

IMPACT OF REGULATIONS ON THE CDS / (I)CSD MARKETPLACE

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Section 1 | **Market overview**

CSDs are a small yet critical part of markets infrastructure, with their fortunes tied into the broader changes across capital markets

Securities sell side and infrastructure revenue pools

VALUE CHAIN	ACTORS					TOTAL
	Sell-side	Execution venues	(I)CSDs	Custodians	Data & technology	
Primary						\$55–\$60 BN
Client Coverage						
Execution	Commissions					\$190–\$210 BN
	Risk premiums					
	Financing					
Clearing						\$5–\$10 BN
Securities services	Settlement					\$40–\$45 BN
	Custody					
	Collateral management					
Post trade data and analytics						\$20–\$25 BN
Revenue	~\$240 BN	~\$24 BN	~\$3 BN	~\$44 BN	~\$23 BN	~\$330 BN

 Impacted by regulation and market structure change

CSDs will be caught up in the broader regulatory agenda forcing change as customer business models react to the new market structure

Regulation	Overview	CSD impacts
T2S (2015–2017)	<ul style="list-style-type: none"> Streamlines cross-border settlement in EU and creates a common platform serving CSDs 	<ul style="list-style-type: none"> Decrease in settlement revenue T2S connectivity cost
EU CSD regulation (TBD)	<ul style="list-style-type: none"> CSDR to allow issuer access to all EU CSDs and increase competition 	<ul style="list-style-type: none"> Ring-fence banking activities
CPSS-IOSCO (End 2012)	<ul style="list-style-type: none"> More demanding standards for payment, clearing & settlement 	<ul style="list-style-type: none"> Standardisation of risk management
EMIR (TBD)	<ul style="list-style-type: none"> Dodd-Frank, EMIR, Basel 2.5/III: promoting central clearing of derivatives 	<ul style="list-style-type: none"> Settlement requirements for CCP-related transactions
AIFMD (Mid-2013)	<ul style="list-style-type: none"> Tighter regulation of alternatives/HFs – single depository requirement and increased liability 	<ul style="list-style-type: none"> Opportunity to internalise settlement and extend asset servicing
MiFID II and Securities Law Directive (Consulting)	<ul style="list-style-type: none"> Focused on market transparency and investor protection 	<ul style="list-style-type: none"> Increase competition and operational requirements Increase compliance requirements if classified as investment service
Basel III (CRD IV) (2013–2019)	<ul style="list-style-type: none"> Minimum leverage ratio to be respected at group level 	<ul style="list-style-type: none"> Limited impact on CSDs Indirect from custodians
FACTA	<ul style="list-style-type: none"> Requires foreign financial institutions (FFIs) to identify US accounts and report them to the IRS 	<ul style="list-style-type: none"> Low impact given nurture of client relationships & core services offered

As regulation bites, market participants are shifting business models to position for emerging opportunities, particularly in the post trade space













Expansion of market participants across value chain

VALUE CHAIN	ACTORS				
	Sell-side	Execution venues	(I)CSDs	Custodians	Data & tech
Primary					
Client Coverage					
Execution	Commissions				6
	Risk premiums				
	Financing				
Clearing					
Securities services	Settlement	1		3	4
	Custody				
	Collateral management				
Post trade data and analytics		2		5	

- 1 Sell side integrating post trade into front to back offering
- 2 (I)CSDS adding asset servicing and collateral solutions
- 3 Custodians building execution and clearing services competing with the sell side
- 4 Custodians adding collateral services competing with CSDs
- 5 FinTech focused on efficiency solutions into post trade service chain

Emerging business model shifts

Requirements for CSDs will continue to vary by client type, we expect to see CSDs unbundling services and expanding their service offering

	Universal banks	Private Banks	Broker-dealers	Buy-side/ Corporates
Client examples	  	  	  	  
CSD key offering requirements	<ul style="list-style-type: none"> • CSD with advanced asset servicing portfolio • Full T2S access with CeBM¹ • Collateral management 	<ul style="list-style-type: none"> • Modular, unbundled services – “pick and choose” • Open collateral management² • Full T2S access with CeBM¹ 	<ul style="list-style-type: none"> • Modular, unbundled services – “pick and chose” • Full T2S access with CeBM¹ • Open collateral management² 	

