DISCLOSURE FRAMEWORK
FOR SECURITIES SETTLEMENT SYSTEMS

June 2012
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Introduction

This document is in response to the “Disclosure Framework for Securities Settlement System issued by the Committee on Payment and Settlement Systems (CPSS) and the International Organisation of Securities Commissions (IOSCO). The disclosure framework supplements the CPSS-IOSCO Principles for Financial Market Infrastructures\(^1\) (FMIs Report) and supports the interested financial Market Infrastructure (FMI) in providing a comprehensive level of disclosure according to principle 23 of FMIs Report\(^2\).

This Principle emphasises the importance of transparency on market infrastructure functioning, in order to foster confidence in the soundness of the financial system as whole. Disclosure covers rules, key procedures and market data to enable participant and other interested parties to have a clear understanding of the risk and controls deriving from the participation to the FMI.

For this purpose CPSS and IOSCO prepared a disclosure framework that system operators and participant could use to gain a clearer understanding of the rights, obligations, exposures associated with the SSSs. It is not intended to set prescriptive standards replacing rules and procedures of the SSS and it is not a legal representation or a binding contract. Moreover, the framework does not necessarily identify all information that the SSS should disclose in the light of its individual facts and circumstances and therefore it may be necessary for

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\(^1\) The report Principles for financial market infrastructures contains new and more demanding international standards for payment, clearing and settlement systems, including central counterparties. Issued by the CPSS and the International Organization of Securities Commissions (IOSCO), the new standards (called "principles") are designed to ensure that the infrastructure supporting global financial markets is more robust and thus well placed to withstand financial shocks. The report is available at the following URL [http://www.bis.org/publ/cpss101.htm](http://www.bis.org/publ/cpss101.htm)

\(^2\) Principle 23: Disclosure of rules, key procedures, and market data

An FMI should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the FMI. All relevant rules and key procedures should be publicly disclosed.
participants to discuss issues directly with the SSS to obtain a full understanding of the system. This framework should, however, help market participants and regulators to organise and understand the information that they need in order to appraise the risks, including any systemic risks, potentially associated with SSSs.

The following sections below are intended to elicit important information from SSSs in the areas of organisational structure and market context, ownership arrangements, rules and procedures, relationships with participants, links to other SSSs and intermediaries, procedures for funds and securities transfers, default procedures, settlement of back-to-back transactions, risk control measures and operational risk.

Recently CPSS and IOSCO released for comment the new “Disclosure Framework for Financial Market Infrastructures” and the “Assessment Methodology for the Principles for FMIs and the Responsibilities of Authorities (Assessment Methodology)”. Considering that the consultation process will end in June 2012, the present Monte Titoli’s “Disclosure Framework for Securities Settlement Systems” is drafted in line with the disclosure template currently in force.

Requests for further information and updating may be directed to Monte Titoli competent department³.

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³ For all contacts details please refer to the relevant section of Monte Titoli website http://www.montetitoli.it/servizio-clienti/servizio-clienti.en.htm
I. Basic information

This chapter provides for a general description of the basic functions of the SSS operated by Monte Titoli S.p.A., of its organisational and ownership structure of the operator, including information on its legal basis and corporate governance.

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A. What is the name of the SSS?

B. Where and in which time zone is the SSS located?

Monte Titoli S.p.A. is the operator of the SSS named EXPRESS II located in Italy, Central Europe Time zone.

C. What functions does the SSS perform?

1. Does the SSS serve as a securities depository and/or provide securities settlement services?

In this regard it should be noted that according to article 41 of the of Bank of Italy and CONSOB joint Regulation governing Financial Market Infrastructure (here and after “Joint Regulation”) the authorization to manage settlement services may be issued only to a company that carries on the activity of central depository for financial instruments or to a company limited by shares with registered office in Italy that is controlled, singly or jointly, by organizations carrying on central depository activity in Italy or abroad, provided these are subject to supervisory measures equivalent to those provided for in Italian law.

Monte Titoli S.p.A. is authorised to manage a central security depository system as well as to perform the settlement services both on both on a net and gross basis pursuant to Italian law. In particular Express II settlement system combines the common real time gross system (RTGS) with two netting cycles.

4 Also know as “Rules governing central depositories, settlement services, guarantee systems and related management companies (adopted by The Bank of Italy and CONSOB on 22nd February 2008 and amended by joint Bank of Italy/CONSOB act of 24 December 2010)".
Moreover Monte Titoli offers cross-border securities settlement services respectively through accounts opened within linked foreign SSS.

a. **What types of instrument are eligible for deposit at the SSS (e.g. debt, equities, warrants, etc.)?**

b. **What types of instrument are eligible for transfer within the SSS?**

All financial instruments that could be entered in a book-entry form within the central securities depository system are eligible for deposit within for transfers within Express II.

Monte Titoli CSD Rules and Instructions provide for admission procedures pursuant to requirements provided by Consolidated Law on Finance (CLF) and Joint Regulation on Market Infrastructure. Article 7 of the CSD Rules provides for the following the categories of financial instruments eligible to be eligible for deposit:

- securities tradable on the capital market referred to in Article 1, paragraph 1-bis, of the Consolidated Law on Finance (CLF);
- Government securities and other public debt securities;
- shares/units of collective investment undertakings;
- securities traded on the money market;
- any other security that can be traded on the capital market.

c. **Please describe whether eligible securities are dematerialised, immobilised or transferred physically.**

Italian legal framework provides two regimes for central deposit: dematerialisation and immobilisation.

The dematerialisation regime was introduced in 1998 by Decree n. 213/1998 (Euro Decree) and then transferred in the Consolidated Law on Finance (CLF).

According to article 83-bis of CLF and article 15 of Joint Regulation on Financial Market Infrastructure dematerialisation is compulsory:

- for all financial instruments traded or due to be traded on Italian regulated markets;
- for all financial instruments traded or due to be traded on MTF upon issuer consent;
- shares and other securities that represent risk capital, bonds and other debt securities, any other financial instrument that allows for the purchase
of other financial instruments and relative indices, where the issuer has other financial instruments listed on the Italian regulated markets, or it is included on the list of widely distributed issuers held by CONSOB;

- bonds and other debt securities where the amount of the issue exceeds €150 million.

A part from the list above, any issuer may choose to subject its financial instruments to dematerialisation regime on voluntary basis.

The Consolidated Law on Finance (artt. 85 and sbq.) provides also for central deposit of financial instruments represented by securities (i.e. immobilisation). In this case the central depository is be authorised to carry out all transactions inherent to central depository activity in compliance with the relevant regulation, for instance requiring the whole issue of securities to be represented by a global certificate for the purpose of deposit. In both cases the transfer of securities happens through the correspondent book-entry records in intermediary accounts opened within the central depository system.

After such registration, the account holder is fully entitled to exercise of rights pertaining to the financial instruments registered on that account and he may dispose of them.

d. Does the SSS provide safekeeping for physical certificates?

Safekeeping services have been maintained for the physical certificates which are not dematerialised.

These securities, mainly represented by global certificates, are immobilised at Monte Titoli and transferred correspondent by book entries without any physical transfer.

2. Does the SSS provide cash accounts and/or provide funds transfers in conjunction with securities transfers? If so, in which currencies?

In the context of the domestic settlement service Monte Titoli does not provide cash accounts in conjunction with securities transfers. Indeed all transactions denominated in euro currency and settled through DVP transfers are carried out in central bank money on the cash accounts held by participants in TARGET 2 System managed by European Central Bank.

With reference to the cross-border settlement service Monte Titoli performs DVP settlement through its cash account in TARGET 2 providing funds transfers in
conjunction with securities transfers on behalf of its participant following the so-called pre-funding mechanism i.e. the verification of the availability of cash on the TARGET 2 account of the purchasing participant or of its agent bank.

Anyway according to art. 42, paragraph 1, of the Joint Regulation on Financial Market Infrastructures Monte Titoli may provide its participants with cash accounts and funds transfers functionalities on a DVP basis in euro and non-euro currencies.

3. Does the SSS provide a trade matching service? Do others provide such services for securities settled at the SSS?
Monte Titoli currently provides trade matching and routing service named X-TRM for DVP and FOP services regarding all types of securities.

4. Does the SSS provide a trade netting service (as distinct from undertaking the settlement of securities transfers on a net basis)? Do others provide such services for securities settled at the SSS? In either case, what types of netting (bilateral or multilateral), if any, are performed?
X-TRM service includes a netting function specific for trades entered by CCP. This function performs, on behalf of the CCP, the automatic aggregation of trades subject to novation, with the consequent entry into SSS of the bilateral balance vis-à-vis the CCP (the type of operation created is “transfer”).

5. Does the SSS offer a securities lending or borrowing program?
Monte Titoli provides automated securities lending and borrowing facilities supporting its settlement services as agent on the basis of a dual mandate to contract in the name of and on behalf of the counterparties (borrowers and lenders). This service is a tool both for the reduction of settlement risks and for the diversification of portfolio management.

The Service follows the settlement timetable and is divided into two cycles: overnight and daytime.

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<thead>
<tr>
<th>Cycle</th>
<th>Phases</th>
<th>Time</th>
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<tr>
<td>Overnight securities lending</td>
<td>Opening of the Service</td>
<td>Within the overnight settlement cycle</td>
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<td></td>
<td>Closing of the Service</td>
<td>At the closure of the overnight settlement cycle</td>
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<tr>
<td>Daytime securities lending</td>
<td>Opening of the Service</td>
<td>At the beginning of the daytime settlement cycle</td>
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<tr>
<td></td>
<td>Matching Closing</td>
<td>h. 15.00</td>
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<tr>
<td></td>
<td>Closing of the Service</td>
<td>h. 19:30</td>
</tr>
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The **overnight securities lending** process is activated at the end of the phase which identifies securities short positions, should there be any. It is a totally automatic process: the participants in the Service do not need to perform any operating steps.

The **daytime securities lending** is activated at the same time as the start of the daytime net cycle. Starting from the activation and until the closure of the matching it is possible to generate securities lending contracts. From this point on, the matching facility is closed and, therefore, it is no longer possible to generate securities lending contracts. However, until closure, all the other functions provided by the Service continue to be enabled, and it is possible to input loan requests and/or offer profiles valid for the following day’s overnight net cycle.

6. **Does the SSS provide custodial and/or related services such as the collection of interest, dividends, principal or withholding tax reclamation? Which types of service are provided?**

Monte Titoli is authorised to perform central security depository services according to article 80 of CLF. In particular it performs both notary and central maintenance services with reference to all financial instrument admitted into the system.

In addition it provides ancillary services related to those core services, such as initiating the processing of corporate action, with reference to: dividend and interests payments, capital redemption, exercise of warrants or option rights, securities conversions (both on mandatory and voluntary basis), general meeting and other information services related to the exercise of shareholders’ rights.

Monte Titoli also offers withholding tax reclamation services relating to foreign securities held by Monte Titoli’s participants and deposited with cross border CSDs.

7. **Does the SSS act as a central counterparty or principal to transactions with its participants? Other? Please specify.**

Monte Titoli never acts as a central counterparty or principal to transactions with its participants. According to the Joint Regulation on Market Infrastructure (art. 9) an SSS may only have a participation in CCPs.
D. What type of organisation is the SSS?

1. Please indicate whether the SSS is a public sector or private sector entity.

2. Please indicate whether the SSS is organised on a for-profit or a non-profit basis.

Monte Titoli is a private company incorporated in Italy and subject to both company law provisions provided by Italian Civil Code and other specific requirements for the system operator lay down by CLF and the related enacting provisions. It is organised on a for-profit basis.

3. What is the legal basis for the establishment of the SSS and for securities transfers made through it?

The relevant legal bases are:

Decree No. 58 of 24 February 1998 Consolidated Law on Finance (CLF) provides for the legal recognition and description of clearing and settlement services of transaction involving financial instruments other than derivatives (art. 69) and for the general discipline of central depository activity in relation to financial instrument (art. 80 and sbq.);

Joint Regulation on Financial Market Infrastructures (Rules governing Central Depositories, Settlement Services, Guarantee Systems and Related Management Companies, 22nd February, 2008 and subsequent amendments) enacts general principle set buy CLF and includes specific provisions regarding operators, functioning of the system and their supervision by the competent authorities.

Legislative Decree No. 210 of 12th April 2001 Implementation of Directive 98/26/EC on the Finality of Orders Entered into a Payment or Securities Settlement System;

CSD Rules and Instructions issued by Monte Titoli and approved by Bank of Italy and CONSOB pursuant to article 81 of CLF;

Operating Rules of the Settlement System and Instructions issued by Monte Titoli and approved by Bank of Italy and CONSOB pursuant to article 46 of the Joint Regulation.
E. Please describe and provide a diagram outlining the organisational and ownership structure of the SSS.

