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# **Summary report of the targeted consultation on the review of the Directive on financial collateral arrangements**

**12 February 2021 - 7 May 2021**

**This document provides a factual overview of the contributions to the targeted consultation on the review of the Directive on financial collateral arrangements that took place from 12 February to 7 May 2021. The content of this document should not be regarded as an official statement of the position of the European Commission on the subject matters covered. It does not prejudge any feedback received in the context of other consultation activities.**

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## 1. INTRODUCTION

### 1.1. The Financial Collateral Directive (FCD)

The Financial Collateral Directive<sup>1</sup> (FCD) was adopted on 6 June 2002. It introduced a harmonised framework for the use of financial collateral to secure transactions. By doing so, it helped facilitate the cross-border use of financial collateral. Prior to the FCD, only collateral security provided to a central bank or in connection with participation in a payment or securities settlement system covered by the Settlement Finality Directive<sup>2</sup> (SFD) (SFD system) was protected by EU law in the event of the insolvency of the collateral giver. A more comprehensive approach covering OTC transactions was deemed necessary because divergent national rules applicable to financial collateral were frequently impractical and often untransparent, resulting in uncertainty as to the effectiveness and enforceability of ‘financial collateral arrangements’.

The FCD protects collateral takers by ensuring that financial collateral arrangements can be mobilised and are realisable without delay due to national formalities; and providing for close-out netting provisions to be enforceable in accordance to their terms and ring-fencing the operation of financial collateral arrangements should one of the parties become insolvent. Where applicable, these protections may constitute exceptions to the principles of equal treatment of creditors upon the opening of insolvency proceedings and universality of insolvency proceedings. In such a way, they help to avoid systemic contagion risks throughout the EU. The FCD does not fully harmonise national laws applicable to financial collateral arrangements but partially harmonises certain provisions whilst disapplying others. By doing so, the FCD aims to remove barriers to the timely cross-border creation and operation of collateral arrangements.

### 1.2. The targeted consultation

Article 12a of the SFD requires the Commission to report on the SFD by 28 June 2021. To this end, the Commission is reviewing the SFD. Since the FCD is closely related to the SFD, it was decided to review the FCD in parallel.

For the FCD to continue to serve its purpose, it is important to consider developments that could affect its functioning and to ensure coherence across legislative frameworks. Relevant issues can arise from market developments (economic, financial or technological) and/or regulatory changes.

Two issues dealt with in this consultation are also important for the SFD: recognition of ‘close-out netting provisions’ and ‘financial collateral’ (‘cash’ and ‘financial instruments’ are the two most commonly used forms of ‘collateral security’ under the SFD). The Commission does not intend to deal with the (re-) use of financial collateral given under ‘security financial collateral arrangement’ by the collateral taker in this review because it was recently addressed in the Securities Financing Transactions Regulation<sup>3</sup> (SFTR), which provided for improved transparency and monitoring. As reporting under the SFTR only started in July 2020, it is too early to draw any conclusions.

To support the review, the Commission conducted a targeted consultation<sup>4</sup> between 12 February 2021 and 7 May 2021, in parallel to a targeted consultation on the SFD. It covered the following areas: scope of the FCD; provision of cash and financial

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<sup>1</sup> [Directive 2002/47/EC \(OJ L 168, 27.6.2002, p. 43\).](#)

<sup>2</sup> [Directive 98/26/EC \(OJ L 166, 11.6.1998, p. 45\).](#)

<sup>3</sup> [Regulation \(EU\) 2015/2365 \(OJ L 337, 23.12.2015, p. 1\).](#)

<sup>4</sup> See: [https://ec.europa.eu/info/consultations/finance-2021-financial-collateral-review\\_en](https://ec.europa.eu/info/consultations/finance-2021-financial-collateral-review_en)

instruments under the FCD; ‘awareness’ of (pre-) insolvency proceedings; recognition ‘close-out netting provisions’ in the FCD and its impact on SFD systems; financial collateral; the FCD and other Regulations/Directives; and other issues.

The Commission received 27 responses to the targeted consultation and thanks all respondents for their contributions.

