

**Box 1. 2006 FSAP Recommendations for IBERCLEAR<sup>14</sup>**

RSSS 9 (settlement risk): IBERCLEAR should improve risk controls by prohibiting debit balances in a participant's securities account in the SCLV platform (to balance credits in other participants' accounts).

RSSS 11 (operational risk): IBERCLEAR should test its backup facility with its members more frequently. Its backup facility is 20 km from the main site and appears to rely on many of the same resources, which represents a risk. The actual independence of critical services, such as telecommunications facilities, should also be evaluated.

RSSS 15 (cost-effectiveness): IBERCLEAR should implement an effective process to obtain the views of its participants on the efficiency and costs of its services and operations, or it should regularly survey its participants on these matters.

RSSS 16 (international communication standards): IBERCLEAR should implement international communication standards for all participant communications.

RSSS 18 (regulation and oversight):<sup>15</sup> CNMV should review the participation of its personnel on the IBERCLEAR Board. While this practice has existed for some time without apparent adverse consequences, it potentially complicates the governance of IBERCLEAR. More importantly, it could present regulatory and reputational problems for CNMV if IBERCLEAR should determine to adopt inappropriate measures (which then must be reviewed by CNMV), or if IBERCLEAR should experience operational or other difficulties. In addition, the scope of oversight of the IBERCLEAR system and its participants exercised by the CNMV and the BdE is complex, and may not be fully transparent to users and the public. The current environment is a dynamic one and CNMV and the BdE should continue to coordinate closely and clearly define their oversight roles.

**16. At the national level, the retail payment system, SNCE has also undertaken a number of developments, in part to improve its European integration.** It has been adapted to process new pan-European instruments and its rules have been amended to comply with the provisions of the new legal framework for payment services. Different links

<sup>14</sup> The following is extracted from *Spain: Financial Sector Assessment Program—Detailed Assessment of the CPSS-IOSCO Recommendations for the Securities Settlement Systems*, June 2006.

<sup>15</sup> Recommendation 18 was considered observed, however improvements were suggested according to best international practices.

with other retail payment systems have been created in order to provide pan-European reachability to its participants. In addition, significant technical improvements have been implemented to increase the efficiency and scalability of the system.

17. **Major changes are underway to achieve the European integration of domestic post-trading systems.** Unlike large-value payment systems, the integration of securities infrastructure, which is central to integrating Europe's capital markets, has remained limited. This is largely because securities transactions are considerably more complex than cash payments, and there are cross-country differences in market practices and legal, regulatory and fiscal regimes. However, work is under way to improve the situation. In 2006, the Eurosystem launched a project to create a common platform for the settlement of securities transactions, T2S. It aims at creating a common technical platform for settlement in central bank money of securities transactions, with the objective to make cross-border transactions as cost effective and secure as domestic ones, thereby complementing the integration of cash settlement through the implementation of TARGET2. As of September 2015, T2S should provide harmonized delivery-versus-payment (DvP) settlement in central bank money for almost all heavily traded securities circulating in Europe. Then, the financial crisis gave the European Commission the needed impetus for going further in harmonizing the related legal framework and three new legislative initiatives have been launched, which will address over-the-counter (OTC) derivatives and CCPs, central securities depositories (CSDs), and securities rights. Work is most advanced on OTC derivatives and CCPs (see Appendix 2 for further details on the T2S project and European legislative initiatives).

18. **The European integration of domestic post-trading systems requires the Spanish clearing, settlement, and registry system to undertake substantial changes.** The current Spanish clearing, settlement, and registry system has proven to be particularly robust and secure; however, its particularities make it difficult to adapt to the European harmonization and integration process. Spanish authorities have therefore launched a comprehensive reform plan and securities and derivatives systems have entered in a transition period. A key component of the reform is the replacement of the current principle of assured delivery of equities in IBERCLEAR by incident-resolving mechanisms involving the interposition of a CCP.<sup>16</sup> The use of a CCP is indeed expected to become mandatory for equity transactions traded multilaterally on a regulated market or in a multilateral trading system (several CCPs, be they domestic or global, may offer the related clearing services). This will address one of the major recommendations of the 2006 FSAP. Another key component of the reform is the replacement of the registrar reference (RR)-based settlement and registry system by a system based on standardized management of balances of book-entry securities held in the accounts

---

<sup>16</sup> The current assurance of delivery arises from the obligation of the stock market regulation to settle all stock market trades. To this end, Iberclear guarantees the delivery of both securities and cash on their agreed settlement date, through the use of guarantees posted by market participants. However, this may create temporary excesses of securities (securities inflation), which was one of the issues of concern raised in the 2006 FSAP.

kept by IBERCLEAR for its participants and in the detailed accounts kept by participants for their clients.<sup>17</sup> Those changes will allow to better separate the clearing, settlement and registration responsibilities as it is commonly done elsewhere, net transactions for the same security, make IBERCLEAR's practices compatible with those of T2S, and shorten the settlement cycle (as the European CSD regulation will require). In addition, equities settlement will be able to adopt a DVP model 1 (real time gross settlement) and the time of settlement finality will be aligned with the current practice in Europe (that is to say at the time of settlement rather than at the time of trade). A major step in implementing this reform was the approval of the revised SMA version in October 2011, which establishes the fundamentals of the future framework. A lot remains to be done, at the operational and secondary legislation level, the aim being to be ready in time for joining T2S in 2015.