Monte Titoli organisational structure comprehends the following units with the specified main tasks in respective area of business:

**Product Development:** new products and services offer; fee schedule proposal and pricing definition; existing services and products enhancement following clients' requests or new needs, service gaps, regulation changes or increased competition, margin improvement and risks minimization;

**Project Management:** management relating to new product services and to product requirements enhancement, implementation and supervision; technical compliance verification during the implementation phase; business continuity on mission critical services;

**Operations:** management of custody and settlement services, focusing on minimizing operational and regulatory risks; customer services for operational management; escalation and crisis management;

**Client Support & Membership:** management of legal contracts for each services with clients; maintenance, preparation and distribution of statistical data related to membership of clients; support to clients about products, services and their problems and/or questions; training and educational services for all services offered website content management and client communication management.

1. Who are the owners of the SSS?

Monte Titoli is currently owned by:

- Borsa Italiana (part of London Stock Exchange Group) (98.804%)
- foreign central securities depositories, investment firms and others (1.96%).

2. What entity or entities operate the SSS? Which functions of the SSS, if any, are outsourced to third parties?

As specified above the settlement and custody systems are operated by a single authorized operator i.e. Monte Titoli, in its quality of management company. IT (Information Technology) processes for custody and settlement services are outsourced to SIA S.p.A., the financial and payment services provider, whilst IT processes for value added services are outsourced to Borsa Italiana S.p.A.. Monte Titoli retains ownership of all software.
3. Does the SSS have a Board of Directors?

   a. What is its composition?

   The Board of Directors is composed of a number of 9 members. The members of the Board of Directors are appointed in accordance with Italian Corporate law, by the shareholders’ general meeting every three years.

   b. What are its responsibilities?

   In general terms the tasks and duty of the Board of Directors is to manage the company in order to perform the operations necessary to achieve the company’s purpose.

   Based on the information received, the Board will assess the adequacy of the organizational, administrative and accounting structure of society, when processed, examines the strategic, industrial and financial companies, currency, based on the report of the executive bodies, the general performance.

   The Board determines the content, limits and possible ways of the delegation of executive powers and can always issue instructions to the delegates and advocating self transactions falling within the delegation. In particular functions are delegated by Monte Titoli BoD to the Chairman, the Deputy Chairman and the General Manager.

   Directors shall ensure that the organizational, administrative and accounting is appropriate to the nature and size of the company and report to the Board of Directors and the auditors, at the intervals specified in its rules and in any case at least every six months on overall operating performance and its outlook and on the most important, because of their size or characteristics, made by the company and its subsidiaries.

   Directors are required to act in an informed manner, each director may request the executive bodies in the board are provided information about the company's management.

   Moreover According to the Italian Civil Code (ICC), directors of a joint stock company may be held liable for damages occurred as a consequence of the breach of their duties towards the company, its creditors or any company's shareholder and/or any third party, directly damaged by the concerned directors’ improper management activities.
Finally according to article 80, persons performing director, management and control functions are subject to the integrity, professionalism and independence requirements of established by the Minister of the Economy and Finance\textsuperscript{5}.

Those requirements are subject to the assessment by the company and then verified by authorities on the basis of information provided. For this purpose Monte Titoli sends a copy of the minutes of meetings in which the competent bodies conduct the assessment. The resolution must be analytical and therefore mention the grounds on which the assessments were based. In particular, the minutes must show, for each person concerned, the documents and criteria taken into consideration in order to attest in particular the compliance with independence requirements established by the law.

The Bank of Italy and CONSOB may require alleging documentation proving that the requirements are satisfied and that no causes for suspension from office or impediments to the holding of office exist.

\textbf{F. Please describe the financial resources of the SSS.}

1. \textbf{Amount of paid-in capital and retained earnings?}

According to article 10 of the Joint Regulation the minimum paid-up and existing capital of central depositories that also performs securities settlement shall be €12.5 million. Anyway CSD companies must have capital and financial resources capable of preserving their stability and proportionate to their operations and size.

For this purpose at the end of 2011 paid-in capital and retained earnings amounted approximately Euro to 56,500,000,00 MIO.

2. \textbf{Guarantees, insurance coverage or other similar arrangements? Credit lines or letters of credit?}

In order to compensate for damage caused on a wilful or negligent basis to investors when carrying out their activities, article 11 of the Join Regulation requires Monte Titoli

\textsuperscript{5} Please refer to decree n. 471/1998 providing for Regulations for the identification of integrity and professionalism requirements for directors of management companies of regulated markets and central depositories systems as well as the integrity requirements of shareholders.
1. to establish a special guarantee fund different from the legal reserve and made-up of non-earmarked provisions. Such provisions shall be made up until the fund amounts to half of the share capital. Currently this special guarantee reserve has an amount approximately of Euro 8,000,000 MIO.

2. **Take out appropriate policies with one or more insurance companies.**

3. **Powers to assess participants or equity holders?**

According to art. 12 and 46 of the Joint Regulation Monte Titoli verifies the eligibility of intermediaries and issuers on the basis of their capability to interact with Monte Titoli exclusively through electronic networks.

Monte Titoli has no power to assess equity holders, however they are subject to integrity requirements identified by the Ministry of Finance. The direct or indirect purchase and disposal of major shareholding, must be disclosed by the acquirer to CONSOB, the Bank of Italy and Monte Titoli within twenty-four hours, together with documents confirming the acquirer’s possession of the requirements.

In addition Monte Titoli notifies Bank of Italy and CONSOB without delay of every change to the company share register and annually makes public the updated company share register.

**G. Please describe whether the SSS or its operator is subject to authorisation, supervision or oversight by an external authority.**

According to both article 69 of CLF and 44 of the Joint Regulation the SSS is subject to the authorisation and supervision by Bank of Italy in agreement with CONSOB.

Nevertheless is should be considered that according to article 41 of the Joint Regulation the authorization to manage settlement services may be granted only to a company that carries on the activity of central securities depository or to a

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6 Please refer to decree n. 471/1998 providing for Regulations for the identification of integrity and professionalism requirements for directors of management companies of regulated markets and central depositories systems as well as the integrity requirements of shareholders
company that is controlled, singly or jointly, by organizations carrying on central depository activity.

Consequently Monte Titoli is also authorised to manage Central Security Depository System according to article 80 of CLF. In this case the authorisation and supervision activity is lead by CONSOB in agreement with the Bank of Italy.

As concerns supervision on the SSS, article 77 of CLF endorses the so-called functional approach. Consequently Bank of Italy has supervisory powers for what concerns stability and systemic risk containment, while CONSOB oversees transparency and investor protection. To this end, the Bank of Italy and CONSOB may require system managers and intermediaries to provide information and records, periodically or otherwise, concerning the clearing, settlement and guarantee of transactions and may carry out inspections. The authorities may also require Monte Titoli to adopt specific measures to ensure the orderly, secure, continuous and efficient functioning of the central depository and settlement services.

In cases of necessity and as a matter of urgency, Bank of Italy shall adopt appropriate measures, including its acting in the place of Monte Titoli.
II. Rules and procedures of the SSS

This chapter deals with structures and processes for taking decisions that are at the core of Monte Titoli corporate governance.

The questions below focus broadly on how participants can obtain copies of the SSS’s rules and procedures, how participants can provide input to the rules and procedures, how they are notified of changes, the applicability of the rules and procedures to the SSS as well as its participants, and the circumstances under which the rules and procedures can be overridden. Taken together, the questions are intended to provide participants with an understanding of the role that the system’s rules and procedures play within the operation of the SSS.

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A. Does the SSS maintain a complete list of the rules and procedures governing the rights and obligations of participants and the duties of the SSS?

1. How can participants obtain a copy of the rules and procedures?

Updated versions of the rules and procedures are available on Monte Titoli website, section “Download area”.

2. Does other documentation provided to participants (e.g. user guides) have the same status as the rules and procedures?

All documents expressly mentioned as annexes to the Rules or to the participation contracts are binding on participants and therefore each of them has to comply with all provisions contained therein.

Any other documentation (e.g. brochure describing services) is provided only for information purposes.

3. Describe the process for changing rules and procedures, including any need for regulatory approval.

   a. What authority is required and how does this differ depending on the type of change involved?

The procedure to approve the Rules and their subsequent amendments is established by CLF and the Joint Regulation.

Firstly, pursuant to article 7 of The Joint Regulation in case of amendments to Rules due to relevant changes in the functioning of the services and systems Monte Titoli consults with users in order to assess the impact of the initiatives and the appropriateness of the functionalities supplied.

After the consultation phase, as required by article 68 of the Joint Regulation Monte Titoli notifies the draft amendments to Rules to the Bank of Italy and CONSOB at least 20 days before their formal approval by the Board of Director explaining the contents and purposes of the proposed changes.

Once the amendments have been passed by the Board of Directors, they are submitted for formal approval to the competent authorities, accompanied by the results of the consultation phase.

After the authorities have granted their approval Monte Titoli publishes the updated version of the Rules specifying the date of entry into force.

As for Instruction to the Rules they are only notified to the supervisory authorities once approved only by the chief executive officer.

b. How are participants notified of changes in rules and procedures?
Without prejudice to the consultation phase, participant are informed about changes in Rules by posting the text thereof on Monte Titoli website at least 15 (fifteen) calendar days before the effective date of the amendments. In such communication Monte Titoli specify the time within which participants may exercise the right of withdrawal. As a matter of urgency consequent upon measures adopted by the authorities or for duly explained technical or operational reasons the time may be reduced by a minimum of 5 (five) calendar days.

Moreover in case of changes to the Rules or Service Manuals, Monte Titoli sends an e-mail the same day of the notification of the changes through the website.

c. Is there a procedure for participants or others to comment on proposed rule changes?
In the consultation phase participants and main association of interested stakeholders are invited to provide comment on the proposed changes to Rules or services.
B. Are the rules and procedures binding on the SSS as well as its participants? Under what conditions and on whose authority can written rules and procedures be waived or suspended by the SSS?

The rules and procedures are binding between Monte Titoli and participants. Nevertheless, Monte Titoli may modify or supplement any provision of the Rules and of the participation contracts, including the Annexes, without prejudice to participants' right of withdrawal.

Moreover CONSOB and Bank of Italy have the power to require changes to Rules in order to ensure they are likely to achieve supervisory purposes.
III. Relationships with participants

This section addresses the nature of the relationships that the systems have with their participants. Different types of membership that are available, admission requirements, account structure of the SSS as well as the procedures for and consequences of terminating participation in the SSS. General limitations on SSS liability to participants are the subject of the final question in this section. These questions are obviously important in enabling participants to establish the magnitude of their exposures to different risks associated with the SSS.

Although these questions provide the basic framework of the relationship between participants and the SSS, many of the most important aspects of these relationships concern the resolution of failures to settle or events of default. Specific questions on these topics are discussed in Section VII.

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A. Please describe the types of membership offered by the SSS.

1. How do the types differ?

According to article 70-bis of CLF EU investment firm and banks authorised to provide investment services and activities may access settlement systems pursuant to article 69 of CLF in order to finalise or arrange the finalisation of transactions on financial instruments. In line with the CLF, Monte Titoli grants access to central security depository system and to settlement services according to non-discriminatory, transparent and objective criteria.

Operating Rules (article 4) provides for the list of entities admitted to Express II which includes:

- Italian, EU and non-EU banks, pursuant to article 1, paragraph 1 of Italian Legislative Decree 385/93;
- Italian investment firms (SIM) and EU and non-EU investment firms;
- Italian asset management companies (SGR) provided by article 1, paragraph 1 lett. h) of Legislative Decree 58/98, with the exception of the provisions of article 36 paragraph 2 of Legislative Decree 58/98;
- Stockbrokers entered in the single national roll provided for in article 201 of Legislative Decree 58/98;
- central banks;
- foreign entities offering services analogous to the centralized administration and settlement services and managing systems analogous to financial
instruments guarantee systems, as long as they are subject to supervisory measures equivalent to the ones provided in the Italian jurisdiction;

- entities managing the contracts guarantee systems referred to in art. 68, paragraph 1 of Legislative Decree 58/98;
- central depositories, companies managing settlement guarantee founds and central counterparties, to the limited extent of the activities indicated in article 69 paragraph 2 and 70 of Legislative Decree 58/98;
- financial intermediaries entered in the list provided for in article 106 of Legislative Decree 385/93, authorized to the activity provided for in article 1, paragraph 5, lett. a) and b) of Legislative Decree 58/98;
- Poste Italiane S.p.a.;
- Cassa Depositi e Prestiti
- Italian Ministry for Economy and Finance.

Monte Titoli offers direct membership to all eligible participants. Participation can be on own account or on behalf of third parties, using the corresponding securities accounts opened within the central securities depository system managed by Monte Titoli.

2. Within each membership category, are all participants subject to the same rules and procedures? Please describe important exceptions, including both differences in rules across participants and the rationale for these differences.

For the purpose of settlement services direct participant are subject to the all rules and procedures of the settlement system.

