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REFORM OF SPANISH POST-TRADING SYSTEMS

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INTRODUCTION

The amendment to the Spanish Securities Market Act ("**SMA**"), approved by the first final provision of Act 11/2015,¹ entered into force on June 20, 2015, aiming to make the necessary legal changes to implement the reform of the Spanish post-trade systems initiated in 2011 (the "**Reform**"), to harmonize these systems with European practices and standards and increase their level of competitiveness. The Reform will be implemented in two phases: a first phase for equities on October 7, 2015; and a second phase for fixed-income securities in February 2017 (to coincide with the connection of Iberclear to TARGET2-Securities – "**T2S**").

The Draft Royal Decree on the clearing, settlement and registration of marketable securities represented by book entries, and on the transparency requirements for issuers of securities admitted to trading on an official secondary market (the "**Draft Royal Decree**") was published on June 23, 2015, and was submitted to public consultation until June 30. The Draft Royal Decree implements the Reform and amends the Royal Decree on transparency (Royal Decree 1362/2007²) to reflect the new provisions of Directive 2013/50/EU.³ The new provisions on the Reform included in the Draft Royal Decree are expected to enter into force on October 7, 2015.

This document describes aspects of the Reform that we consider most relevant to our practice, specifying matters that have been amended or implemented by Act 11/2015. As soon as the definitive text of Draft Royal Decree is approved, we will publish two legal flashes to examine the implementation of the Reform and the developments introduced with regard to transparency.

¹ Act 11/2015, of June 18, on the recovery and resolution of credit institutions and investment firms.

² Royal Decree 1362/2007, of October 19, implementing Securities Market Act 24/1988, of July 28, on transparency requirements regarding information on issuers whose securities are listed on a Spanish official secondary market or on another regulated market of the European Union.

³ Directive 2013/50/EU of the European Parliament and of the Council, of October 22, 2013, amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market; Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading; and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC.

MAIN ASPECTS OF THE REFORM AND OF ACT 11/2015

- **Purpose of the Reform.** The Reform seeks to harmonize the Spanish post-trade system with European practices and standards, increase its level of competitiveness and enable its integration with the T2S Project,⁴ the EMIR Regulation⁵ and the CSDR Regulation⁶.
- **Introduction of a central counterparty (“CCP”).** The Spanish post-trade system for transactions in equities has been characterized to date by the absence of a CCP as a result of the principle of assured delivery, which guarantees the settlement of any transaction accepted by the system, always delivering securities in exchange for cash. This principle of assured delivery, based on a system of pooled guarantees managed by the Spanish central securities depository (“CSD”), commercially known as Iberclear, is replaced in this Reform by the intervention of a CCP that will assume the risk of non-delivery of securities or cash in the transactions. BME Clearing, a company of the BME Group⁷, is expected to start providing CCP services for the equities market on October 7, 2015.

Act 11/2015 has amended the SMA to regulate specific aspects of CCPs (their supervision by the Spanish Securities Market Commission (“CNMV”), their prohibition to act as a CSD and applicable penalties in the event of breach of their obligations).

- **Change in the timing of finality of the transfer.** The removal of the principle of assured delivery implies moving finality of transactions from the time of trade to the time of settlement.
- **The “two-tier” registry system and the new individual third-party accounts.** The “two-tier” registry system is kept, but based on balances. The

⁴ T2S is one of the largest infrastructure projects implemented until now at European level and constitutes a significant step towards achieving an integrated, single securities market for financial services. T2S is intended for central securities depositories, which are offered the possibility of using the European Central Bank’s single settlement platform for cash securities transactions. The T2S project will be implemented in four phases, the first of which took place on June 22, 2015. Spain expects to join in the last phase in February 2017.

⁵ Regulation (EU) No. 648/2012 of the European Parliament and of the Council, of July 4, 2012, on OTC derivatives, central counterparties and trade repositories.

⁶ Regulation (EU) No. 909/2014 of the European Parliament and of the Council, of July 23, 2014, on improving securities settlement in the European Union and central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No. 236/2012.

⁷ BME is the operator of all stock markets and financial systems in Spain. It has been a listed company since July 14, 2006.

registry system is arranged into two levels: a central register kept by Iberclear (“first tier”) and a detailed register kept by the participants (“second tier”). As a new feature, in addition to proprietary accounts (for their own transactions) and third-party accounts (for the transactions of their clients), participants can have individual third-party accounts in the central register in their clients’ name. These new individual third-party accounts are managed by the participant, but are registered in the name of the client. Act 11/2015 amends the *pro rata* rule applicable in the event of the participant’s insolvency to clarify that an individual third-party account would not be affected in the event of a shortfall in the general third-party account.

- **The current register references (“RR”) system will be replaced by a settlement system based on balance sufficiency.** RRs are numeric codes allowing each transaction to be identified. They are a unique feature of the Spanish settlement system that, although enabling a detailed control of transactions, is now replaced by a more efficient mechanism operating in other European countries. After the Reform, the sufficiency of securities and cash balances will determine the settlement of an order, without relying, as it does now, on the seller’s delivery to Iberclear of RRs relating to the securities sold.

Act 11/2015 establishes a new system to facilitate supervision by CSDs and the CNMV and to guarantee, at least, the same traceability of transactions as provided by the RRs, enabling transactions to be traced at different stages (trade, clearing and settlement). The system that has been implemented and that will be managed by BME is known as the **PTI** (Post Trading Interface).

- **Developments regarding settlement.** As a result of the Reform, a cost-reducing bilateral system will replace the current multilateral clearing and settlement. In addition, a single platform, compatible with T2S, will be established to settle any securities (including equities, fixed-income securities and warrants), which will replace the current settlement platforms: SCLV (for equities) and CADE (for fixed-income securities). Initially, transactions will continue to be settled in the current T+3 time period, but after November 2015, it will be reduced to T+2 under the provisions of the CSDR Regulation. Act 11/2015 has amended the SMA to regulate specific aspects of CSDs (their supervision by the CNMV and applicable penalties in the event of breach of their obligations) and to align its current wording with that of the CSDR Regulation. Lastly, to mitigate settlement risk, Act 11/2015 establishes measures protecting settling entities, trading members and clearing members.

- **Management and reporting of corporate actions** (e.g., payment of dividends). Another of the Reform's developments is the CSD's management of the execution of financial transactions arising from holding securities ("corporate actions," including payment of dividends, exchange of securities and capital increases) under the standards defined by the Corporate Actions Joint Working Group (CAJWG) and the Joint Working Group on General Meetings (JWGGC).

Act 11/2015 amends the SMA to impose the obligation on issuers to report their corporate actions to the stock exchange governing body and to the CSD as soon as they adopt the relevant resolution. As a result of the Reform, the record date (the cut-off date determining the positions to be considered to calculate the mandatory action) and the ex-date (the date on which the security is traded without being entitled to participate in the action) order will change. In practice, this change will allow a full settlement cycle to be included and fewer adjustments, e.g., in case of a dividend payment.

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