19. **In parallel, BME is reorganizing its clearing activities to adapt to the future European framework and be able to face further competition.** MEFF and MEFF RF are in the process of integration and in the near future it is expected that MEFF will be the only CCP in BME Group, with three segments: stock-exchange derivatives, power derivatives, and Spanish Government debt repos. It may also decide to offer clearing services for other groups of products, such as listed equities. The Royal Decree 1282/2010, on regulated markets on futures, options and other derivatives instruments paved the way to this restructuring. It entered into force in October 2010 to adapt the Spanish regulations to the international standards, enabling the Spanish markets of derivatives to introduce new products, services and business lines as well as a different registry system, so that they are on sound conditions to compete with other markets.

### III. MAIN ISSUES AT STAKE

#### A. Effectiveness of the Oversight/Supervision of the Systemically Important FMIs

##### Payment systems

20. **For the conduct of its oversight mission, BdE applies the decisions of the Governing Council of the European central bank (ECB).** Within the Eurosystem framework, BdE is entrusted with ensuring that the operators of the TARGET2-BdE and SNCE implement the common policy stance adopted by the Eurosystem on systemically important payment systems and retail systems. In practice, the main TARGET2 oversight activities are carried out cooperatively by the Eurosystem central banks under the coordination of the ECB. A similar arrangement is also in place for the oversight of EURO1, with the ECB acting as lead overseer and the rest of Eurosystem central banks participating in the oversight activities on a “no compulsion, no prohibition” basis. The ECB and NCBS

---

<sup>17</sup> At present, deliveries of equities require the provision of a registration reference for each beneficial owner prior to their settlement, which is time consuming and adds significant complexity to the settlement process in Iberclear.

ensure consistency in the enforcement of the common oversight policy stance and, in particular, that standards are applied in the same way for all the payment systems concerned. As for CLS, primary responsibility for its oversight is with the Federal Reserve of New York, which has set up an oversight international college in which the ECB participates.

21. **The BdE has the necessary tools and resources to discharge its payment system oversight responsibility.** The central bank's statute, in its Article 16, gives the BdE the powers to regulate payment clearing and settlement systems, to oversee them, to suspend application of the decisions adopted by a payment system manager; in case of failure to comply with the provisions of this Article, the institutions managing payment systems under the oversight of the BdE will be subject to the Law on the Discipline and Intervention of Credit Institutions.<sup>18</sup> In addition to the prior approval of the rules of payment systems, its oversight tools are system monitoring, application of international standards, collaboration with system operators and participants, and cooperation with banking supervisors. The BdE has a dedicated payment system oversight team of five staff, with a background in economics. Specific skills are drawn on from other areas, such as the BdE's legal and information system departments. The fact that many of the oversight activities are carried out on a cooperative basis by the ESCB (e.g., for TARGET2) implies that the resources of different central banks can be pooled, avoiding overlaps and minimizing the use of resources. The oversight unit is separated from the TARGET2-BdE operational unit, but reports to the same head of department.

22. **One of the objectives of the BdE is to ensure that the Spanish payment systems comply with the standards adopted by the ESCB, which are based on the CPSS Core Principles.** To this end, the central bank is assessing their compliance and inducing change where necessary. As a SIPS, TARGET2 has to comply with all the applicable core principles,<sup>19</sup> while SNCE, classified as a prominently important retail payment system, has to comply with only six of them. Operators of systemically and prominently important payment systems are expected to conduct self-assessments of the safety and efficiency of their respective systems against those standards, and BdE conducts its own assessments. The last in depth assessment of TARGET2 was carried out in 2009; the last in depth assessment of the SNCE was done in 2011 (the previous SNCE's assessment was conducted in 2004/05). In addition, oversight activities related to changes to the systems, incident reports or statistical information are done on a continuous basis. As a result, the BdE may request payment systems to make changes.

23. **The BdE has been successful in inducing changes in the Spanish payment system landscape over the past decade.** The whole payment infrastructure has been rationalized,

---

<sup>18</sup> Law 26/1988 of 28 July 1988.

<sup>19</sup> CP V is not applicable to RTGS systems, such as TARGET2.

being now composed of a large value payment system and a single retail payment system. Settlement risk has been reduced, with the mandatory use of the RTGS system for payments over certain thresholds (e.g., EUR 100,000 for checks or credit transfers in the national format). Efficiency has been increased over the years and the central bank is currently playing an essential catalyst role for the European harmonization of retail payments.

24. **Since 2005, BdE has adopted a transparency principle.** It disclosed its oversight policy on its website in 2005, in Spanish and English. Since 2005, it has also published an annual oversight report, which provides a description on payments systems' activities and a summary of its oversight policy implementation (in Spanish). A part of its website is dedicated to the oversight of payment systems. In addition, the Eurosystem policy, which BdE clearly refers to, is made public, through several documents, regularly updated: the Eurosystem Oversight Policy Framework, Oversight standards for euro retail payment systems, and Terms of reference for the oversight assessment of euro systemically and prominently important payment systems against the Core Principles.