B. Can participants establish accounts for their customers’ assets that are segregated from their own asset accounts at the SSS?

1. If so, is this accomplished through a single omnibus customer account or through a multiplicity of accounts and/or sub-accounts?

2. Is the segregation optional or compulsory?

Upon request of participants Monte Titoli opens for each of them, distinct own accounts and third party accounts within its central security depository system. Each account shall be subdivided into as many sub-accounts as are the types of centralised financial instruments. This account structure is required by article 30 of the Joint Regulation in order to segregate third party and proprietary assets.
Third party accounts are “omnibus” as in this this accounts intermediaries may collectively hold assets of all their clients. Indeed segregation between clients asset of the same intermediary is not required within the security depository system as it is a duty of the intermediary as referred to in article 32 of the Joint Regulation.

Nevertheless participants to Express II who act as settlement agents may open, for this purpose, one or more securities third party account dedicated to activities of each client (or group of clients) according to their needs.

Monte Titoli records in each account all transfers that occur. These accounts may not present debit balances.

3. Does the fact that a sub-account at the SSS bears the name of a third party give any rights to that third party as a participant under the rules of the system?

Direct participants who hold the account within the system, is fully responsible for fulfil the obligation deriving from settlement. Therefore even in case where the sub-account bears the name of intermediary’s client such circumstance gives him no rights as participant.

C. Please describe participant requirements for each type of membership.

1. Are participants required to be domiciled or resident in a particular jurisdiction?

No, they are not. Anyway according to the general rules on provision of investment and banking services, EU investment firms and banks provide services under passport regime while non EU-participant have to be authorized by CONSOB or by Bank of Italy in order to offer services and ancillary activities in Italy.

2. Are participants required to be subject to a supervisory regime? If so, please describe.

The categories of intermediaries eligible for participation in the System for settlement purposes (banks, investment firms, stockbrokers, other securities settlement systems) are all subject to a supervisory regime. Italian banks and Italian subsidiaries of non-EU banks based in Italy are supervised by the Bank of Italy. Italian investment firms and subsidiaries of non-EU investment firms are
supervised by the Bank of Italy together with CONSOB. Stock brokers are supervised by CONSOB. EU participants (including Italian subsidiaries and other securities settlement systems) are supervised by the supervisory authority of their home country.

3. Are participants required to hold an equity stake in the SSS?

No, they are not.

4. Are there financial, economic, personal or other requirements (e.g. minimum capital requirements, "fit and proper" tests)? If so, please describe.

Express II participants are requested to fulfil on a continuative basis the following operational requirements:

- have a securities account at Monte Titoli and/or at central securities depositaries through which financial instruments can be settled;
- for cash settlement in euro, have accounts in the TARGET2 System, or use an agent bank;
- for cash settlement in currencies other than the euro, have a specific account at Monte Titoli or banks authorised in Italy or EU banks with which Monte Titoli has stipulated a specific agreement, or use an agent bank;
- use the X-TRM service, or use daily matching and routing systems managed by third parties;
- use the protocols and technical standards prepared by Monte Titoli for the dispatch of communications concerning transactions to be settled.

In order to participate in net settlement service, participants must also participate in gross settlement service.

Regarding participation to the CSD Rules provide for the following operational requirements as well.

As mentioned above, all eligible participants are entities subject to the supervision of the competent authorities. Consequently they have to comply with specific requirements provided for such entities as well as with the ones deriving from their participation to the SSS.
D. Does the SSS engage in oversight of its participants to ensure that their actions are in accordance with its rules and procedures? If so, please describe.

Participants shall notify, in the manner and within the time limits specified in the Instructions, compliance with the above mentioned requirements as well as any change in or temporary non-compliance with such requirements.

Monte Titoli performs all necessary controls (administrative and electronic) to ensure its participants’ adherence to established rules and procedures. If necessary, Monte Titoli informs CONSOB and Bank of Italy of any participants’ actions not in accordance with its rules and procedures which have led or may lead to malfunctioning or delays in the execution of services.

As far as telecommunications and systems standards are concerned, tests are carried out with participants before the launch of a new service or amendments to an existing one. Transactions not complying with standards are usually rejected however, exceptions to approved procedures and standards may be authorized by senior management on a case-by-case basis. As regards EXPRESS II, Monte Titoli is allowed to suspend from settlement services any participant who does not comply with the Operational Rules and other operating standards.

As regards centralised depository services, the eligibility of participants is verified considering their capability to comply with operating procedures and, in particular, to interact with Monte Titoli exclusively through electronic networks.

In case of continuous, serious violations on the part of a participant, Monte Titoli can exclude the participant from the systems.

E. Under what conditions can participants terminate their membership in the SSS? Does this mark the end of all liabilities of the participant? If not, please describe what liabilities could remain.

The participation contracts have an indefinite term. Consequently participants have the right to withdraw from the Contract at any time by sending a communication indicating the effective date of withdrawal at least 30 (thirty) calendar days before such date. Withdrawal does not exonerate the client, even in part, from the requirement to perform all the obligations entered into under the contract or indirectly deriving from the participation to the SSS.
F. Under what conditions can the SSS terminate a participant’s membership in the SSS?

Participation terminates automatically in the following cases:

- in the event of failure to pay fees within the prescribed time limits for more than 90 (ninety) calendar days;
- in cases of exclusion from the Service provided for in the Rules;
- in the case in which the performance of the Service ceases as a consequence of legislative or administrative measures.

Moreover pursuant to the Operating Rules, where the case may be, Monte Titoli exclude from the SSS:

- participants undergoing an insolvency procedure;
- participants no longer belonging to the categories listed in the Operating Rules;
- that, repeatedly, do not comply with the rules and procedures or that conduct themselves in ways incompatible with the normal and proper operation of the settlement systems.

An excluded participant may not enter new transactions in the Settlement system.

Bank of Italy and CONSOB, the daily matching and routing systems managed by third parties, the participants, the market management companies, the central counterparties, are immediately informed by Monte Titoli about any suspension or exclusion of participants from the settlement services.

G. Please describe the scope of the SSSs liability to participants, including the standard of liability (negligence, gross negligence, wilful misconduct, strict liability or other), the force major standard, and any limitation to the scope of liability of the SSS (e.g. indirect or consequential damages). Where are these liabilities and their limitations set out (e.g. in statute or contract)?

Monte Titoli’s liability and its limitation are set out in the participation contact as follows:

**Liability against participants.** The liability of Monte Titoli exist for any claim deriving from the participation contract, only for losses that are immediate and
direct consequence of gross negligence and wilful misconduct of Monte Titoli itself.

In this cases participants must send Monte Titoli a report within 10 (ten) calendar days, under penalty of foreclosure, from the day on which it became aware, or should have become aware using due diligence of the occurrence of a loss-producing event it deems should be indemnified. Failure to respect such time limit shall entail lapse of the participant rights in this regard. The report shall contain a precise indication of the time at which the loss-producing event occurred, the circumstances under which it occurred and an assessment of the loss produced. The related supporting documentation, including in relation to the size of the loss incurred and consequent claim, must be received within 20 (twenty) calendar days of the expiration of the time limit referred to above.

**Liability against third parties.** Without prejudice to any liability that the Monte Titoli may have to the participants, they shall hereby hold Monte Titoli harmless, in the event of claims for damages consequent upon actions by third parties, including other participants, from any claim made in relation to deeds or actions inherent in the performance of the services provided.

**Exclusion of Liability.** No liability for Monte Titoli shall exist for non-performance of obligations deriving from the provided services if such non-performance is due to events beyond its control, including, but not limited to causes of force majeure (war, earthquake, floods etc.); national or local strikes (including at company level); electrical outages or interruptions and/or malfunctioning of electronic data carrier services due to faults in data transmission lines provided third parties; impediments or obstacles caused by legislative or administrative measures or judicial acts.
IV. Relationships with other SSSs and commercial intermediaries

This chapter contains relevant information as regards relationships or linkages between SSSs and other intermediaries who performs functional services. Disclosure of such information would be essential for participants to fully evaluate the associated risks. The appraisal of risks may differ depending on whether the linkage allows only free deliveries or whether cash accounts at the two SSSs are also involved.

***

A. Does the SSS maintain linkages (including sub-custodian or cash correspondent relationships) or other relationships with other SSSs?

1. Please identify each of the other SSSs used and the type of securities transferred via the linkages.
   a. What is the name of the other SSS? Where is it located?

   Monte Titoli has in place the linkages with the following national SSS:

   - Clearstream Banking Frankfurt (Germany)
   - Euroclear France  (France)
   - OeKB (Austria)
   - Iberclear (Spain)
   - SIX SIS (Switzerland)
   - DTCC (United States of America)
   - EUROCLEAR UK & Ireland (United Kingdom and Northern Ireland)

   In addition it is linked with two European ICSDs:

   - Clearstream Banking Luxembourg (Luxemburg)
   - Euroclear Bank (Belgium)

   b. What securities are eligible for transfer via the linkage to the other SSS?

   All securities (held in fungible form) eligible to be deposited at Monte Titoli and the other SSSs can be transferred via the links.
c. Are transfers of securities made via the linkage to the other SSS limited to only those that are free of payment or are transfers against payment also made via the linkage to the other SSS? If against payment, please describe the timing of the transfers and the corresponding payments.

In general Monte Titoli’s Cross-border Settlement Service provides for both DvP and FoP settlement of transactions. Currently DvP settlement of transactions is provided only through links with CBL, and Euroclear Bank, CBF, SIX SIS and Euroclear UK & Ireland.

This Service requires Monte Titoli to operate within linked settlement systems, on behalf of its participants. To this end transactions are entered into the foreign system following the pre-positioning and pre-funding, i.e. the verification of the availability of the financial instruments on the securities account that the selling participant holds at Monte Titoli, or the availability of cash on the TARGET 2 account of the purchasing participant or of its agent bank.

The transactions are routed to the Cross-Border System for their settlement:

- in case of both DVP and FOP deliveries disposed through X-TRM upon capturing of the instruction. In case of unavailability of the balance on the accounts, the transaction will be put on hold and re-processed daily until the end-of-validity date;
- in case of FOP securities deliveries disposed through a RNI message, upon capturing of the instruction, in case of “on sight” transactions, or upon the expiry date in case of “deferred settlement date”. In case of unavailability of the balance on the accounts, the transaction will be put on hold until the closing of the accounting day during which the transaction is processed;
- in case of DVP securities disposed through X-TRM, on the ISD, the instructions with a deferred ISD will be put on hold upon capturing by Monte Titoli.

Detailed procedures and timing of transfer and corresponding payments are specified with reference to each link in the relevant operating documents available on Monte Titoli website (under cross-border section).

d. Does the other SSS provide custody services to the SSS and, if so, who bears any credit or custody risk?

At domestic level no other CSD provides custody services to Monte Titoli.
On the other hand, with reference to cross-border settlement services Monte Titoli acts as an investor CSD and therefore it bears “custody risk” for securities held on behalf of its participants in the foreign CSDs.

B. Does the SSS use securities custodians (other than the other SSSs addressed in the previous question) and/or commercial cash correspondents? Please identify the custodians or cash correspondents used and the duties that each performs.

Monte Titoli uses Citi as a technical account operator ("sponsor") for custody, securities settlement and cash settlement purposes in its link with Euroclear UK & Ireland. At the current stage it does not use other securities custodians for any existing link.

C. Please describe the standards used in approving or reviewing relationships with other SSSs, custodians or cash correspondents, including any financial or operational requirements or the presence of insurance or public supervision.

In the past Monte Titoli agreements with other linked CSD were stipulated following the "ECSDA Model Agreement Between the European Central Securities Depositories."

Currently most of those agreements have been replaced by the "General Terms and Conditions" (GTC), as following further legal analysis, it is believed that the new contractual scheme suits better the purpose of establish a legal framework as regards "standard access" link where Monte Titoli participate in another SSS as any other participant (i.e. as a securities account holder).

Any link agreement shall be notified to Bank of Italy and CONSOB together with plans, a specific risk analysis, a description of control measures and, where appropriate, of the customised participation procedures.

Subsequent amendments to those agreements and to risk control procedures must be transmitted to the Bank of Italy and CONSOB that any time may require changes to projects for links, risk control measures and the related contracts.
D. Does the SSS advance funds or securities to or on behalf of other intermediaries such as issuing or paying agents? If so, please identify the circumstances in which such exposure could arise.

Currently, Monte Titoli never provides funds or securities to or on behalf of other intermediaries. Anyway article 42 of the Joint Regulation allows for Monte Titoli to grant loans, including intraday loans, in euros and foreign currencies, and of financial instruments, to be granted to persons admitted to the settlement services on the basis of adequate guarantees and with the aim of allowing such persons to settle their respective positions.

E. Please describe measures in place to protect the SSS and its members against the failure of other SSSs or commercial intermediaries to meet obligations to the SSS, including risk controls, collateral or alternative sources of funds and securities.

