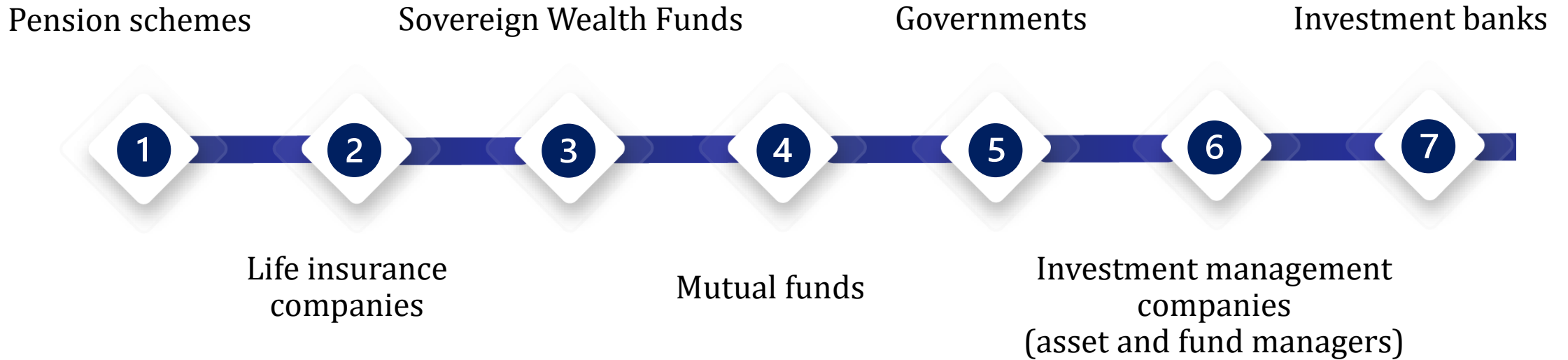




Chapter 2 – Main Industry Participants

10 Questions

Institutional Investors



Individual Investors

→ Let's take a deeper look...



Individual investors invest their own money, either managing investments independently or with the help of financial advisers...

Self-certified sophisticated investors

- Company directors with annual turnover of min. £1 million
- Experience in the private equity sector, or financing SMEs
- Experience making min. 1 investment in an unlisted company

High Net Worth Individuals (HNWIs)

- Min. net annual income of £100,000
- Min. net assets of £250,000 (excluding their primary residence)

The MiFID identifies 3 main categories of clients – each have a **different** level of regulatory protection.

1. Retail Clients

2. Professional Clients

3. Eligible Counterparties (ECPs)



Investors may employ a custodian to keep their investment assets **secure** and to **administer** them on its behalf.

Custodian Key Responsibilities
Provide safekeeping in the local market
Support settlement of the investor's trading activities
Provide market information within that local market
Collect income payments
Manage client cash flows
Manage entitlements through corporate events
Manage tax services
Ensure securities are registered and manage transfer of titles
Reconciliation of assets
Maximize portfolio return through stock lending programmes
Meet reporting obligations to regulatory authorities

→ These will be explored in depth in this chapter...

Custody Services

Investors can manage their custody arrangements in foreign markets in 3 ways



Appoint multiple Local
Custodians for each
foreign market

Appoint one Global
Custodian to manage
the full range of
foreign markets

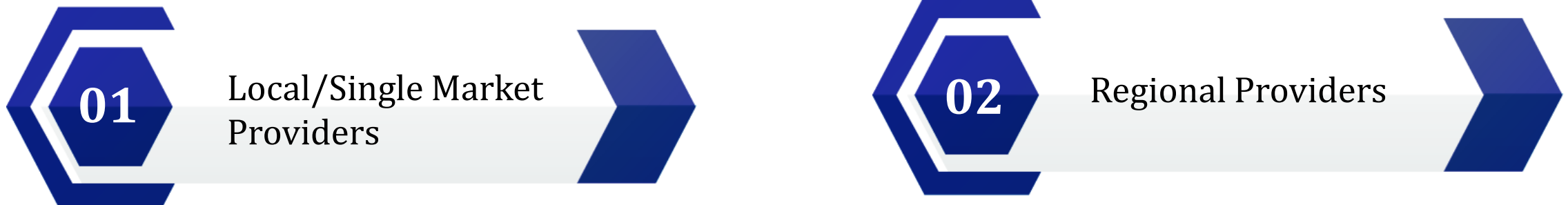
Use CSDs or ICSDs
to settle trades and
hold securities and
cash

Custody Services

Global Custodians maintain an extensive network of branches globally and employ these as local custody providers.