#### **FMI's other than payment systems**

25. **The law provides the CNMV with specific powers with regard to FMI's consistent with its responsibilities, including the ability to obtain information and induce change.** According to the law, the main rules of the FMI's and their changes must get prior approval from the market regulators. In addition to the rule book of each FMI, this includes CCP circulars on the calculation of margins and list of collateral. FMI's annual budgets and tariffs must be presented to the CNMV for approval. The CNMV is entitled to establish exceptions or ask for change of tariffs provided they can affect the financial solvency of the management body, produce disruptions in the securities markets, or can produce discriminations among the different market members. The SMA and Royal Decree 1282/2010 also provide extensive access to information, the market regulator's powers including the right to have access to any document in any form whatsoever and to receive a copy of it. As for inducing changes, the SMA provides the market regulators with a whole range of administrative sanctions (from fines to suspension), and the Royal decree empowers the CNMV for requiring the government bodies to amend their internal regulations if needed.

26. **The CNMV exercises close and continuous supervision over FMI's.** The main supervision tools are approval of the FMI's rules, daily monitoring of their activity, and frequent contact with the FMI's and their participants. Rule Books and General Conditions are approved for each FMI. Circulars related to the types of instruments used as collateral also require of an explicit previous approval by the CNMV. Usually the CNMV receive proposals from FMI's that intend to change their internal regulations. The CNMV analyzes the adequacy of these proposals and approves the amendments and changes, or modifies them. Depending on the issue, the modifications may need a formal approval by the CNMV Board. In the case of MEFF, since the approval of the Royal Decree 1282/2010, more than 15 reports have been produced by the CNMV supervisory department, the most relevant ones

referring to the new Rule Book, new instruments admitted to trading and/or registry for clearing or collateral admitted as guaranty. The Royal Decree also requires that clearing activities operators deliver to the CNMV a specific report on risks, detailing risk management criteria and procedures, and update it as needed. FMIs' monitoring is based on a real time access to all individual transactions and positions processed in the systems, including an alert mechanism that allows the supervisory team to react on a timely basis. This information is also fed in the internal CNMV information system to produce aggregated data. In addition, the CNMV has frequent meetings and phone calls with market participants and FMIs to share the findings in the surveillance of the FMI's activities and to discuss potential needs that could imply changes in regulation and other issues of common interest. On-site inspections of FMIs are infrequent: IBERCLEAR's in 2005/2006, in the context of the FSAP, MEFF in 2007, and MFAO in 2010.

**27. One of the commitments of the CNMV is to ensure that the main Spanish FMIs comply with the CPSS/IOSCO Recommendations, but it does not conduct regular assessments to this end.** One of the salient responsibilities of the CNMV with respect to FMIs is to ensure they comply with the Spanish legal framework. The SMA makes no distinction among systemically and nonsystemically important FMIs to the purposes of regulation, supervision and oversight. However, when requiring FMIs to comply with CPSS/IOSCO Recommendations, the CNMV takes into account their level of activity, measured through the effective trading volume and the level of margins collected. Other specific factors inherent to each particular FMI may be considered as well. As a consequence the small-sized FMIs may be not obliged to comply with CPSS/IOSCO Recommendations. This is the case for MFAO. The list of FMIs that have to comply is not publicly available. Their operators are expected to conduct self-assessments of their respective systems against those standards (but the CNMV does not validate these self-assessments), and the CNMV may conduct its own assessments. Although the CNMV supervises on an ongoing and tight basis the main sources of risks inherent to FMIs and the fulfillment of main aspects of the current CPSS/IOSCO Recommendations, it has assessed the FMIS that are under its supervisory responsibility on a very infrequent basis: IBERCLEAR was assessed only once, at the end of 2005, at the request of the IMF in the context of the FSAP. The CCPs have not been assessed. It is therefore recommended that regular assessments against the CPSS/IOSCO standards<sup>20</sup> be conducted for all FMIs to draw a clear and comprehensive picture of their observance of the international standards.

**28. Inducing changes takes time.** Despite an improvement in the general level of observance, some of the main recommendations of the 2006 FSAP regarding IBERCLEAR have not been addressed six years later (Box 2). Some of them are not feasible before the securities clearing, settlement, and registration reform is completed. Discussions on the

---

<sup>20</sup> The current CPSS/IOSCO standards (RCCPs and RSSSs) by end 2012 and the new ones (Principles for FMIs) as from 2013.

reform began in 2007, and the CNMV and BdE disclosed with preliminary proposals on the main issues to be reformed in December that year, reflecting the commitment of the authorities to improve the soundness and competitiveness of the Spanish FMIs. However, the reform efforts were suspended during the financial crisis and it is now planned to implement the agreed changes by end-2014. A detailed timetable, which includes all relevant workstreams has been agreed by the stakeholders to meet this deadline. The securities clearing, settlement, and registration reform should stick to the agreed timetable.

**Box 2. Follow-up of the 2006 FSAP Main Recommendations for IBERCLEAR**

RSSS 9 (settlement risk): Debit balances are still possible at the level of individual client's securities account in the SCLV platform. The latter issue is of a technical nature, linked to the guarantee of settlement (which ensures a very low rate of settlement fails) and is closely depending on the design of the settlement system; it can only be addressed through the changes foreseen in the ongoing reform.

RSSS 11 (operational risk): According to the 2010 FSB peer-review, the proximity of IBERCLEAR's backup site to the main site may need to be re-examined for operational risk purposes: in particular, the advantages and costs of having the backup site in a different seismic zone or geographical area need to be carefully assessed, taking into account that the Madrid region is considered as a extremely low seismic risk area.

RSSS 15 (Cost-effectiveness): Although the CSD has made good progress in obtaining periodic feedback from a large number of its participants on the quality and costs of its services via the two technical committees that it has established for this purpose, high level user representation is still an issue since the users are not part of the Board and user committees are only of technical nature.