Monte Titoli enters into agreements only with those EU SSSs who are included in the list of eligible systems for the use of EU securities settlement systems in ESCB credit operations.

As regards non-EU SSSs, Monte Titoli verifies if they comply with similar standards and if they are subject to supervisory rules similar to the ones regarding Monte Titoli.
V. Securities transfers, funds transfers and linkages between transfers

This section begins by focusing on the process, if any, for matching settlement instructions prior to beginning the settlement process itself. The mechanism of securities and funds transfers are then addressed, including the issue of where cash transfers associated with securities transfers at the SSS take place. The following questions also address the circumstances under which the SSS extends credit to participants as an aspect of providing funds transfer capability at the SSS. The questions then explore the timing of processing within the SSS and the type of DVP model adopted by the SSS. DVP is a mechanism which ensures that final delivery occurs if and only if final payment occurs, which eliminates principal risk and contributes to reductions in liquidity risk.

The issues which arise in the practical implementation of DVP mainly concern the finality of the securities transfers and the funds transfers which together constitute the DVP settlement. Transfers are final if they are both irrevocable and unconditional. A transfer is irrevocable when the parties to it can no longer revoke their instructions and it becomes unconditional when there are no longer any circumstances that could cause the SSS to unwind it. If transfers are provisional at the time of processing, even if DVP is achieved, the risk remains that transfers may have to be unwound later if finality cannot be achieved.

If not properly recognised and controlled, this "finality risk" could have systemic effects. Members of SSSs are often provided with immediate availability of securities received, even if the transfer is not final. If these members then sell the securities again, or make them available to custodial clients, and the original transfer is subsequently unwound, additional transfers by the member or the member's clients may also have to be unwound, spreading the impact of the unwind to unrelated parties. It could also ultimately lead to losses to be shared among participants. For these reasons, the questions below attempt to clarify precisely the circumstances under which transfers become final.

The questions also address the provision of settlement guarantees by the SSS.

***
A. Please discuss whether and how settlement instructions are matched between participants prior to processing by the SSS.

1. Is matching required for all transactions without exception?

According to Operating Rules matching is required for all DVP transfers without exception while it is optional for FOP transfers.

For this purpose Monte Titoli manages a daily matching and routing system named X-TRM. Mainly it allows for acquisition, matching and routing of transactions to Express II net and gross settlement services or to foreign settlement systems. X-TRM guarantees the correspondence of information related to the same transaction (confirmation) and performs a series of controls that are needed in order to send settlement instructions to the above mentioned systems.

Usually transactions entered by markets connected to X-TRM are already matched as those systems are based on electronic trading systems, which carry out the automatic trade confirmation.

As for guaranteed transactions X-TRM calculates securities and cash bilateral balances when this requested by the central counterparties in accordance with the provisions set forth in their agreements.

X-TRM also provides for the correction of transactions, which allows the users to change or cancel transactions entered as well as the automatic updates of transactions deriving from corporate actions.

Unmatched transactions are automatically cancelled.

X-TRM provides participants with complete information on the status of their transactions. Some information will be provided automatically while other upon request of the participants themselves, as specified in the operating instructions related to the service.

2. What procedure is used when instructions do not match?

The X-TRM service automatically cancels all transactions that are not matched on the intended settlement date. In such cases, X-TRM marks the operations to indicate that it was cancelled automatically by the system.
3. Are matched settlement instructions binding on participants?
   
a. If so, please describe the consequences of failure by participants to meet obligations (e.g. forced settlement, penalties, and short positions).
   
b. Please describe whether this is a feature of the SSS’s rules and procedures or of national law or regulations.

Matched transactions are binding on participants but bilateral cancellation is allowed for OTC trades.

The trades unsettled at the ISD are considered fails. Fails occurring in the net cycles are forwarded to the real time gross settlement procedure in order to attempt their settlement. If it is not possible to settle transactions, the procedure removes them and resubmits them for settlement the following days until the validity date, defined by participants for OTC transactions, within the limits established by MT, or by the organized trading venue or by the CCP.

When the validity date expires, fails are excluded from the settlement system and returned to participant, to the trading venue or to the CCP. As regards guaranteed or non guaranteed market trades, fails are subject to buy in/sell-out procedure automatically activated by the CCP or initiated on request of the non defaulting party. Fails on OTC transactions are managed bilaterally.

Moreover pursuant to art. 47 of the Joint Regulation the SSS operator shall require participants to make the financial instruments and cash needed to settle their own obligation in the services promptly available, to facilitate the orderly functioning of settlement services. To this end Monte Titoli implemented the following settlement discipline measures:

- **Penalties for the late payment of the cash balance in the daylight net cycle (since 2007):** these apply when an Express II participant does not cover the net debit cash balance after one hour from the receipt of Express II report. The penalty is consist of a fee that varies on the basis of the frequency and length of the delay plus an interest fee calculated applying a rate to the net debit cash balance;

- **Penalties on failed transactions (since 2011):** these are applied on all securities position not covered at the end of the RTGS cycle regardless the intended settlement date. Penalties are calculated with reference to each settlement account and for each ISIN on the securities balance counter value related to whole amount of unsettled transactions. Penalties collected from failing participants are redistributed to their counterparties who hold net credit securities position on ISIN considered to calculate penalties.
c. Please provide a time line indicating the points at which matched instructions become binding, as well as any pre-matching process that takes place.

Articles 14 and 33 of the Operating Rules govern the moments of irrevocability and of transactions to be settled in both the net and the gross settlement systems.

The Rules provide for transactions to be irrevocable at different moments depending on their origin: market or OTC; guaranteed or not guaranteed. These moments are summarised in the table below.

<table>
<thead>
<tr>
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<th>Irrevocability for the purposes of the settlement system</th>
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<tbody>
<tr>
<td>Non-guaranteed</td>
<td>Entry into XTRM (T)</td>
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<tr>
<td>market trades</td>
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<tr>
<td>Non-guaranteed</td>
<td>Entry into Express II (L-1)</td>
</tr>
<tr>
<td>OTC trades</td>
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<tr>
<td>Guaranteed trades</td>
<td>Entry into Express II (L-1)</td>
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</table>

For non-guaranteed trades concluded on organised markets, irrevocability starts from the moment such transactions are entered into XTRM so as to give certainty to market trades (and to the prices formed on the markets), whose cancellation is governed in detail by the Market Rules. In the interval between the moment of irrevocability (entry into XTRM) and the moment of finality transactions may be cancelled in the event of a market or judicial insolvency.

For non-guaranteed OTC transactions, the moment of irrevocability coincides with the moment of finality and starts from the moment such transactions are entered into the settlement system.

For trades guaranteed by a counterparty, the moment of irrevocability for the purposes of the settlement system coincides with the moment of finality and starts from the moment such transactions are entered into the settlement system.

It is possible for these transactions to have previously acquired irrevocable or final status for the purposes of the clearing and guarantee system in accordance with
the operating rules of the central counterparty system (in the case of CC&G, they are irrevocable and final from the moment the transactions are concluded on the market).

Starting from the moment of irrevocability, transactions are binding and participants are required to settle, without the possibility of exemptions resulting from any underlying relationships with the subject on behalf of which they are settling, with the exception of a declaration of insolvency, including the market insolvency, of that third party.

Currently the discipline of irrevocability moment as defined above is under review in order to anticipate this moment for OTC transactions as their entry in to the X-TRM service.

**B. Are securities transferred within the SSS registered?**

No they are not. As Monte Titoli is not a registrar it is not involved in the registration process. However it provides for the “registration” of financial instruments in the form of book-entries in the securities accounts maintained in the name of issuers or intermediaries within the Central Securities Depository System managed by Monte Titoli.

1. **Who is the registrar?**

In Italy registrar functions, such as shareholder register and corporate action processing, are mainly performed by the issuer who has the duty to hold and update the shareholders’ register.

Moreover for securities held in book-entry form in the central depository system, the CSD may offers services related to corporate action processing.

2. **Is it normal practice to register the securities in the name of the SSS (or its nominee) or in the name of the beneficial owner? Are there instances in which securities housed within the SSS are registered to neither the SSS (nor its nominee) nor the beneficial owner?**

All financial instruments admitted to the SSS are registered in intermediaries’ account.

3. **If the SSS offers custodial services, will it hold securities registered in the name of the beneficial owner?**

No, Monte Titoli always holds securities on behalf of its participants.
4. Under what circumstances does the SSS initiate registration of securities in the buyer's name?

5. How long does the registration process typically take? Are participants notified when registration is complete?

At the end of the securities settlement process, or following accounting transfers ordered by the intermediaries, Monte Titoli notifies the intermediaries of the account entries made. As soon as they receive such notifications the intermediaries make the necessary entries in their accounts.

After such registration, the ultimate account holder shall legitimately have full and exclusive exercise of rights pertaining to the financial instruments registered on that account and may dispose of them.

6. Can securities be transferred within the SSS before registration in the buyer's name is complete? If so, do the rules and procedures of the SSS provide for an unwind or reversal of such transfers in case of bankruptcy or other events which result in the buyer's name not being entered on the register?

Securities could be transferred only after registration as discussed above.

C. Please describe how securities transfers are processed within the SSS.

Express II settlement system includes two integrated settlement phases: the netting settlement phase that is divided into the overnight and daytime net cycle and the RTGS phase.

Overnight cycle (by 7:00 a.m. of the settlement date). First, the net settlement process calculates the multilateral securities (by type of securities and for each securities account held by the participant) and the multilateral cash (by currency, for each cash account held by the participant or agent bank) balances. Then the optimisation mechanism is performed in order to identify trades that could not be settled according to criteria set out in the Operating Rules. At the end of roll-back operations the final multilateral balances on trades eligible for settlement are calculated. Finally, securities payable are settled on the participants’ accounts, transferring the securities to a technical securities account for clearing. Following such transfer the net settlement process activates cash settlement via electronic transmission to the TARGET2 system, according to timetables provided by the rules governing the TARGET2 system of a specific request to transfer cash.
including both debit and credit movements. The TARGET2 system transfers cash from the participants' accounts with debit positions to a technical cash account registered in the name of the SSS, and, subsequently, credits cash to the participants’ accounts with a credit position, debiting the technical account for clearing. Contextually, the net settlement process settles multilateral balances of securities receivable debiting the technical securities account for clearing to which the securities were previously transferred. At the end of the aforementioned operations, on basis of Monte Titoli instruction, the TARGET2 system releases the unused liquidity reserve previously created by participants.

**Daytime net cycle** *(9.30 am – 1.00 pm)*. In this cycle transactions not settled during the overnight cycle are processed. The net settlement cycle calculates multilateral balances and, on an iterative basis, and until the cut-off time, checks the availability of the securities accounts of participants delivering securities, transferring securities made available by the participants on a technical securities account. At the cut-off time, the net settlement process activates the roll-back procedure. At the end of roll-back processing, the net settlement system calculates multilateral cash balances and sends the Bank of Italy the request for settlement of cash amounts payable to the accounts opened by TARGET2 system participants. Balances for which there are insufficient funds in the participants’ accounts are put in the TARGET2 system's stand-by list. If, at the cut-off time for cash settlement, one or more balances remain on the stand-by list, they are removed from the TARGET2 system's queues. Subsequently, the net settlement process activates the roll-back procedure, applying the same criteria as those established for the overnight cycle. At the end of roll-back transactions, the net settlement process performs the final calculation of multilateral balances of transactions eligible for settlement and determines any returns of securities and/or cash through the relevant technical accounts. Finally the securities, previously set aside on the technical securities account for clearing, are credited to collecting participants' securities accounts with Monte Titoli or with other central securities depositories. At the same time, the net settlement process concludes settlement via transmission to the TARGET2 system of the request to credit cash to collecting participants’ accounts, debiting the technical cash account registered in the name of the Settlement system.

Transactions not settled as at the end of the daytime cycle are submitted to the RTGS phase.
RTGS phase (from 8:00 a.m. to 6:00 p.m.). DVP and FOP securities transfers processed through the gross settlement component of EXPRESS II that is executed in real time. RTGS checks the availability of the seller's securities account and, if the outcome is positive, places an accounting block equal to the negotiated quantity, until cash settlement has been completed. If the seller's securities account has insufficient availability, the transaction is conveyed to the queue-management system according to the relevant criteria. Cash settlement for transactions in euro is performed using the accounts opened by participants or agent banks at the TARGET2 system. Once the relevant securities have been blocked in the seller's securities account, gross settlement activates the cash settlement process via electronic dispatch of a specific request. If there is insufficient availability in the accounts, the transaction is routed to the TARGET2 stand-by lists. If the transaction is cancelled from the TARGET2 system's stand-by lists, gross settlement deletes the transaction and removes the block previously put on the seller's securities account. A FOP transaction that does not involve cash settlement is settled by debiting the seller's securities account and crediting the buyer's securities account, without being sent to the TARGET2 system.