Emerging market dynamics mean that clients are likely to adopt an optimised model leveraging (I)CSDs and proximity to central banks or a custodian led model

Source: Oliver Wyman analysis

1. CEBM: Central Bank Money settlement which is lower risk than Commercial Bank Money settlement; 2. Open collateral management architecture, e.g. Euroclear's Collateral Highway solution, allows clients to utilise assets from wherever they are held to serve as collateral, e.g. assets held at Asian bank could be used for trade with non-Asian counterparties

Europe: T2S & CSDR will damage CSD economics likely driving further consolidation

Key success factors in T2S & CSDR response and peer segment perspectives

1 Network expansion to drive scale

- Scale is key given reducing margins and little differentiation
- Price pressure positions smaller/local providers as consolidation targets

2 Specialisation as an alternative to scale

- Niche services further away from commoditisation
- Where scale is not possible, becoming a local expert is an option

3 Successful use of peripheral services

- New value sources needed as core product offering commoditises (low margin, little differentiation)
- New regulation is creating opportunities

4 Competitiveness not reliant on historical geographical silos

- Removal of national barriers e.g. CSDR allows listing on any European CSD
- Providers who relied on them must find new competitive advantages

ICSD impacts

- Decrease in settlement margins due to shift in domestic/cross-border mix
- High cost of T2S connectivity
- Opportunity for expansion by acquiring local CSDs

Local CSD Impacts

- Disadvantaged relative to regional CSD to capture flow, leading to erosion of settlement revenues
- Relatively high cost of T2S connectivity
- Potential consolidation target

Source: Oliver Wyman analysis

Europe: Differences across the CSD and Custodian service offering are becoming blurred as they pursue alternative revenue streams

Competitive advantages in the post-trade industry

Business	Traditional competitive advantage	Emerging market dynamics
CSDs	<ul style="list-style-type: none"> Historically set up and owned by national authorities with protectionist regulation 	<ul style="list-style-type: none"> Outsourcing of cross-border settlement to T2S platform
ICSDs	<ul style="list-style-type: none"> Established international network with significant number of links to local CSDs Strong power coming from market duopoly (Clearstream and Euroclear) 	<ul style="list-style-type: none"> Competition from foreign CSDs on asset servicing Potential development of CSD activities by custodians
Sub-custodians	<ul style="list-style-type: none"> Historically provided access to local CSDs, with role at times projected by regulation High level of local expertise (tax law, regulation, technical) to ensure efficient connectivity to CSDs 	<ul style="list-style-type: none"> Requirement to connect to CSDs via sub-custodians disappearing Increased competition for custody service offering
Global custodians	<ul style="list-style-type: none"> Strong relationship with investor client base Scale as a source of cost leadership (operational efficiency) Ability to adapt service offering to large clients (“flow monsters”) 	<ul style="list-style-type: none"> Rise of investor CSDs as a result of T2S implementation More sophisticated asset servicing offering from CSDs

Source: Oliver Wyman analysis

Asia: The region continues to work on developing the bond markets with a focus on harmonisation, while several players continue to build their offerings

Investor issues

- Structural difference across the market create high barriers to entry that prevent the cross-border activity to develop, e.g.
 - FX controls, taxes, investor registration in several countries
 - China, Thailand, Philippines and Indonesia with the highest barriers vs. HK and Singapore which have lower barriers
- Post-trade infrastructure issues make it more costly and risky for investors, e.g.
 - Relatively high cross-border transactions costs, being 3x higher when compares to US or EU¹
 - Complicated trade structures with many involved parties, FX risks which is magnified for transactions involving ICSDs based in European time-zone



CSD / (I)CSD activity

- ABMI evaluated creating an ICSD following the European model or improving CSD linkages to address some of the investor post-trade issues
- HK, Malaysia, Indonesia, Thailand and Euroclear recommended the development of “Common Platform Model”, serving as basis for cooperation in the region
 - One key weakness identified was the lack of asset servicing among regional CSDs or the high extent of manual processes of those were offered

1. As per 2010 study by the ABMI Group of Experts report

Section 2

Considerations for today

There are three key themes impacting CSDs today

- Shifting customer business models and post trade needs
- Globalisation of the post trade space and business models
- Difficulty in harmonization of the regulation and finding convergence of regulatory principles (despite divergence in interpretation locally)
- Digitalization and electronification of the marketplace increasing the speed change

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