RSSS 16 (International communication standards): IBERCLEAR has begun adopting international communication standards and is planning to achieve the process in two to three years, at the time T2S goes live.

RSSS 18 (regulation and oversight): CNMV's personnel is no longer part of IBERCLEAR's Board. The scope of oversight of the IBERCLEAR system and its participants exercised by the CNMV and the BdE still needs to be made more transparent to users and the public

29. **In the next three years, CNMV's supervision methods will need to be adapted to the new European supervisory framework and the future domestic FMIs' responsibilities.** The Secondary Market Department, which is in charge of the supervision of markets and FMIs is organized in three different workstreams: equities, debt, and derivatives. Since there is no dedicated supervision of FMIs, but rather an approach by market, in general the staff of each workstream covers all the functions of a given market, from trading to settlement, including market operators and participants. Overall, 23 people are in charge of supervising secondary markets, from which the equivalent to five/six full-time people are

involved in the monitoring and supervision of FMIs (but only one person is working full time on this issue in each workstream). The implementation of the new European supervisory framework for CSDs and CCPs will necessitate high level resources in particular to comply with the new cooperation requirements (for each CCP, for example, a supervisory college will need to be created, with the participation of foreign relevant authorities). On the domestic side, the replacement of the RR-based settlement and registry system by a system based on standardized management of book-entry securities accounts will call for an appropriate change in the supervision process and the creation of new clearing services will require high level supervisory expertise. Grouping all clearing activities' supervision in a dedicated team, cross-market, could allow further specialization of staff and better focus on these activities. Other equivalent alternatives in terms of effectiveness could be envisaged as well. In addition, given the scarcity of resources, the CNMV may want to consider adopting a more risk-based approach, giving up the daily monitoring of the FMIs' operations, focusing on approving the main rules changes and assessing the compliance with the CPSS/IOSCO standards. This could be complemented by regular on-site inspections. In any case, the implementation of the supervisory provisions of the forthcoming European legislation will be key in driving the adaptation of the CNMV's supervision methods.

30. **Since 2007, the CNMV has increased the transparency of its actions.** The CNMV Annual Report, accessible in the CNMV Web site in Spanish and English, includes two specific chapters on markets and post trading infrastructures. A description of the relevant supervision activities carried out in the year, main concerns and challenges for the supervision and main policies to be implemented are explained and commented in those chapters. Besides, since 2007 the CNMV publishes the Plan of Activities that sets out the broad guidelines governing its activities and its specific objectives for the following year, including deadlines, however specific supervisory actions that are considered confidential are excluded. The Plan of Activities contains a specific section dedicated to markets efficiency and transparency that includes the objectives of the CNMV on: (a) supervision of securities markets and their participants; (b) enhancing transparency and disclosure; and (c) improvements in risk prevention and risk management. The 2011 Plan explained that the reform of Spain's clearing, settlement, and registry system was a priority for the CNMV but did not mention FMIs' supervision as such.

31. **The BdE carries out complementary oversight activities over post-trade FMIs.** As requested by law, the central bank provides opinions to the MEC and the CNMV on the creation of an FMI and change of its rulebook. It also participates in assessments and on-site inspections, if any. The central bank's focus is mainly on cash settlement process and liquidity arrangements. In addition, as a member of the ESCB, BdE assesses the performance of IBERCLEAR against the standards for using securities settlement systems in credit

transactions of the Eurosystem every two years.<sup>21</sup> It also assesses the performance of the two settlement platforms of IBERCLEAR with specific reference to the pledging procedure in obtaining financing from the BdE. Inside the securities settlement system unit, BdE dedicates three staff to the oversight activities of IBERCLEAR and CCPs. Specific skills are drawn on from other areas, such as the BdE's legal and information system departments. The central bank does not publish its oversight policy over post-trade FMIs and does not include information on its implementation in its annual oversight report.

## **B. Cooperation Between Domestic Authorities**

**32. Cooperation between authorities is essential to ensure a consistent oversight/supervision approach, minimize reporting burden from FMIs, and avoid supervisory gaps.** Cooperative arrangements based on mutual assistance provide a mechanism whereby the responsibilities of an FMI's individual authorities can be fulfilled more efficiently and effectively. Cooperative arrangements should be managed to deliver regulation, supervision, and oversight consistent with each relevant authority's responsibilities and without prejudice to their statutory or other responsibilities. Cooperation also should minimize the duplication of effort and the burden on FMIs and the relevant authorities. Cooperation should seek to avoid inconsistency in policy approaches and reduce the probability of gaps in regulation, supervision, and oversight that could arise if authorities did not coordinate with each other.

**33. The law requires appropriate coordination between the CNMV and the BdE.** As far as payments systems are concerned, there is no need for specific cooperation arrangements since only BdE is in charge of their oversight and the CNMV has no supervisory responsibility. Cooperation is key for FMIs other than payment systems. The two authorities have cross-representation on each other's governing bodies: the vice-president of CNMV is a member of the BdE Board, and the deputy governor of BdE sits on the CNMV Board. The respective roles assigned to CNMV and BdE with respect to the oversight and supervision of FMIs that are not payment systems are located in separate provisions of the SMA, and in some cases are ambiguous or appear to overlap. When this is the case, the law provides that both institutions shall coordinate by signing agreements to set out the corresponding responsibilities. Last update of the MoU for the exchange of relevant information related to the supervision of credit institutions and financial markets between both authorities is dated June 2009. However, the MoU is quite general and does not address the issue of FMIs' oversight and supervision in detail.<sup>22</sup> Finally, the law authorizes

---

<sup>21</sup> The BdE, as member of the Eurosystem, has adopted standards for the use of securities settlement systems in Eurosystem credit operations. These user standards, which are not oversight standards, ensure that the Eurosystem credit operations are conducted according to procedures which prevent central banks from assuming inappropriate risks and ensure the same level of safety for credit operations throughout the euro area.