1. Please indicate whether the transfers are processed as debits and credits to members' accounts or via some other method.

Securities transfers are processed as debits and credits to members' accounts.

2. On a continuous (real-time) basis, or in one or more batches?

Please refer to V.C above.

3. If continuous, during what hours does the process occur? If in batches, at what time or times is the process initiated and completed?

Please refer to V.C above.

4. Do securities settlements occur daily? Please identify securities for which settlement occurs only on specific days of the week or month.

DVP transfers processed through the DVP-RTGS component of EXPRESS II and FOP securities transfers are executed immediately upon receipt of valid instructions by Monte Titoli.

Within the EXPRESS II net cycles, Monte Titoli settles securities transactions daily.
D. Please describe whether final funds transfers in conjunction with the SSS are made as debits and credits to balances held at the SSS, at one or more commercial banks, at the central bank; or via some other method.

Final funds transfers are made in central bank money, through the TARGET 2-Bank of Italy system.

1. Does the SSS maintain cash accounts for its participants? Are these accounts equivalent to deposit accounts at a commercial or central bank or do they serve only as "cash memorandum" accounts?

For the time being, Monte Titoli does not maintain cash accounts for its participants to the domestic settlement services.

2. On what entity (SSS or other) does the participant bear cash deposit risk?

Since the custodian of cash accounts is the central bank, participants do not bear any cash deposit risk.

As regards EXPRESS II, neither Monte Titoli nor its participants will bear any cash deposit risk as funds transfers will be made in central bank money. The agent bank may bear cash deposit risk for settlement participants on behalf of which the act as agent.

3. Under what circumstances does the SSS provide credit extensions or advances of funds to its participants and thereby expose itself to credit risk?

4. How long can such credit extensions last? How long do they typically last?

Monte Titoli does not provide either credit extensions or advances of funds to its participants.

E. Is the SSS a DVP system? If so, please describe the DVP used according to the models outlined in the DVP Report Please also provide a diagram indicating the timing of events in the process of securities and funds transfers in the SSS. Where the SSS provides more than one alternative for settlement processing, please provide a response for each alternative and indicate the relative importance of each alternative.
1. Are funds transfers and securities transfers processed within the same system or in different systems? If different how are they linked?
   a. Please describe whether each securities transfer is linked to a specific funds transfer on a trade-by-trade basis or on a net basis or via some other method.

Express II is interfaced with TARGET 2 system for processing funds transfers.

Regarding securities transfer processing, as described above, EXPRESS II is an integrated settlement system including three settlement phases (subsystems): two net cycles (overnight and daytime) and one gross settlement phase.

The net component of Express II is based on model 3 DVP standard, providing net multilateral settlement of both cash and securities. Consequently transfers of net balances in securities are linked to a specific fund transfer calculated on net bilateral position.

RTGS settlement follows model 1DVP standard, so each funds transfer is linked to a securities transfer on gross basis.

b. Does the SSS "split" large transactions into multiple transactions or require participants to do so?

Unsettled large transactions (i.e. that are equal or bigger than certain threshold) are split by Express II at the end of the second netting cycle into multiple transactions and then forwarded to RTGS.

2. When do securities transfers and funds transfers become final?
   a. At what time do securities transfers become final? After what event or events?
   b. Does this timing allow for same-day retransfer of funds received in exchange for securities?

Decree n. 210/2001 implementing Finality Directive, provides that “transfer orders” and netting shall be legally enforceable and binding on third parties even in the event of insolvency proceedings against a participant, provided that transfer orders were entered into the system before the moment of opening of such insolvency proceedings. Therefore securities and funds transfer in execution of a final transfer order are always final.

Monte Titoli set the moment relevant for the purpose of finality of funds and securities transfers in the Operating Rules (articles 14 and 33). Consequently transfer orders to be settled within the net settlement cycle become final as of the start of the overnight net settlement cycle on the intended settlement date while
DISCLOSURE FRAMEWORK FOR SECURITIES SETTLEMENT SYSTEMS

transaction entered solely for the gross cycle are final once they are entered in the settlement system.

Once trades are settled, securities and cash balances are immediately available for subsequent deliveries or payments as soon as they are registered in the accounts of the receiving counterparty. For instance securities credited at the end of the overnight cycle are eligible for the subsequent settlement cycles.

c. If final delivery of securities precedes the final transfer of funds, can participants dispose freely of such securities prior to funds finality? If so, what actions will be taken if funds are not received?

The final delivery of securities does never precede the final transfer of funds.

d. If final delivery of funds precedes the final transfer of securities, can participants dispose freely of such funds prior to securities finality? If so, what actions will be taken if securities are not received?

Not applicable as within EXPRESS II funds and securities are segregated and they may not be available for disposal by participant prior to the settlement.

e. Does the timing of finality differ depending on the type of security transferred or the currency in which payment is to be made? Please describe.

Not applicable as the timing of finality does not differ depending on the type of security transferred and funds transfers may be made only in Euro through TARGET2 system.

3. Please discuss whether participants are notified of securities or funds transfers while they are still provisional, only when they are final, or both.

No provisional transfers are allowed within EXPRESS II.

Participants are notified in real-time of any change in their securities balances by EXPRESS II and in their cash balances by TARGET2.

At the end of each settlement day, Monte Titoli sends to its participants a statement reporting all movements carried out in their securities accounts as well as initial and final balances.

F. Does the SSS itself “guarantee” funds or securities transfers?

1. Under what circumstances and at what point are transfers guaranteed by the SSS?

2. What actions does the guarantee obligate the SSS to take?
3. Please indicate whether the guarantee is a feature of the SSS's rules and procedures or of national law or regulations.

Funds and securities transfers are never guaranteed by Monte Titoli.
VI. Default procedures

This section attempts to lay out in one place the available procedures of the SSS in the event of a default or other events that would trigger exceptional measures. The questions also address the possibility that securities or funds transfers will be unwound by the SSS.

***

A. Please discuss the events or circumstances that would constitute default of a participant under the rules and procedures of the SSS or that would lead the SSS to make use of exceptional settlement arrangements or unwind procedures.

1. Failure by a participant to meet a test of its solvency under the applicable laws of its jurisdiction?

According to Italian legal framework failure by a participant to meet solvency test is considered a default event for the purpose of the SSS in the following circumstances.

Judicial Insolvency. Pursuant to Italian Insolvency Law (“restoration or liquidation procedures”) a participant is declared bankrupt when an insolvency status occurs. Such condition is verified in case of failures or other external circumstances, demonstrating that the participant is no longer able to meet its obligations.

Market Insolvency. Article 72 of CLF provides for “market insolvency” procedure where by agreement with the Bank of Italy, CONSOB may declare market insolvency of parties admitted for trading on regulated markets and in multilateral trading systems and of participants in the central counterparty systems.

Market insolvency is caused by serious failures or by other external circumstances that demonstrate the inability of the trader, settlement agent or participant in central counterparties system.

Monte Titoli excludes participants who are subject to those insolvency proceedings and performs the unwinding of trades pertaining to them.
2. Failure to make payments or deliveries of securities within the time specified?

In our regulatory framework participant’s failure to make payments or delivery on time does not constitute a default event but this is considered critical for contingency liquidity issues that are addressed through fails management’s procedure in place within the SSS.

3. To the extent that the rules and procedures grant discretion in the determination of the use of default or other exceptional procedures, please discuss where the authority to exercise such discretion resides and the circumstances in which this authority would be used.

Judicial or market insolvency is declared by the competent authority not discretionary basis but following the ascertainment of assumptions provided by the law.

Since this declaration, default procedures are automatically triggered and should be managed according to provisions on insolvency proceeding included either in Insolvency law or in CLF and its enacting regulation. Therefore the operator of the SSS has no discretion in order to use such procedure or other exceptional measure. In those circumstances the operator has to strictly comply with disposition made by competent authority. Notably in case of market insolvency the liquidation procedure is managed by a commissioner designated for this purpose. For contracts stipulated in regulated markets or on MTF, or that are guaranteed by a CCP the procedure could be carried out by the respective management companies.

B. What procedures are followed by the SSS once it has determined that a default event has occurred or that exceptional settlement arrangements are to be employed?

Following a declaration of judicial or market insolvency, the SSS manages transactions pertaining to the insolvent participant according to default procedures according to finality provision and to the Joint Regulation.

Consequently transactions not yet final are subject to unwinding procedures, while the system attempts to settle final transaction until the end of the day on which insolvency is declared. If those trades could not be settled due to lack of the necessary cash or securities they are excluded from the system.
1. How and at what point participants are notified that this has occurred?
Participants in EXPRESS II and TARGET 2 are immediately notified by Monte Titoli and Bank of Italy, respectively, of any problem occurring in the settlement process.

2. Would the SSS be expected to continue to meet all its obligations to participants under these circumstances? Please discuss the resources in place to ensure that this would occur (e.g. collateral, participants' fund, insurance, loss-sharing arrangements, etc.).

3. Please describe and provide a time line indicating the order in which these resources would be used as well as the timing of participant notifications and important deadlines (e.g. when the SSS's obligations to participants would be met, when participants would need to cover their loss-sharing obligations).
Not applicable as Monte Titoli has no obligation to participants in case of a default event. Indeed unsettled transactions, due to lack of securities or funds, are cancelled within the time limits set in the Operating Rules.

4. Please describe all conditions under which irrevocable transfers of securities or funds could be unwound by the SSS.
As specified above, transfers of funds and securities are never irrevocable as a consequence of finality granted to the correspondent transfer order entered in the settlement system.

Unwinding of irrevocable transfer orders is provided anytime they are entered in the settlement system after an insolvency procedure is activated against a participant unless they are settled on the same day and the SSS operator demonstrates that he was not aware of the pending procedure.

a. How and on what authority would a decision to unwind securities or funds transfers be made by the SSS?
As provided in the Joint Regulation and in the Operating Rules of Express II, the unwinding procedure is automatically activated as soon as the competent authorities notify the opening of insolvency procedure against a participant to the SSS.

b. When and how would participants be notified of a decision to unwind provisional securities or funds transfers?
Participants are notified of the unwinding procedure in real time.
c. How long would participants have to cover any debit positions in their own securities or funds accounts resulting from an unwind?

Participant have to cover debit position until the defined cut-off time that could be modified by Monte Titoli taking into account to the amount of position to be covered.

d. In the event of an unwind, would all transfers be unwound or would only a subset of transfers (e.g. only securities purchases or only those of a subset of participants) be unwound?

All unsettled trades pertaining to a defaulting participant are unwound.

e. If only a subset of transfers, what procedure would be followed to determine which transfers and in what order?

Not applicable.

5. Can bankruptcy or insolvency be declared retrospectively in the SSS’s jurisdiction (e.g. under a “zero-hour” rule), and could this cause provisional securities or funds transfers to be unwound?

The finality of both payments and securities transfers performed through designated systems is ensured by the law implementing in Italy the Settlement Finality Directive.

In particular according to article 4(2) of the decree n. 210/2001 the opening of insolvency proceedings has no effect retrospectively on the rights and obligations of participants connected with their participation in a system, which arose before the time of opening of such proceedings.

Express II was designated as a “system” for the purpose of provision of finality of order transfer in October 2003 while the centralised administration system managed by Monte Titoli was designated in June 2004 as regards free of payment transfers of securities.

6. Please describe any circumstances in which transfers of securities or funds that were defined as final in response to question V. E.2 above would ever be unwound.

Article 82 of Joint Regulation provides that following the declaration of insolvency the SSS shall exclude, in accordance with the operating rules of such services, the transactions entered by the defaulting participant that cannot be settled for lack of the necessary cash or financial instruments.
Consequently the Operating Rules provides that final transaction could be unwound from the SSS only in case they are not settled at the end of the day of the declaration of insolvency.

C. Has a participant in the SSS ever been declared in default or become insolvent?

Yes.

1. Have loss-sharing procedures been invoked?
Not applicable as Monte Titoli is never involved in the insolvency procedure given that unsettled trades of defaulting participant are unwound. Loss-sharing procedures are provided according to CCP or market rules.

2. Please describe whether any of these defaults or insolvencies resulted in losses for the SSS or its participants and how they were absorbed.
Monte Titoli never suffer any losses from the defaults and insolvencies of its participants. Any losses incurred by participant are managed bilaterally out of the settlement system.
VII. Securities overdrafts, securities lending and back-to-back transactions

This section focuses on several related issues that can arise in conjunction with these procedures.

The first set of questions in this section relates to the possibility of debit positions in participants' securities accounts at the SSS. Because such positions indicate instances where participants have been allowed to transfer securities that they do not have on deposit at the SSS, they clearly involve substantial risk that the SSS may not be able to obtain the actual securities and complete all necessary settlements.