In locations where a global custodian does not have its own branch, it may appoint an external agent bank or **Sub Custodian**.

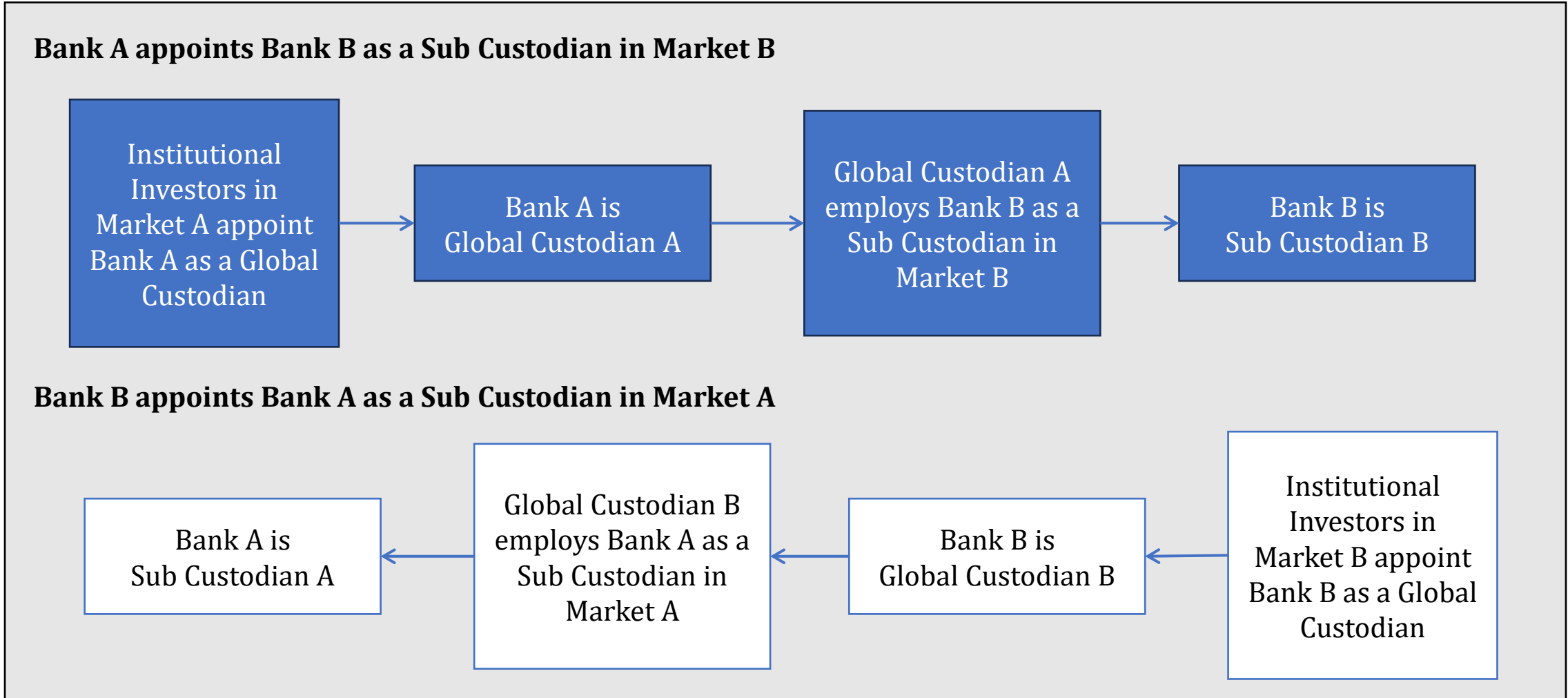
Sub Custodians can be:



The advantageous features of both Local and Regional providers can be outlined as follows:

Local Provider	Regional Provider
Country specialists – especially on taxation	Higher credit rating
Act as eyes and ears that are focused on the local market	Lessons learnt in one market may be applicable in other regional markets
Regular dealings with local financial authorities and politicians	Ability to leverage innovation across markets and deliver economies of scale benefits
Expert knowledge on local market practice, language and culture	Standardised reporting
Longer track record, customer base and goodwill in the local market	Ability to reduce administrative burden for Global Custodians (since they have to deal with only one provider for multiple markets)

Global and Sub Custodians may enter into **Reciprocal Arrangements**.



Custody and Sub-Custody Agreements

Each party has to enter into an agreement outlining the legal conditions, responsibilities and procedures to follow.

Here is a list of agreements:



Custody Agreement –
Institutional
Investors & Global
Custodian



Service Level
Agreement (SLA) –
Institutional
Investors & Global
Custodian



Sub Custody
Agreement – Global
Custodian & Sub
Custodian
(Local/Regional)

Selecting a Custodian

When selecting a global custodian, an institutional investor will request candidates to complete a detailed request for proposal (RFP).

Here is the main selection criteria in the RFP:



Background of the
Custodian



Service Capacity



Account, Reporting,
and Settlement
Processing



Safekeeping



Value-Added Services



Cash Management
and FX



Sub Custodian
Network



Pricing Structure

A Global Custodian does not have its own branch in a foreign location. Which of the following entities would resolve their issue?

- A. Single Market Provider
- B. Hedge Fund
- C. ECPs
- D. Credit Union



CSDs and ICSDs

What does a Depository like CSD or ICSD do?

Settles trades on a
delivery versus payment
(DvP) basis



Allows members to hold
book-entry accounts for
dematerialized securities

Provides basic
custody services

The instruments deposited in a CSD or ICSD include equities, government bonds, corporate bonds and money market instruments.

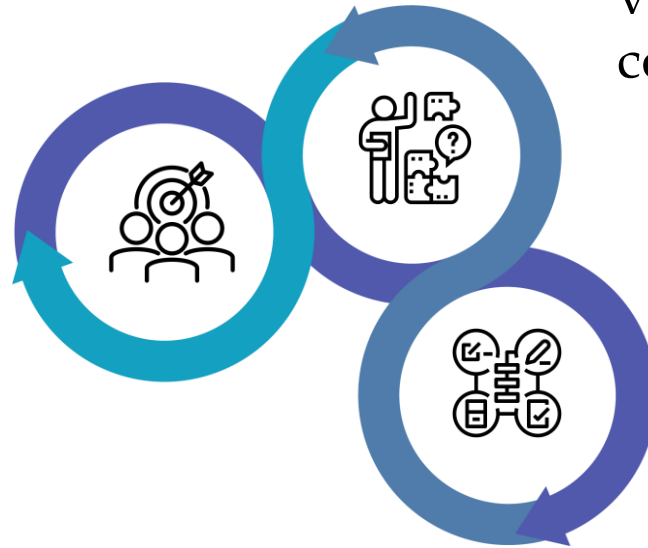
These securities can be held in 2 formats: **Certificated** or **Dematerialized**.