<sup>22</sup> The MoU provides that both authorities cooperate when they consider it necessary for the exercise of their relevant respective responsibilities with respect to payment and securities systems.

communication of confidential information between both authorities for fulfilling their respective functions.

34. **In practice, cooperation seems to work generally well.** From the point of view of FMIs (other than payment systems), the CNMV acts as a single point of entry and is the primary regulator and supervisor. Besides the framework for cooperation for the exchange of relevant information related to the supervision of credit institutions and financial markets, close cooperation takes place between the CNMV and BdE in other areas, such as the current reform: in 2007, the CNMV and BdE published a joint report on securities clearing, settlement and registry systems including a description of the post trading situation and enumerating some potential initiatives and recommendations to be assessed for improving the overall efficiency of post trading infrastructures and their ability to compete in the European securities integrated market. Since then, both authorities have jointly been active in the reform process.

35. **Further transparency on the BdE's responsibilities and the cooperation framework would assist in understanding the supervisory structure.** The BdE's role with respect to the oversight of FMIs other than payment systems is not part of the central bank's statute, but stems from various other legal provisions. Spanish regulation needs to be revisited to clarify the roles of the CNMV and the BdE with regard to the oversight of FMIs other than the payment systems. For example, amending the BdE's statute to extend its oversight responsibilities to all FMIs would give the central bank a formal basis to discharge its responsibilities. It would also allow the central bank to disclose the oversight policy of BdE over all FMIs (not only payment systems), which would provide clarity on its remit and responsibilities for Spanish and foreign market participants, as well as foreign authorities. In addition, both authorities may want to complement their MoU with respect to the FMIs oversight and supervision, and publish the revised MoU, excluding any possible sensitive provision, both in Spanish and English, for the sake of transparency toward domestic and international markets.

### **C. Financial Risk Management and Corporate Governance of the Spanish CCPs**

36. **Spanish CCPs benefit from robust financial risk management frameworks.** Both MEFF and MEFFClear settle in central bank money. They are not linked to other CCPs. MEFF offers individual segregation for clients (for positions as well as collateral posted) and MEFFClear only deals with proprietary accounts of the clearing members. According to their rules, both CCPs aim at covering the default of the clearing member with the largest position plus 10 percent of this position through a clearly defined resource waterfall, and in practice, according to the outcome of their daily stress tests, they currently benefit from collateral enough to cover the default of the participants with the five largest positions. This is in part due to their conservative approach in calculating margins and the fact that clearing members actual deposits are higher than the required amounts (especially in the case of MEFFClear). Clearing members are obliged to deposit 30 percent of their initial margins in cash, but in

practice they do it by more than 70 percent, which provide both CCPs with a high level of liquid resources. In addition, MEFF (but not MEFFClear) has the right to draw on the cash deposited by nondefaulting members up to a 10 percent limit. All cash collateral is invested in overnight repos on the Spanish debt (although MEFF is permitted to maintain cash available at the central bank in extraordinary market conditions). Noncash collateral is not invested but readily available in CSDs (IBERCLEAR and Clearstream Banking Frankfurt). Appendix 3 provides additional detail on MEFF and MEFFClear risk management frameworks.

**37. Liquidity risk management could be further improved by regular liquidity stress-tests and access to central bank liquidity.** Currently, and given the liquidity risk management features described in the previous section, the authorities and CCPs' management are confident that the cash collateral invested in overnight repos will be sufficient to cover liquidity needs and readily available in all cases of default. However, no liquidity stress-tests have been undertaken to confirm it. In extreme scenarios, the defaulting clearing member may also be the largest repo counterparty (the CCPs often choose clearing members as repo counterparts) and as market conditions would probably be deteriorating quickly, even leading to a repo market closing, the CCP may have difficulty to get the necessary funds to cover its obligations, triggering a spillover effect. It is therefore recommended that CCPs conduct regular liquidity stress-tests. Having access to central bank liquidity would allow the CCPs to benefit from an alternative way of funding in case its own funds are not readily available. According to the Eurosystem policy,<sup>23</sup> national central banks may provide intraday credit to euro area CCPs on a routine basis under the same conditions as for credit institutions when authorized by the Governing Council of the ECB. For the time being, MEFF has not applied for access to intraday credit, although it has informed BdE about its intention to do so when MEFF's reorganization is completed. In addition, following the Eurosystem policy, in emergency situations the Governing Council of the ECB may decide to facilitate overnight liquidity access to CCPs on ad hoc basis, under the same conditions as credit institutions,<sup>24</sup> provided they hold an account in TARGET2, have been authorized to access intraday liquidity, and are subject to supervision and/or oversight by competent authorities. Therefore, MEFF could access overnight liquidity if decided by the Governing Council, provided that MEFF is authorized to access to intraday credit. It is therefore recommended that MEFF applies for the access to central bank liquidity as soon as the on-going reorganization of clearing activities is completed.