The existence of a securities lending program at the SSS and the conditions under which securities loans are triggered is another important topic covered by the questions in this section. Participants need to understand both when the SSS will arrange for securities to be lent to them and when securities they hold on deposit at the SSS will be made available for lending to others. The existence and terms of a securities lending program may also have implications for the SSS's ability to facilitate settlements in a variety of circumstances, particularly for back-to-back transactions.

The final questions in this section attempt to clarify the risks entailed by back-to-back transaction. These practices involve a pair of transactions that require a counterparty to receive and redeliver the same securities on the same day. They have the major advantage of avoiding unnecessary funding costs by the party buying and selling the securities.

This practice poses no particular risk when the delivery follows an actual final receipt of the securities, as there is then no risk that this receipt would have to be unwound. Especially in the cross-border context, differences in the timing of settlement cycles or of finality have led to the development of practices whereby SSSs in some circumstances allow on-deliveries under back-to-back transactions before the initial securities receipts are final, in effect extending temporary (often intraday) securities loans.

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A. Is it possible for debit positions (overdrafts) in securities accounts at the SSS to arise?

Monte Titoli does not allow debit positions (overdrafts) in any participant’s account.

In EXPRESS II, debit positions in securities accounts are prevented by the system itself since multilateral net balances are settled by value date only when the seller has sufficient holdings in its securities account at Monte Titoli. Debit instructions in securities are processed by Monte Titoli only if the full amount of securities is available in the accounts at the time of settlement.

Within EXPRESS II, to cope with temporary unavailability of securities, during the night cycles of the net component the procedure offers:

- an automatic securities lending procedure;
- an automatic collateralisation mechanism that allows the participants to receive intra-day financing from Bank of Italy on its TARGET2 account;
- a roll-back facility that optimises the settlement process identifying and skipping trades that cannot be settled due to lack of securities or cash;
- during the daylight cycle of the net component, the procedure offers securities lending and roll-back facilities;
- during the DVP-RTGS component, the procedure reprocesses the transfer orders up to the end of the settlement process.

1. Under what conditions could such debit positions occur?

   a. Do these conditions always result in debit positions in securities accounts rather than failed transactions? If not, please explain the basis for differential treatment by the SSS.
b. Are these situations covered explicitly by the rules and procedures of the SSS?

2. How long such debit can positions last? How long do they typically last?

3. How are debit positions in securities accounts prevented, rectified or managed?

4. What procedures would be followed by the SSS in case the debit cannot be rectified? (e.g. failure by a participant with a debit balance in a securities account or unavailability of the securities in the market).
   a. Application of loss-sharing provisions allocating the loss to participants?
   b. Absorption of the loss by the SSS?
   c. Other? Please specify.

Questions from no. 1 to no.4 are not applicable as debit positions in securities account are never allowed as described before.

**B. Under what circumstances does the SSS provide for the lending of securities to ensure settlements?**

Within EXPRESS II, Monte Titoli provides a securities lending facility, as agent, to support the settlement process during both the overnight cycle and the daylight cycle. During both cycles, the securities lending service is activated in the case of a securities fail. The service generates requests that are added to the group of transactions to be settled at the end of the respective cycle.

At the end of the cycle, multilateral balances are recalculated and once again compared with participants’ availability. In the absence of fail situations, the transactions are sent for settlement.

1. Is the process for lending securities automatic. If not, please describe the procedures used by the SSS to determine whether a securities loan will be made.

The security lending procedure automatically generates requests for loans equal to the size of the fails identified on the basis of:

- instructions given by lenders;
- the list of counterparties established by participants;
- availability of the securities on the lenders’ accounts, net of deliveries to be made in the cycle and of securities receivable coming from the same settlement cycle.
2. At what point are participants notified that securities are being lent to them in order to complete their settlements?

As regards the overnight securities lending program, participants are notified early in the morning, when all reports relating to the night cycle are sent to them; with reference to the daylight securities lending facility, they are immediately notified that securities are being lent to them.

3. Which securities on deposit at the SSS are eligible for lending? Do participants have the option to make securities available for lending or is it mandatory?

In principle, all securities deposited with the System are eligible for lending. Some securities may be excluded from the service: (i) some bonds with anticipated maturity date (or maturing during or at the end of the lending period) (ii) other securities identified by the Markets.

Participants are not obliged to make securities available for lending.

4. Are lent securities identified by the SSS with specific participants as lenders or only with a common pool of securities available for lending? Does the participant whose securities are lent become a principal to the transaction?

Lent securities are identified with specific participants as lenders. The participant whose securities are lent becomes a principal to the transaction.

C. How does the SSS settle back-to-back transactions?

Given that EXPRESS II is a multilateral netting procedure, back-to-back transactions are settled by the System as any other transaction. A mini-netting procedure for the gross basis settlement system is provided to allow the netting of cash positions and ease the execution of transactions involving central counterparties.

Monte Titoli is developing optimisation functionality to manage back-to-back OTC transaction within RTGS cycle.

1. Under what conditions are delivery instructions by participants receiving and redelivering securities on the same day under back-to-back transactions settled for same-day value?
a. Only if the participant has securities on deposit with the SSS that have been received pursuant to a final securities transfer?

b. If the participant has securities on deposit with the SSS that have been received pursuant to a provisional securities transfer?

c. Before securities have been received either provisionally or finally, but when a matched receipt instruction exists for the same or greater value? Is such a practice limited to markets where matching is binding?

d. Before securities have been received either provisionally or finally, but when a third party has promised to deliver to the SSS securities of the same or greater value? Must the provider of the guarantee have itself received the securities through a final transfer? Please describe how the SSS evaluates such promises, and whether they are addressed by the written rules and procedures of the SSS.

e. Other? Please specify.

2. Please describe limits or controls in place with respect to any of the above arrangements for the settlement of back-to-back transactions, including limits on amounts involved or related to the liquidity of the underlying securities.

Questions from no.1 to 3 are not applicable as back-to-back transactions are processed as any other transaction within the securities settlement system.

3. Under what conditions are payment instructions by participants in the SSS under back-to-back transactions settled for same-day value? Can participants use the proceeds of an undelivery of securities without the need for an extension of credit?

As described above back-to-back transactions are processed as any other transactions within settlement system. Nevertheless Express II provides for a interconnection with Bank of Italy collateralisation facilities that allow participant to obtain credit extension during the overnight cycle.

The automatic collateralisation facilities can be activated only on securities and/or accounts notified to Monte Titoli by participants (as self- collateralisation or firm collateralisation). If automatic collateralisation facilities have been activated, the securities are transferred from the participants' own accounts and/or from the technical account for collateral to the Bank of Italy's and/or Monte Titoli’s collateral accounts, with a procedure and timing such as to assure the granting of financing.
VIII. Risk control measures

This section of the disclosure framework is intended to provide a description of the risk management systems employed by the SSS. Sound risk management encompasses a number of aspects, including assessment of risks and senior management and Board of Directors input into the risk management process particularly with respect to the review of new products and services by the SSS. Internal and external audits as well as supervisory oversight can also play a vital role in ensuring that the risk management approach is sound and implemented with integrity.

A range of different risks can arise in conjunction with the different services that SSSs may provide. For example, in the course of providing settlement services, the SSS may become exposed to credit, custody or liquidity risks if it either explicitly or implicitly extends funds credit or lends securities to participants. In the provision of custody services, the SSS may take on credit risk if it extends funds to or on behalf of third parties. The questions also address several other provisions or tools that may be helpful to SSSs in managing or containing the different risks that they face, but are not meant to exhaust all the possible approaches that SSSs may employ.

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A. Please describe the roles and responsibilities of those areas of the SSS responsible for risk management and control.

1. Please describe the process for the internal review of risk management policies and procedures.

The internal audit system, in its complex structure, is the cornerstone of the risk containing measures in place at various corporate levels, in order to deal effectively with the risks to which Monte Titoli is exposed in the course of its business and reduce them to a level deemed reasonable by top management. The internal audit system is implemented through a number of operational and organizational measures that are intended to ensure the quality and integrity of data and processes to support services and achieve efficiency levels in line with international standards and best practice.
After having identified the risks typical of its own industry in relation to the applicable legislation and regulations as well as to the technological and information technology structures and after evaluating their impact on the company’s processes and objectives, Monte Titoli adopted a series of specific measures aimed at ensuring optimal provision of the services and the necessary segregation of functions with reference to management of potential conflicts of interest and monitoring of operational risk.

The Monte Titoli adopted a risk management system which ensures for top management that the company have implemented a system capable of controlling and mitigating risks to which such companies are exposed and which could hinder the achievement of business objectives.

In particular, the process ensures that the risks identified at the business unit level are reported with an indication of the parties responsible for each risk, the assessment of the risks in terms of impact and likelihood, the measures implemented for the reduction/mitigation thereof and the relevant contact persons.

2. Is there a risk management policy that addresses the review and approval of new products and services offered by the SSSs? At what level of the organisation is risk management approval given for a new product or service?

The decision to launch a new service is taken by Monte Titoli’s Board of Directors. For the services that have significant impacts and, consequently, have an high inherent risk, the development of a new service or product is reviewed by Italy Internal Audit during all its phases until the go live.

3. Does the SSS have a risk management function with clear independence from and authority over operational or marketing functions?

Yes. Risk management function is part of the Group Audit/Risk Department and is independent from any operational or marketing function.

4. Does the Board of Directors review risk management policies and procedures? Does the Board have a risk management or audit committee?

The Board of Directors reviews risks relating to new products and strategic services, as applicable. The Audit and Risk Committee reviews all the risk management policies and procedures.

B. Please describe any internal or external audits or supervisory/regulatory examinations that are performed with respect
to the SSS. For each such audit or examination, please address the following question.

1. Who performs the audit or examination?

2. What is the scope of the audit or examination?
   a. Please indicate whether and how it addresses the sufficiency of and compliance with internal controls.
   b. Please indicate whether and how it addresses the SSS’s compliance with its own rules and procedures.

Audits and examinations are performed by three bodies: the Italy Internal Audit function, the External Auditors and the Statutory Auditors Board. This last is a controlling authority whose activities and responsibilities are described below.

The Italy Internal Audit function undertakes periodic reviews of the main activities and processes that are carried out by Monte Titoli following a risk-based approach. This function is independent from line management and reports directly to the Board. It is required to evaluate the effectiveness of the internal controls and Monte Titoli’s compliance with these controls and external and internal regulations, including how risks are assessed and managed. The internal audit function performs audits on the basis of an annual plan which is approved by the Audit and Risk Committee and Monte Titoli’s Board of Directors. The audit planning process is based on an assessment of the inherent risks of the business and designed to provide assurance on a 3-year cycle, with areas of high inherent risk subject to audit review on an 18-24 month interval and areas of medium inherent risk subject to review on a 24-36 month interval, depending on the velocity of risks within the business area. Also, the audit plan includes the requirements/expectations from the Company’s Regulators. Audit reports prepared by the internal audit function are for the use of Monte Titoli management and are made available for review by External Auditors, the Statutory Auditors Committee, Bank of Italy and CONSOB upon request.

The internal auditing function performs periodic reviews in accordance with the Audit Plan, which includes the annual mandatory IT audit in compliance with the Joint Regulation. The internal auditing mainly evaluates:

- the efficiency and effectiveness of the internal controls system in Monte Titoli, as well as compliance with such controls;
- compliance of all Monte Titoli’s activities and services with external regulations and internal policies and procedures;
the integrity of Monte Titoli’s data and Information Systems including Business Continuity and Disaster Recovery.

External audits are performed according to Italian regulatory provisions and the Accounting Principles issued by the Italian Certified Public Accountants Association. Their scope includes the company’s financial statements as well as the adequacy and sufficiency of the internal controls.

The Statutory Auditors’ activities are regulated by law. They perform periodic checks and examinations to ensure that the company is meeting both the regulatory legal and fiscal requirements as well as the objectives established by the Board of Directors. They are also responsible for ascertaining the existence of an efficient and effective internal controls system. Monte Titoli’s Statutory Auditors attend the meetings of the Board of Directors.

3. What is the frequency of the audit or examination?

The statutory review of financial statements is done by the external auditors on an annual basis. Quarterly reviews are also carried out to cover such topics as the adequacy of internal procedures concerning fiscal requirements, the updating of mandatory books and the preparation of financial provisional statements.

Internal Audit function prepares an annual audit plan for the approval of the Audit and Risk Committee and the Board of Directors.

Furthermore, on an annual basis Bank of Italy and CONSOB require to perform an audit of the Information Technology infrastructures supporting the SSS activities as described above.

The Statutory Auditors perform their reviews on a periodic basis (usually on a quarterly basis). They hold periodic meetings with the internal audit to monitor independent control activities and to be informed of major audit results. They also meet with the External Auditors and the relevant managers to be informed on any major issues that may have impact on Monte Titoli.