Depository Arrangements in Selected Markets (Summary)

Country	Depository	Depository Arrangement
UK	Euroclear UK & International	Facilitated by the CREST system. Full dematerialized with book-entry transfers. Firms looking to settle securities transactions in CREST can become a user or a sponsored member through another CREST user.
US	DTC & Federal Reserve	DTC handles corporate stocks and bonds, municipal bonds, MM instruments, ADRs and certain mutual funds. DTC uses book-entry transfers. Federal Reserve manages US government bonds and MBS.
Europe	<i>Multiple</i>	Euroclear France is the CSD for France. Interbolsa is the CSD for Portugal. Euroclear Bank is the CSD for Ireland. The NYSE Euronext-zone CSDs are supported by an integrated settlement solution known as ESES. LCH.Clearnet SA is the CCP for all NYSE Euronext European markets.
Germany	CBF	CASCADE for domestic securities and CREATION for international settlement with book-entry transfers.
Spain	Iberclear	Maintains the book entry register and manages securities and cash transfers
Australia	CHESS	All securities traded on the ASX are cleared and settled CHESS.
Japan	JASDEC	Settlement is by book-entry transfer. Stock certificates are dematerialized.
Hong Kong	HKSCC & CMU	HKSCC for equities. CMU for corporate and government debt securities.
Singapore	CDP	Provides clearing, settlement, and depository services, with CCP functions.
India	NSDL & CDSL	Mandatory dematerialized settlements. Book-entry transfers.
South Korea	KSD	Book-entry transfers on a multilateral netting basis. Partial settlement is not allowed.
Brazil	CBLC, SELIC & CETIP	CBLC for equities. SELIC for government debt. CETIP for corporate debt and OTC derivatives, all dematerialized and issued in book-entry form.

ICSDs

Initially created to provide integrated clearing, settlement, and custody services for the Eurobond market



ICSDs now offer a range of value-add services which compete with custodians

Euroclear Bank and **Clearstream Banking** are the 2 main ICSDs that will be discussed in this chapter.

Characteristics

Securities held in immobilised form with book-entry transfer

Settlement Services

Provides DvP settlement with simultaneous and irrevocable transfers

- Batch Process: Runs Overnight
- Real-time Process: Runs between 1:30 and 19:30 CET

Provides 3 distinct ways for settlements

- Fully automated overnight & daytime DvP processing is through CreationOnline
- Handles all steps in the transaction life-cycle on a real-time basis
- Daytime processing window: 21:30 (SD-1) to 20:00 CET
- Settlement extension has moved the deadline to 21:30 CET

Clearstream Banking

Characteristics

Access Channels are Creation Connect, SWIFT, and Creation Online

Bridge settlement support exchange of messages with Euroclear Bank

Settlement Services

Handles all steps in the transaction life-cycle on a real-time basis

Daytime processing window from 21:30 (SD-1) to 20:00 CET

Settlement is fully automated overnight and daytime DvP processing is through CreationOnline



Settlement extension has moved the deadline to 21:30 CET

The Giovannini Barriers (Summary)

Barrier	Description
Barrier 1	Need to eliminate connectivity problems from national differences in IT and technology
Barrier 2	Need to remove national restrictions on the location of clearing and settlement
Barrier 3	Need to harmonise national rules relating to corporate actions processing
Barrier 4	Need to guarantee intra-day settlement finality in all links between settlement systems
Barrier 5	Need for national governments to create conditions that enable remove access to national clearing and settlement mechanisms to be guaranteed
Barrier 6	Need for settlement periods for all equity markets to be harmonized
Barrier 7	Need for operating hours for national clearing and systems to be standardised
Barrier 8	Need for securities issuance practices to be harmonized
Barrier 9	Need to remove national restrictions on the location of securities
Barrier 10	Need to remove restrictions on the activity of primary dealers and market makers
Barrier 11	Need to allow all financial intermediaries (est. in EU) to offer withholding agent services in each of the EU member states
Barrier 12	Need to remove any provisions that require the collection of taxes on securities transactions to be done via local systems
Barrier 13	Need to establish an EU-wide framework for the treatment of ownership of securities
Barrier 14	Need to address inconsistencies across EU states in the legal treatment of netting procedures
Barrier 15	Need to address inconsistencies in conflict of law rules applicable across EU states

The 2001 Giovannini Report highlights 15 factors that prevent efficient cross-border clearing and settlement services in the EU.