**38. Governance arrangements will need to be changed to comply with the new European regulation on OTC derivatives and CCPs (EMIR), which will allow RCCP 13**

---

<sup>23</sup> See Annex III of the TARGET2 Guideline on provision of intraday credit.

<sup>24</sup> Which includes, in particular, provision of appropriate collateral, as defined in the Eurosystem operations framework.

**on governance to be fully observed.** Current governance arrangements are transparent: as a listed company on the Spanish Stock Exchange, BME follows stringent governance arrangements, which are available in its annual report, including the composition of the Group Board of Directors and the Board of Directors Committees. BME's Board include at least five independent members (independent from the shareholders and the users, mainly academics or retirees), and each of its subsidiary has its own Board. MEFF is a 100 percent owned subsidiary of the BME Group and as any other Limited Company (Sociedad Anónima) in Spain, it is governed by a Board of Directors, appointed by the General Shareholders' Meeting, in this case BME as the sole shareholder. However, MEFF Board does not include independent members and it covers both trading and clearing activities. According to EMIR, CCPs should be legal entities with independent members on their Board (one third of the members, but no less than two), as well as representatives from clearing members and clients. The current MEFF's risk committee is composed of the MEFF CEO, the two deputy CEOs and the CCP managing director, which does not fulfill RCCPs' requirement that there should be a clear separation between the reporting lines for risk management and those for other operations of the CCP. According to EMIR, a CCP shall establish a risk committee, which shall be composed of representatives of its clearing members and independent members of the Board. This is in line with RCCP 13. Therefore, in the near future, MEFF will need to adapt its governance arrangements, by ring fencing the clearing activities, hiring independent members for its Board and completely changing the composition of its risk committee. BME is working to this end, in parallel with the objective of organizing all clearing functions under the same legal entity, which is likely to be MEFF.

39. **The orderly exit of BdE from BME's capital should be planned.** When the central bank transferred the SSS it operated for fixed-income securities (CADE) to Iberclear in 2004, it received in exchange nine percent of the newly formed holding, BME. Since then, its share has dropped to five percent, which still makes the central bank one of the main shareholders of the stock exchange group. As this was the case with the participation of CNMV's staff in IBERCLEAR's Board in the past, this practice has existed for some time without apparent adverse consequences. However, it could present oversight and reputational problems for the central bank if BME should determine to adopt inappropriate measures (which then must be reviewed by the CNMV), or if BME should experience operational or other difficulties. In addition, it would create a conflict of interest if and when BME gets access to central bank liquidity for its CCP activities (see above). For all these reasons, it is recommended that BdE plans its exit from BME's capital, choosing the right moment to do so and avoiding sending a wrong message to the market by clearly explaining the reasons of such a move.

#### **D. Crisis Management**

40. **Legal provisions, operational procedures, and coordination arrangements are in place to deal with the default of an FMI's participant.** Each FMI benefits from clear default management arrangements in their rules, backed by the law. In particular with respect to CCPs, the SMA establishes that in the event of legal declaration of bankruptcy or the

commencement of insolvency proceedings of one of its participants, the CCP, upon previous communication to the CNMV, will manage to transfer the contracts and open positions that the defaulter participant has registered on behalf of its clients, and the financial instruments and cash balances posted as collateral. As for the CSD, the SMA provides that under the same circumstances, the CNMV, without prejudice to the powers of the BdE, may, immediately and at no cost to the investors, transfer their securities to another firm authorized to perform this activity. If no firm is in a position to take on this responsibility, it will provisionally be undertaken by the CSD itself until the clients request that their securities be transferred. The Financial Stability Committee (CESFI), which was established in 2006, proved to be a useful means of coordination among the various regulatory agencies during the crisis. The three financial sector regulators are represented on this Committee, together with the State Secretary for Economic Affairs (acting as Chair) and the Secretary General of the Treasury and Financial Policy (in charge of the Secretariat of CESFI). The Committee, created through an MoU signed by its members, offers a forum for information exchange on potential systemic financial stability issues. While CESFI does not have any decision making powers of its own, the exchange of relevant information allow coordinated actions by its members.

41. **Spanish FMIs should conduct regular (at least annual) default management stress-testing exercises with the involvement of participants and relevant public authorities.** Lehman's default was handled smoothly in all Spanish FMIs: the defaulting institution was an indirect participant in IBERCLEAR and MEFF and its direct participants managed to terminate its activity in a few days without any loss for them or Lehman's counterparties. No litigation procedures have followed. This showed that participants, FMIs' operators and authorities were aware of the relevant procedures and were able to apply them properly. However, Spanish FMIs have not faced a default of a direct participant in the past decade. Conducting regular default management exercises would allow all stakeholders to check their state of readiness to handle crisis situations. Although this is not a requirement under the current CPSS/IOSCO standards, it was recommended by the ECB in the aftermath of the 2008 crisis.<sup>25</sup> Test scenarios should include not only the default of major participants, but a combination of participants' defaults and deteriorating market conditions. Indeed in a crisis, uncertainty surrounding market developments is likely to influence the behavior of market participants. For instance, once a default materializes, uncertainty about the possible impacts might lead to a situation where participants limit their exposure also to the rest of the market, and thus adversely affect market liquidity conditions.