4. Are audit or examination reports available for review by participants?

Audit reports issue by Italy Internal Audit function are for internal use only and are not available for review by participants.
C. Please discuss whether the SSS has the capacity to value (i.e. mark to market) the securities that it holds.

Monte Titoli values (mark-to-market) all securities other than debt securities entered in to the centralised deposit.

1. Please describe how these valuations are used by risk control systems at the SSS.

The valuations are done for accounting, pricing, and financial control purposes only, as there are no risk management implications for Monte Titoli.

2. How frequently are securities revalued?

Securities are revalued on a daily basis.

3. What are the sources for security valuations?
   a. What outside price or data sources are used?
   b. If pricing models are used, please describe how the models are chosen and how the model inputs are obtained.

Shares and similar securities are valued according to market prices or, if not available, at nominal value, except for shares with no par value, priced at the conventional nominal value of € 1.00, and warrants and covered warrants awaiting quotation, priced at the conventional nominal value of € 0.30. Bonds, including Government bonds, and similar debt securities are valued at nominal value. For securities denominated in other currencies, the average balance is expressed in euros applying the official daily exchange rate.

D. Please discuss whether the SSS has a lien on the securities held in or transferred through it.

Monte Titoli does not have a lien on the securities held in or transferred through it.

E. Please discuss the circumstances in which the SSS requires collateral to limit or mitigate risks.

1. Does the SSS manage its own collateral system?

2. Does the SSS share a collateral system with another SSS or payment system?

Monte Titoli does not manage its own collateral system for the purposes of the settlement system. Nevertheless Express II directly interacts with TARGET 2
Bank of Italy system collateral facilities which entail no credit risks for Monte Titoli. They are could be activated during the overnight cycle and require for intermediaries to offer securities as collateral against intraday liquidity provided by the Bank of Italy.

The automatic collateralisation facilities can be activated only on securities and/or accounts notified to Monte Titoli by participants. Securities are posted as guarantee, in the order indicated below:

- securities already held in the participants' own accounts, net of deliveries to be made during the clearing cycle;
- securities receivable originating from the settlement cycle, intended for the own account and temporarily credited to a technical account as collateral.

In the latter case above, the securities used as collateral contribute to calculate the final multilateral balance.

3. Can collateral at the SSS be posted and returned on the same day?
Yes. Collateral is posted in the account that Bank of Italy holds in Monte Titoli at the end of the overnight settlement process of Express II (7 a.m.). Intermediaries will receive back their securities immediately after giving back cash received by Bank of Italy.

4. What types of transaction at the SSS involve the use of collateral?
Intermediaries are requested to provide collateral to receive intraday liquidity from Bank of Italy within the overnight cycle of Express II.

5. What are the policies with regard to the type of collateral used or haircuts required?
The policies adopted follow the same criteria implemented by the European System of Central Banks for the conduction of monetary policy operations.

6. How are collateral valuation methodologies developed and reviewed?
Monte Titoli is informed by Bank of Italy on the methodologies of collateral valuation to be adopted.

7. To what extent are collateral policies described in the written rules and procedures of the SSS?
Collateral policies are the ones adopted by the European System of Central Banks to carry out monetary policy.
F. Please describe the SSS use of limits on exposures to monitor or control risks.

1. Please explain the types of limit used and the exposures to which they apply.

2. Do the limits apply to all participants and/or to other SSSs with which the SSS is linked? What are the exceptions to the limits?

3. Do limits apply to participants individually or in the aggregate or both?

4. Do limits apply to implicit as well as explicit extensions of credit or securities (e.g. when on-deliveries of securities are pursuant to provisional but not final delivery of securities)?

5. Does the SSS automatically reject transactions that exceed limits or is compliance determined ex post?

6. How are limit policies developed and reviewed?

7. To what extent are limit policies described in the written rules and procedures of the SSS? Where does additional authority to set or amend limit policies reside?

Monte Titoli does not impose any limits on exposures because debit balances on participants’ securities accounts are not allowed. Limits are established and monitored by the agent banks in connection with EXPRESS II, by means of a facility provided by Monte Titoli (CAPS), managed by the agent banks.

G. Please describe other controls to mitigate or reduce risks at the SSS.

1. Does the SSS or its participants have the capacity to monitor participants’ accounts continuously during processing?

Any information about the transfers executed, as well as the balances of the participants’ securities accounts, are available to the System. Participants have the possibility to monitor their own accounts. Participants are notified of any change in their securities accounts in real time. Besides, they are given the opportunity to make an inquiry in real time to continuously monitoring their balances. In addition, supervisory authorities have the possibility to monitor the settlement process in real-time.
2. Is there a special risk control regime that the SSS would apply to a participant known to be experiencing financial difficulties?

No, Monte Titoli does not apply any special risk control regime to a participant known to be experiencing financial difficulties.

3. Does the SSS maintain or administer loss-sharing arrangements other than those applicable to events of default and addressed in Section VI above? Are these loss-sharing pools pre-funded by participants?

Not applicable as we explained in our response VI B.3 above.
IX. Operational risks

This chapter provides for a description of internal controls over the operations of the SSS. In particular it gives a view of the business continuity measures that address all the business functions and resources that the SSS would need to renew operations.

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A. Please provide assessments of the operational reliability of the computer and other systems used by the SSS, including any criteria that the SSS uses internally for this purpose.

1. What is the percentage uptime of the systems used by the SSS?
   a. Whole system overall?
   b. Broken down by major components? (e.g. communications network, central processing facility)
   c. During critical processing periods?

The system’s availability has been close to 99%.

Moreover Monte Titoli, provides its Information Systems with appropriate technical measures designed to guarantee the systems’ processing continuity ensuring: adequate back-up procedures, recovery and restart of operations within 40 minutes in case of temporary unavailability of the processing environment; restoration of data-handling processes within four hours from the time a disaster situation or event concerning the processing site has been declared.

In order to ensure the orderly and continuous performance of Settlement system, Monte Titoli provides continuous monitoring of the data processing cycles as well as a dedicated support service for participants to meet any information requirements.
2. Has the SSS experienced major operational problems during the past two years?

   a. Have settlements been delayed, been disrupted or otherwise failed because of operational problems during this period?
   b. Please describe the nature of any such problems.

   The system experienced two outages during the migration from host to open databases. Immediately after a stabilisation plan was implemented.

   **B. Please describe contingency or disaster recovery planning at the SSS.**

   All procedures, data-base and messages within the securities settlement procedure are duplicated. Therefore, operational risks are mitigated through back-up procedures. In case of failure of the primary system, the duplicated information may be used to ensure the smooth functioning of the system. However, when the failure involves the whole system, an off-site Disaster Recovery Plan (DRP) can be activated, ensuring the recovery of the information and restoring the operations of the system. The DRP provides for the utilization of a second mainframe computer where all Monte Titoli’s data, processed on the primary site, are duplicated on a real time basis.

   1. Does the SSS have a formal plan for business continuity in place?

   Yes, Monte Titoli has formal plan for business continuity. The Business Continuity Plan (BCP), approved by the Board of Directors and covering the management of the following possible crises scenarios: non-availability of a building housing critical offices or services, sudden lack of essential staff, sudden absence of outside services, attacks from outside or inside, major disaster.

   The BCP includes the Business Continuity and Contingency Plan (BCCP) dedicated to Monte Titoli’s IT systems both managed by Monte Titoli and outsourced to third parties.

   2. Is this plan available for review by participants?

   BCCP is an internal procedure and the information included are considered “confidential”.

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3. How often is this plan tested? Does this involve participants in the SSS?

The BCP is tested once a year whilst the Disaster Recovery plan is tested twice a year. DR’s test involve mainly the participation of the IT providers SIA and Borsa Italiana, Bank of Italy and Monte Titoli’s participants.

4. What are the major elements of the business continuity plan?

Monte Titoli’s BCP:

- classifies internal activities by their importance to the function performed;
- identifies, for each activity, the objectives and technical and organizational measures needed;
- provides for the allocation of sufficient resources to implement the plan;
- specifies the frequency and scope of checks;
- indicates the functions involved in tests, including suppliers;
- indicates the remedies adopted for services outsourced to providers;
- provides for a system for assessing the plan and identifying corrective measures;
- identifies possible interrelations with outside institutions, including cross-border activities.

The plan considers the possible crisis scenarios.

As regards the continuity of the Monte Titoli’s IT systems mentioned in the BCCP, there are specific policies and procedures for maintaining business continuity both from a prevention and from a remedial point of view.

5. How long would it take the SSS to resume operations if primary systems become unusable?

Monte Titoli can resume its operations within a maximum period of four hours.
C. What are the key feature of the internal controls covering operations and security at the SSS (e.g. change controls or those covering remote access)?

1. Please describe controls or security procedures in place to ensure that the SSS acts only on authentic settlement instructions from valid participants.

Internal controls to ensure that Monte Titoli acts only on authentic settlement instructions from valid participants are based on:

- the exchange of authentication keys and codes with participants for all electronic messages sent to and from Monte Titoli. Instructions sent by means of fax or letter are also authenticated by means of authentication codes as well as by accepting only authorised signatures;
- control features to identify errors/unauthorised parties are built in the electronic applications developed by and for Monte Titoli;
- a data security system based on passwords is in place to guarantee only authorised accesses to the system;
- protection devices in place to protect communication flows through the Internet (Firewall).

2. Are internal operational and security controls included in the internal and/or external audits of the SSS?

The adequacy of internal operational and security controls is included in both the internal and the external audits.

3. Are internal operational and security controls covered by regulatory requirements applicable to the SSS?

Yes, internal operational and security controls are provided by regulatory requirements applicable to Monte Titoli, pursuant to articles 4 and 75 of the Joint Regulation and the Guidelines for Business Continuity attached to the Joint Regulation. At least once a year Monte Titoli test the technological and IT structures of significance for the performance of their services, with special reference to the IT security measures put in place and the back-up and recovery procedures envisaged. Such testing could be conducted by third parties or else by internal units, provided they are different from and independent of production units. The results shall be notified to the Bank of Italy and CONSOB, together with the measures taken or to be taken by Monte Titoli to eliminate the problems found and the timetable for their implementation.
D. Does the SSS impose minimum operational or performance standards on third parties (e.g. communications providers)?

1. How does the SSS ensure that such standards are met on a continuing basis and what sanctions are available to the SSS if they are not?

2. How would the SSS allocate losses incurred due to operational problems caused by third parties?

Monte Titoli specifies the objectives assigned to outsourced functions in relation to their overall strategy, maintain knowledge and governance of the related processes and protect against the related risks. To this end Monte Titoli have access, including direct access, to outsourcers, to the important information concerning the outsourced activities, and assess the quality of the services provided and the adequacy of outsourcers’ organization and capital.

Moreover contracts with suppliers must specify guaranteed “service levels” in case of emergency and identify solutions that satisfy the SSS needs, consistent with the risk analysis scenario and operational objectives.

Losses incurred because of operational problems caused by third parties would be addressed on a case-by-case basis.
GLOSSARY

The following glossary of terms is not intended to provide legally precise definitions for all relevant terms but rather clarifying the usual meaning of various terms. This is intended as a tool to help in understanding the questions and the related responses.

**Back-to-back trades**: a pair of transactions that requires a counterparty to receive and redeliver the same securities on the same day. The transactions involved may be outright purchases and sales or collateral transactions (repurchase agreements or securities loans). For example, a securities dealer might buy and sell the same securities for the same settlement date in the course of making markets for customers or it might buy securities for inventory and finance the position through a repurchase agreement.

**Beneficial ownership/interest**: entitlement to receive some or all of the benefits of ownership of a security or financial instrument (e.g. income, voting rights, power to transfer). Beneficial ownership is usually distinguished from "legal ownership" of a security or financial instrument.

**Bilateral netting**: netting between two parties.

**Book-entry system**: an accounting system that permits the electronic transfer of securities without the movement of certificates.

**Bridge**: the "bridge" is the name commonly used for the link that permits cross-system settlement of a trade between a participant in one ICSD and a participant in the other ICSD.

**Cash correspondents**: banks (or similar institutions) used by the SSS to make or receive payments.

**Cash deposit risk**: the credit risk associated with the holding of funds with an intermediary for the purpose of settling securities transactions.

**Cash memorandum accounts**: records kept by the SSS of the funds due to be paid to or received by participants in conjunction with their securities settlements; the records are for information purposes only and do not represent legal claims or liabilities between the SSS and its participants.
Central securities depository (CSD): an institution for holding securities which enables securities transactions to be processed by means of book entries. Physical securities may be immobilised by the depository or securities may be dematerialised (so that they exist only as electronic records).

Certificate: the document which evidences the undertakings of an issuer of a security or financial instrument.

Chaining: a method used in certain settlement systems for processing transfers. It involves the manipulation of the order in which transfers are processed to increase the number or value of transfers that may be settled with available securities and funds balances (or available credit lines).