TARGET2-Securities (T2S)

TARGET2-Securities (T2S) is a centralised settlement platform for the settlement of euro-denominated securities transactions (& some non-euro-denominated) in central bank money (ECB).

Objectives include:

01

Integrations and harmonization of the diverse settlement structures in Europe

02

Reduce the costs of cross-border securities settlement

03

Increase competition among providers

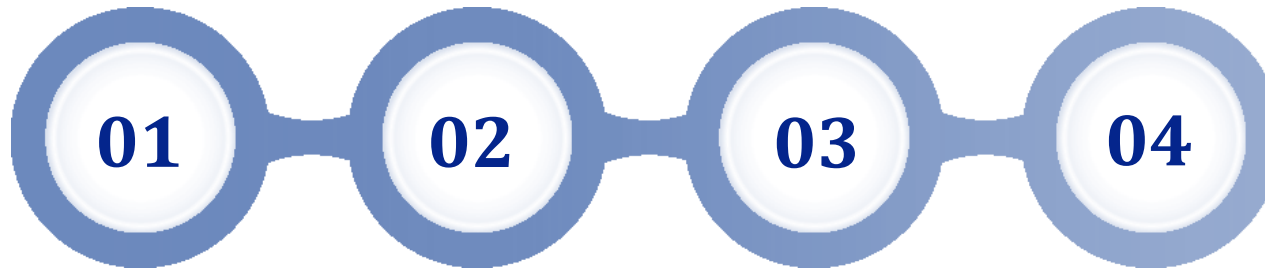
At the time of writing (January 2024), there were **24 CSDs** connected to T2S.

The CSD Regulation in the EU

The CSD Regulation (CSDR) aims to create a unified regulatory framework for securities infrastructure.

Here are some key features:

Fixed the settlement period for securities transactions to **T+2**



Introduced ex ante measures to prevent settlement fails and ex post measures to address them

Introduced the right for issuers to record their securities in **any CSD** in the EU

Outlines **restrictions on the range of commercial** (value-added) **banking activities** a CSD can undertake:

- '1+2' model where a single legal entity provides both core CSD and commercial banking services
- '2+2' model where 2 legal entities provide each service separately