42. **The authorities should consider developing coordinated contingency plans to deal with a potential failure of a CCP, in line with the outcome of the ongoing discussions on this issue at the international level.** CCPs are particularly vulnerable to

---

<sup>25</sup> See ECB's Report on the lessons learned from the financial crisis with regard to the functioning of European financial market infrastructures, April 2010.

wrong-way risk.<sup>26</sup> Indeed, a CCP is most likely to be under stress at the same time as its participants and its liquidity providers. Further, the markets into which it must liquidate collateral are also most likely to be under stress at such times. Currently, there are no specific contingency arrangements to deal with a potential failure of a Spanish CCP. Defining contingency policy and approach in advance for each CCP will allow the authorities to intervene with greater speed and communicate with the market even more quickly and effectively in the event of a crisis, and ultimately avoid a spillover effect. In particular, the authorities should identify in advance what resolution arrangements will apply to CCPs and in what manner. These would either allow the critical services of the CCP to be sustained or for the CCP's winding down in an orderly manner. In this respect, consideration could be given to a special bankruptcy regime for CCP, granting to the authorities special mechanisms to preserve the going concern value of the CCP and to minimize disruption in the financial system. Development of contingency plans to address CCP failures is not a requirement under existing CPSS/IOSCO standards, and international discussions on this issue are still on-going, in particular on what should be the appropriate procedure for an orderly winding down or resolution of a CCP. This crucial issue is not specific to Spain and the Spanish authorities intend to act according to the international discussions' outcome and the related Eurosystem's stance.

---

<sup>26</sup> Wrong-way risk is defined by the International Swaps and Derivatives Association (ISDA) as the risk that occurs when "exposure to a counterparty is adversely correlated with the credit quality of that counterparty".

## APPENDIX 1: OVERVIEW OF THE TRADING, CLEARING AND SETTLEMENT ORGANIZATION IN SPAIN

<b>TRADING</b>	<b>SECURITIES</b>									<b>DERIVATIVES</b>			
	<b>REGULATED MARKET</b>						<b>MTF</b>			<b>REGULATED MARKET</b>			<b>OTC</b>
	BOLSA MADRID	BOLSA BARCELONA	BOLSA BILBAO	BOLSA VALENCIA	AIAF	MERCADO DE DP	LATIBEX	MAB	SENAF	MEFF RF	MFAO	MEFF	
	Equities, Warrants, Fixed Income, Public Debt				Fixed Income	Public Debt	Equities		Public Debt	Derivatives on Public Debt	Derivatives on Olive Oil	Derivatives on Equities and Indices	Derivatives on Energy
<b>CLEARING</b>									MEFF RF		MFAO	MEFF (MEFFPower) (2)	
<b>SECURITIES SETTLEMENT</b>	IBERCLEAR									MFAO	IBERCLEAR		
	SCLV BARNNA (1)	SCLV BILBAO (1)	SCLV VALENCIA (1)							MEFF RF (3)	MEFF (3)		
<b>CASH SETTLEMENT</b>	TARGET2												

(1) Only for securities admitted to trading in the respective Stock Exchange

(2) MEFFPower is MEFF's commercial name for the energy group of contracts

(3) For contracts with delivery settlement, transactions on securities consequence of maturity are settled in Iberclear

Source: CNMV.

## APPENDIX 2: EUROPEAN INITIATIVES IN THE FIELD OF SECURITIES AND DERIVATIVES FMIS

### European legislative initiatives

43. **The EC has launched three new legislative initiatives to further harmonize the legal framework needed to clear and settle securities throughout the European Union (EU).** The three pieces of legislation will address OTC derivatives and CCPs, CSDs, and securities rights. Work is most advanced on OTC derivatives and CCPs.

#### *OTC derivatives and Central Counterparties Regulation (EMIR)*

44. **The European Parliament and Council agreed in February 2012 on a Regulation, also known as European Market Infrastructure Regulation (EMIR), to govern the OTC derivatives markets, the activities of CCPs,<sup>27</sup> linkages between CCPs, and the features of instruments to be cleared, in the same way for all EU countries.** This takes into account the lessons from the financial crisis, and is in line with the objective outlined in the September 2009 G20 meeting, calling for the improvement of OTC derivatives markets. With this legislative initiative, the EU is moving from a “light-handed regulation” to a more ambitious and comprehensive regulatory policy, in particular making some of the ESCB/CESR recommendations binding, at least for CCPs (CSDs will be covered in another legislation). Specifically, EMIR will introduce: (a) a clearing obligation for eligible OTC derivatives with measures to reduce counterparty credit risk and operational risk for bilaterally cleared OTC derivatives; (b) common rules for central counterparties; (c) a reporting obligation for OTC derivatives; (d) rules on the establishment of interoperability between CCPs; and (e) the concept of data trade repositories.

45. **As regard to CCPs, the new Regulation, which is expected to be applicable as of January 1, 2013, will:**

- Introduce a passport for CCP services, relying on national authorization and supervision of CCPs, with a strengthened role for European Securities and Markets Authority (ESMA).<sup>28</sup>
- Define common requirements and procedures for establishing a right for CCPs to become interoperable provided that risks are addressed and competent authorities approve the link.
- Set up common, stringent risk and governance standards for CCPs.
- Require CCPs to offer indirect participants the possibility of having their margins placed in segregated accounts (omnibus or nominal).

---

<sup>27</sup> Currently, CCPs provide services on a European basis, but remain regulated at national level, as there is no community legislation covering CCPs.

<sup>28</sup> ESMA in particular is in charge of developing most of the detailed rules.