Clearance: the term "clearance" has two meanings in the securities markets. It may mean the process of calculating the mutual obligations of market participants, usually on a net basis, for the exchange of securities and money. It may also signify the process of transferring securities on the settlement date, and in this sense the term "clearing system" is sometimes used to refer to securities settlement systems. In this disclosure framework, the term is used only in the first sense.

Collateral: an asset or third-party commitment that is accepted by the collateral taker to secure an obligation of the collateral provider vis-à-vis the collateral taker.

Confirmation: the process by which a market participant notifies its customers of the details of a trade and allows the customer to positively affirm or question the trade.

Counterparty: one party to a trade.

Credit risk: the risk that a counterparty will not settle an obligation for full value, either when due or at any time thereafter. Credit risk includes replacement cost risk, principal risk and cash deposit risk.

Cross-border settlement: a settlement that takes place in a country other than the country in which one trade counterparty or both are located.

Custodian: an entity, often a bank, that safe keeps and administers securities for its customers and that may provide various other services, including clearance and settlement, cash management, foreign exchange and securities lending.
CUSTODY-ONLY LINK: a link between two SSSs which enables transactions in securities held in SSS1 to be settled using SSS2 (rather than SSS1) when the buyer and seller are both participants in SSS2. Custody-only links do not provide for the transfer of funds between SSS1 and SSS2 and cannot be used to settle transactions between a participant in SSS1 and a participant in SSS2.

CUSTODY RISK: the risk of loss of securities held in custody occasioned by the insolvency, negligence or fraudulent action of the custodian or of a sub-custodian.

CUSTOMER: a buyer, seller or holder of securities and financial instruments that does not participate directly in a system. A participant's holdings in a system often include securities and financial instruments of which the participant's customers are the beneficial owners.

DAYLIGHT CREDIT (or daylight overdraft, daylight exposure, intraday credit): credit extended for a period of less than one business day; in a credit transfer system with end-of-day final settlement, daylight credit is tacitly extended by a receiving participant which accepts and acts on a payment order, even though it will not receive final funds until the end of the business day.

DEBIT BALANCE: see net debit position.

DEFAULT: failure to complete a funds or securities transfer according to its terms for reasons that are not technical or temporary, usually as a result of bankruptcy. Default is usually distinguished from a "failed transaction".

DELIVERY: final transfer of a security or financial instrument.

DELIVERY VERSUS PAYMENT: a link between a securities transfer system and a funds transfer system that ensures that delivery occurs if, and only if, payment occurs.

DEMATÉRIALISATION: the elimination of physical certificates or documents of title which represent ownership of securities so that securities exist only as accounting records.

DEPOSITORY RECEIPT: an instrument issued in one country that establishes an entitlement to a security held in custody in another country.

DOMESTIC SETTLEMENT: a settlement that takes place in the country in which both counterparties to the trade are located.
**Domestic trade:** a trade between counterparties located in the same country.

**Failed transaction:** a securities transaction that does not settle on the contractual settlement date, usually because of technical or temporary difficulties.

**Finality risk:** the risk that a provisional transfer of funds or securities will be rescinded.

**Final transfer:** an irrevocable and unconditional transfer which affects a discharge of the obligation to make the transfer. The terms "delivery" and "payment" are each defined as a final transfer. See provisional transfer.

**Forced settlement:** securities or funds settlement that is either mandated or enforced by the actions of a third party.

**Global custodian:** a custodian that provides its customers with custody services in respect of securities traded and settled not only in the country in which the custodian is located but also in numerous other countries throughout the world.

**Gridlock:** a situation that can arise in a funds or securities transfer system in which the failure of some transfer instructions to be executed (because the necessary funds or securities balances are unavailable) prevents other instructions from being executed, with the cumulative result that a substantial number of transfers fail to be executed on the scheduled date.

**Gross settlement system:** a transfer system in which the settlement of funds or securities transfer instructions occurs individually (on an instruction-by-instruction basis).

**Haircut:** the difference between the market value of a security and its collateral value. The haircut is intended to protect a lender of funds or securities from losses owing to declines in collateral values.

**Immobilisation:** placement of certificated securities and financial instruments in a central securities depository to facilitate book-entry transfers.

**Internal settlement:** a settlement that is effected through transfers of securities and funds on the books of a single intermediary. An internal settlement requires both counterparties to maintain their securities and funds accounts with the same intermediary.
**International central securities depository** (ICSD): a central securities depository that settles trades in international securities and in various domestic securities, usually through direct or indirect (through local agents) links to local CSDs.

**Irrevocable transfer:** a transfer which cannot be revoked by the transferor.

**Issuer:** the entity that is obligated on a security or financial instrument.

**Issuing agent:** an institution that acts on behalf of the issuer of securities in distributing the securities and in realising the proceeds thereof for the benefit of the issuer.

**Legal ownership:** recognition in law as the owner of a security or financial instrument.

**Legal risk:** the risk of loss because of the unexpected application of a law or regulation or because a contract or other right cannot be enforced.

**Liquidity risk:** the risk that a counterparty will not settle an obligation for full value when due, but on some unspecified date thereafter.

**Local agent:** a custodian that provides custody services for securities traded and settled in the country in which it is located to trade counterparties and settlement intermediaries located in other countries (non-residents).

**Local custodian:** a custodian that provides custody services for securities traded and settled in the country in which the custodian is located. See global custodian.

**Loss-sharing agreement:** an agreement among participants in a clearing or settlement system regarding the allocation of any losses arising from the default of a participant in the system or of the system itself.

**Loss-sharing pools:** cash, securities or possibly other assets that are provided by the participants in advance and are held by the system to ensure that commitments arising from loss-sharing agreements can be met.

**Marking to market:** the practice of revaluing securities and financial instruments using current market prices. In some cases unsettled contracts to purchase and sell securities are marked to market and the counterparty with an as yet unrealised loss on the contract is required to transfer funds or securities equal to the value of the loss to the other counterparty. See variation margin.
Matching (or comparison, checking): the process for comparing the trade or settlement details provided by counterparties to ensure that they agree with respect to the terms of the transaction. Settlement instructions that have been successfully matched between counterparties are referred to as matched settlement instructions. In some securities settlement systems, penalties may apply to participants that unilaterally revoke matched settlement instructions. In other systems, unilateral revocation of matched settlement instructions may not be possible.

Member: in this disclosure framework, the term is used synonymously with participant. See participant.

Multilateral netting: netting among more than two parties. Net credit or net debit position: a participant's net credit or net debit position in funds or in a particular security is the sum of all the transfers it has received up to a particular time less the transfers it has sent; if this sum is positive, the participant is in a net credit position, if the sum is negative, it is in a net debit position. The net credit or net debit position at settlement time is called the net settlement position. These positions may be calculated on a bilateral or multilateral basis.

Net settlement: a settlement in which a number of transactions between or among counterparties are settled on a net basis.

Netting: an agreed offsetting of mutual positions or obligations by trading partners or participants in a system. The netting reduces a large number of individual positions or obligations to a smaller number of positions. Netting may take several forms which have varying degrees of legal enforceability in the event of default of one of the parties.

Nominee: a person or entity named by another to act on his behalf. A nominee is commonly used in a securities transaction to obtain registration and legal ownership of a security.

Obligation: a duty imposed by contract or law. It is also used to describe a security or financial instrument, such as a bond or promissory note, which contains the issuer's undertaking to pay the owner.

Omnibus customer account: an account in which the securities held by a participant on behalf of all (or at least several) of its customers are kept. See also proprietary account, segregation.
**Participant:** a party which participates in a system. This generic term refers to an institution which is identified by the system and is allowed to send transfer instructions directly to the system or which is directly bound by the rules governing that system.

**Paying agent:** an institution that, acting on behalf of an issuer, makes payments to holders of securities (e.g. payments of interest or principal).

**Payment:** the satisfaction and discharge of a monetary obligation by the debtor's final transfer of a claim on a party agreed to by the creditor. Typically, the party is a central bank or a commercial bank.

**Position netting:** the netting of instructions in respect of obligations between two or more parties which neither satisfies nor discharges those original obligations. (Also referred to as payment netting in the case of payment instructions.)

**Pre-matching process:** process for comparison of trade or settlement information between counterparties that occurs before other matching or comparison procedures. Generally, pre-matching does not bind counterparties as matching can do.

**Principal risk:** the risk that the seller of a security delivers a security but does not receive payment or that the buyer of a security makes payment but does not receive delivery. In this event, the full principal value of the securities or funds transferred is at risk.

**Proprietary account:** an account in which a participant holds only those securities it is holding on its own behalf (as opposed to those securities it is holding on behalf of its customers). See also omnibus customer account, segregation.

**Provisional transfer:** a conditional transfer in whom one or more parties retain the right by law or agreement to rescind the transfer.

**Real time:** the processing of instructions on an individual basis at the time they are received rather than at some later time.

**Registration:** the listing of ownership of securities in the records of the issuer. This task is often performed by an official registrar/transfer agent.

**Replacement cost risk:** the risk that a counterparty to an outstanding transaction for completion at a future date will fail to perform on the settlement date. This
failure may leave the solvent party with an unhedged or open market position or deny the solvent party unrealised gains on the position. The resulting exposure is the cost of replacing, at current market prices, the original transaction.

**Repurchase agreement (repo):** a contract to sell and subsequently repurchase securities at a specified date and price. Also known as an RP or buyback agreement.

**Rolling settlement:** a situation in which settlement of securities transactions takes place each day, the settlement of an individual transaction taking place a given number of days after the deal has been struck. This is in contrast to a situation in which settlement takes place only on certain days – for example, once a week or once a month - and the settlement of an individual transaction takes place on the next settlement day (or sometimes the next but one settlement day) following the day the deal is struck.

**Same-day funds:** money balances that the recipient has a right to transfer or withdraw from an account on the day of receipt.

**Securities borrowing and lending programme:** a facility whereby a loan of securities is made to facilitate timely fulfilment of settlement obligations.

**Securities depository:** see central securities depository (CSD).

**Securities settlement system (SSS):** a system in which the settlement of securities takes place. Often the SSS is a CSD.

**Segregation:** optional or compulsory separation of the securities held by a participant on its own behalf from those held on behalf of its customers. See also omnibus customer account, proprietary account.

**Self-collateralising:** an arrangement whereby securities being transferred can be used as collateral to secure risks involved in the transfer process.

**Settlement:** the completion of a transaction, wherein the seller transfers securities or financial instruments to the buyer and the buyer transfers money to the seller.

**Settlement date:** the date on which the parties to a securities transaction agree that settlement is to take place. The intended date is sometimes referred to as the contractual settlement date.
**Settlement interval**: the amount of time that elapses between the trade date (T) and the settlement date (S). Typically measured relative to the trade date, e.g. if three days elapse, the settlement interval is T+3.

**Settlement risk**: general term used to designate the risk that settlement in a transfer system will not take place as expected. This risk may comprise both credit and liquidity risk.

**Sub-custodian**: where one custodian (e.g. a global custodian) holds its securities through another custodian (e.g. a local custodian), the latter is known as a sub-custodian.

**Substitution**: the process of amending a contract between two parties so that a third party is interposed as an intermediary creditor/debtor between the two parties and the original contract between the two parties is satisfied and discharged.

**Systemic risk**: the risk that the inability of one institution to meet its obligations when due will cause other institutions to be unable to meet their obligations when due.

**Trade date**: the date on which a trade/bargain is executed.

**Trade-for-trade (gross) settlement**: a settlement in which a number of transactions between counterparties are settled individually.

**Trade matching**: see matching.

**Trade netting**: a legally enforceable consolidation and offsetting of individual trades into net amounts of securities and money due between trading partners or among members of a clearing system. A netting of trades which is not legally enforceable is a position netting.

**Transfer**: an act which transmits or creates an interest in a security, a financial instrument or money.

**Unwind**: a procedure followed in certain clearing and settlement systems in which transfers of securities and funds are settled on a net basis, at the end of the processing cycle, with all transfers provisional until all participants have discharged their settlement obligations. If a participant fails to settle, some or all of the provisional transfers involving that participant are deleted from the system and the settlement obligations from the remaining transfers are then recalculated.
Such a procedure has the effect of allocating liquidity pressures and losses from the failure to settle to the counterparties of the participant that fails to settle. Unwinds can be distinguished from debits to securities accounts that do not imply the original transfer is rescinded (e.g. in cases where securities are discovered to be forged or stolen).

**Variation margin**: the amount which is paid by a counterparty to reduce replacement cost exposures resulting from changes in market prices, following the revaluation of securities or financial instruments that are the subject of unsettled trades.

**Zero-hour rule**: a provision in the insolvency law of some countries whereby a bankruptcy or similar procedure declared by a court during the day is considered to have been declared at 0.00 a.m. of the same day. This generally has the effect of retroactively rendering ineffective all transactions of the closed institution that have taken place after 0.00 a.m. on that date.