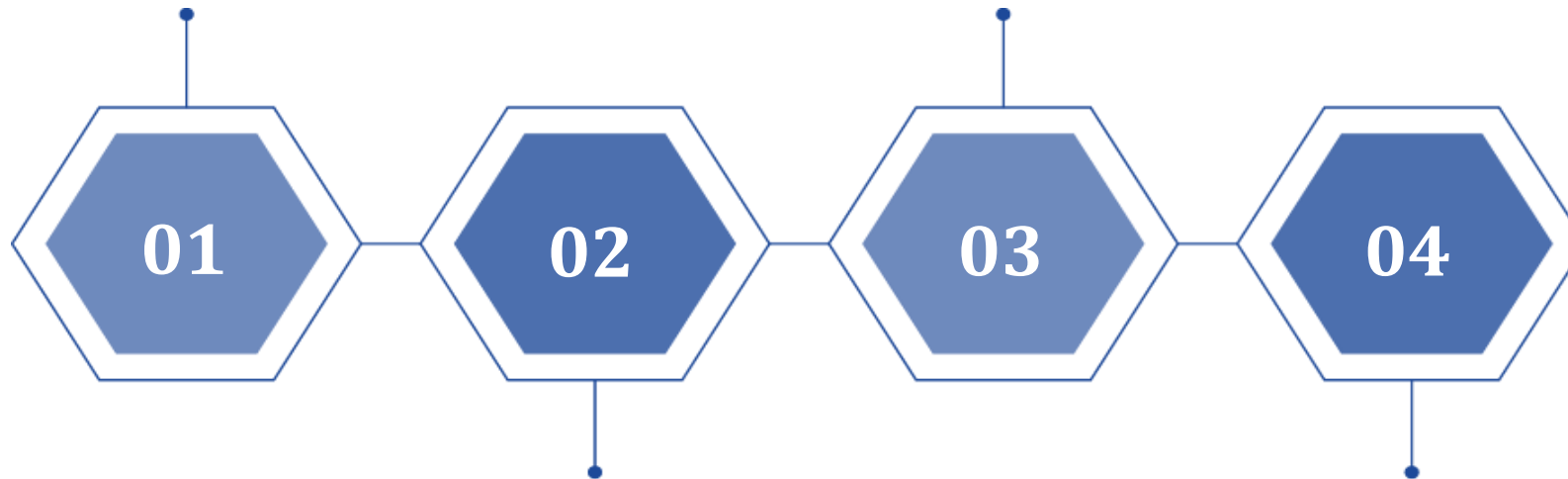
Straight Through Processing

Straight-through processing (STP) is the automated passage of a financial transaction from execution to settlement **without manual intervention**.

STP addresses 4 key concerns:

Some participants still use phone-based reporting, leading to rekeying errors and delays.

Lack of standardization of proprietary systems for holding data and communicating messages between process areas



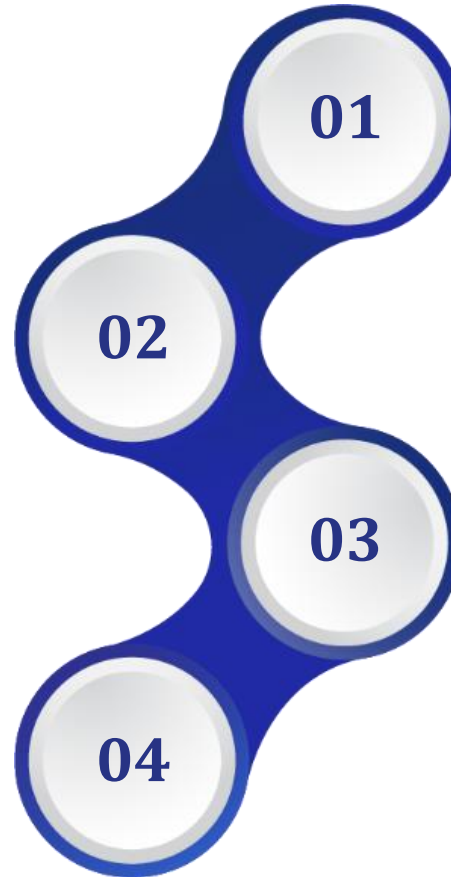
Front and back-office systems often lack integration, limiting automation

Mergers have led to poor connectivity between inherited systems.

Barriers to Promoting Straight Through Processing (STP)

Firms demand quick ROI for system automation investments

New standards like ISO 15022, ISO 20022, and FIX exist but require correct implementation for effective STP



Variations in tax regulations and corporate actions across jurisdictions hinder STP adoption

Smaller firms may prioritize front office tech upgrades over back-office automation

SWIFT promotes the use of standardised messaging services and interface software within the financial services sector

SWIFT adopts 3 key business objectives:

Provide low-cost, competitive financial processing and communications services



Greater automation of the end-to-end financial transaction process



Leverage international position to address industry-level threats, issues and opportunities

SWIFT's core activities include:

Payments

Supports bank instructions, statements, clearing, and settlement (payments account for **almost 60%** of message volume)

Securities

Facilitates trade confirmation, clearing, settlement, and custodial operations (securities account for **over 30%** of message volume)

FX & Treasury

Provides systems for trade confirmation messaging, matching, netting, and reporting of FX and treasury trades

Fintech

Banking & Insurance

- Mobile Banking
- Neobanks e.g. Monzo and Revolut
- Chatbots
- AI in payments, loans, and credit scoring

Financial Services

- Cryptocurrency
- Blockchain
- Electronic trading platforms
- Robo-advisors
- Big Data Analysis
- Robotic Process Automation
- Regtech

The Economy

- AI to predict market direction
- AI to analyse customer retail spending

Which country has implemented the CASCADE system and Clearstream Banking's CREATION platform for transfer settlement processes?

- A. France
- B. Germany
- C. Spain
- D. UK