### *Central Securities Depositories Regulation*

46. **To complement the legal framework of the European clearing and settlement infrastructure, the EC also intends to issue a Regulation on central securities depositories (CSDs).** Preliminary proposals were published for public consultation in January 2011 and a first version of the regulation is expected in the first quarter of 2012.

### *Securities Law Directive*

47. **The Commission services are also preparing a draft Directive on legal certainty of securities holding and transactions (Securities Law Directive).** The Directive is expected to address four issues (a) the legal framework of holding and disposition of securities held in securities accounts; (b) the legal framework governing the exercise of investor's rights flowing from securities through a "chain" of intermediaries, in particular in cross-border situations; (c) the establishment of the free, EU-wide choice of issuers regarding the initial entry of their securities in the relevant holding structures, in particular CSDs; and (d) the submission of any activity of safekeeping and administration of securities under an appropriate supervisory regime. This long-awaited harmonization of the European legal framework on securities rights is expected to be another crucial step toward integration. However, in February 2012, no draft had yet been disclosed.

### **TARGET2-Securities**

48. **In addition to setting harmonized standards for the clearing and settlement infrastructure, the Eurosystem decided to also play a direct operational role and launched the TARGET2 Securities (T2S) project in July 2006.** It aims at creating a common technical platform for settlement in central bank money of securities transactions, with the objective to make cross-border transactions as cost effective and secure as domestic ones, thereby complementing further integration of cash settlement through the implementation of TARGET2. As from September 2015, T2S should provide harmonized delivery-versus-payment (DvP) settlement in central bank money for almost all heavily traded securities circulating in Europe.

49. **T2S will offer a service to CSDs, but will not replace them.** CSDs that join T2S will be "outsourcing" their settlement processes to T2S, however they will retain all their other functions and relations with their clients. Market participants will need to have a legal relationship with a CSD in order to use T2S and only CSDs will sign contracts with T2S. Furthermore, the rest of the post-trading value chain, in particular asset servicing, corporate action processing and tax and regulatory reporting, which will still require specific knowledge of national practices and are difficult to automate, will remain a core function of national CSDs. The use of T2S will not be compulsory and the ability for any intermediary, including ICSDs, to offer securities settlement on their books (in commercial bank money instead of central bank money) will remain.

### APPENDIX 3: RISK MANAGEMENT FRAMEWORK IN MEFF AND MEFFCLEAR

#### MEFF

**50. In the event of default, the Member's proprietary account position will be closed and the clients' positions will be transferred to other members.**

**51. The MEFF Rule Book establishes the waterfall of resources available in case a clearing member defaults, as follows:**

1. Initial Margins of the Member for each group of contracts. There is a daily margining of all positions with a confidence level of 99.9 percent and close-out period of two/three days
2. Defaulting Member's contribution to the default fund for each group of contracts. The total default fund of each group of contracts must cover the largest position, plus 10 percent of this position.
3. Offsetting balances for each group of contracts and execution of the defaulting member's extraordinary and individual fund. Members have to contribute extraordinary and individual funds based on intra-day risk limit and margin call limits or stress test results. At the end of every session, MEFF calculates the exposure of every member under stress test parameters. If the exposure is larger than all the collateral posted by the member and other members' contributions to the default fund, the member is required to increase its individual fund accordingly.
4. MEFF fund (composed of MEFF capital) for each contract group.
5. Remainder of the default fund in the group with losses. The default fund from the groups of contracts with no default will not be affected.
6. Remaining MEFF capital.

**Figure 1. Spain FSAP Update: MEFF Collateral Details at End-November 2011**

(In millions of euros)

	Required Collateral	Posted Collateral	Equities	Fixed Income Securities	Cash	Bank Guarantee
Initial Margin	1,783	1,833	214	228	1,391	0
Individual Fund	224	301	99	19	121	224
Default Fund	30	30	1	3	4	30
Total	2,037	2,163	313	250	124	2,037

#### MEFFClear

**52. In the event of default, the Member's proprietary account position will be closed.** There are no client positions.

**53. The MEFFClear Rule Book establishes the waterfall of resources available in case a clearing member defaults, as follows:**

1. defaulting member's initial margin;
2. defaulting member's individual clearing fund; and
3. MEFFClear capital.

**Figure 2. Spain FSAP Update: MEFFClear Collateral Details at End-November 2011**  
(In millions of euros)

	Required Collateral	Posted Collateral	Equities	Fixed Income Securities	Cash
Initial Margin	842	1,048	103	124	821
Individual Fund	388	635	26	58	551
Total	1,229	1,683	129	182	1,372

**54. The CCP does not currently maintain a mutual default fund and a dedicated MEFFClear fund (composed of MEFFClear capital) buffer.** However, in anticipation of the new EU legislation, such a fund is to be introduced in parallel with changes to the structure of MEFF, which will take over all clearing activities in the Spanish markets. In addition, a share of MEFF's capital will be carved out to form the MEFF Fund for the repo segment. The mutual default fund and the MEFF Fund will be divided by market segment (repo, equity derivatives and energy derivatives).

**55. The basic MEFF default waterfall will therefore be:**

1. defaulting member's initial margin;
2. defaulting member's contribution to the new mutual default fund;
3. defaulting member's extraordinary and individual clearing fund;
4. the MEFF Fund for the segment suffering the default;
5. the rest of the default fund for the segment suffering the default; and
6. MEFF capital.