### 1.3. Methodology of this feedback statement

This feedback statement provides a factual overview of the contributions received. The detailed stakeholder responses are available on the dedicated Commission webpage<sup>5</sup>. Any positions expressed in this feedback statement reflect the contributions received and not the position of the European Commission and its services. This feedback statement takes into account the following:

- As shown in section 2.1.5, the number of responses received varied considerably depending on the question. Some stakeholders focused on specific topics and did not answer all questions. Where no reply was provided, the stakeholder was considered together with those who indicated “don't know/no opinion”.
- For some questions, a relative low number of replies was received, limiting the representativeness of the results. The number of replies received is indicated at the beginning of each section.
- Some replies had identical wording, even though different stakeholders submitted them.
- Some stakeholders corrected their replies after the deadline for submission. This feedback statement takes into account the corrected replies.
- Some stakeholders explained that they ticked the option ‘other’ only to be able to access the free text field to explain in more detail their opinion, but that their preference was for another option. In such cases, this feedback statement takes into account the option indicated in the explanations.

## 2. OVERVIEW OF RESPONDENTS AND RESPONSES

### 2.1. Who responded?

#### 2.1.1. Types of entities

In total, 27 stakeholders replied. **The majority of responses (82%<sup>6</sup>) came from business associations and firms.** In addition, responses were received from 3 public authorities and 2 academic/research institutions<sup>7</sup>. **No consumer organisation or citizen responded** to the targeted consultation.

**Table 1: Types of entity replying**

Replying as	
Business association	14

<sup>5</sup> They were published on 18 June 2021 under: [https://ec.europa.eu/info/consultations/finance-2021-financial-collateral-review\\_en](https://ec.europa.eu/info/consultations/finance-2021-financial-collateral-review_en)

<sup>6</sup> Indicated percentages in this text are rounded for the ease of readability.

<sup>7</sup> Two respondents categorised themselves as “other”. However, due to the nature of their activities, one is listed here as “public authority” and the other as “business association”.

Company/business organisation	8
Public authority	3
Academic/research institution	2
<b>Total respondents</b>	<b>27</b>

### 2.1.2. Field of activity<sup>8</sup>

Among the companies and business associations responding, most of them indicated the following as their field of activity<sup>9</sup>: credit institutions/banking (9 respondents), CCPs (4 respondents) and investment firms (3 respondents). Other fields of activity were mentioned only once or twice and, therefore, are not mentioned here.

### 2.1.3. Country of origin

Around **67% of all responses came from within the EU**, while the remaining **33% were provided from stakeholders in non-EU countries**. 18 stakeholders from 11 Member States responded. 9 responses came from outside the EU. **The United Kingdom was the country with the highest number of replies (26% (7 respondents))**.

**Table 2: Country of origin of respondents**

Country of origin of respondents	
European Union	(67%) 18
Belgium	4
Germany	3
Luxembourg	2
Spain	2
Austria	1
Finland	1
France	1
Italy	1
Latvia	1
Netherlands	1
Sweden	1
Non-EU countries	(33%) 9
United Kingdom	7
United States	2
<b>Total respondents</b>	<b>27</b>

<sup>8</sup> [https://ec.europa.eu/info/consultations/finance-2021-financial-collateral-review\\_en](https://ec.europa.eu/info/consultations/finance-2021-financial-collateral-review_en)

<sup>9</sup> Multiple answers were possible.

#### 2.1.4. Organisation size of respondents

**Table 3: Organisation size of respondents**

Organisation size	
Large (250 or more)	11
Small (10 to 49 employees)	8
Medium (50 to 249 employees)	4
Micro (1 to 9 employees)	4
<b>Total. respondents</b>	<b>27</b>

#### 2.1.5. Feedback on the different sections of the consultation

Although 27 stakeholders provided feedback in total, the number of responses varied between the different sections of the consultation. More specifically:

- **Scope of the FCD:** 21 stakeholders expressed a view on<sup>10</sup> at least one question in this section.
- **Provision of cash and financial instruments under the FCD:** 24 respondents provided an answer to at least one question in this section.
- **‘Awareness’ of (pre-) insolvency proceedings:** 16 stakeholders responded to the question in this section.
- **Recognition of ‘close-out netting provisions’ in the FCD and its impact on SFD systems:** The question the most stakeholders responded to in this section was answered by 17 stakeholders.
- **Financial collateral:** Up to 21 respondents provided input to at least one question in this section.
- **The FCD and other Regulations/Directives:** Up to 9 stakeholder provided input to a question in this section.
- **Other issues:** 5 respondents provided a reply on inconsistencies in FCD transposition which would merit further harmonisation. 4 stakeholders provided feedback on enhancement of cross-border flows, while 11 raised points in the additional information section where 8 respondents uploaded documents.

## 2.2. Key messages

The key messages from the consultation were the following:

- Differing transposition in Member States (especially regarding the scope) creates costs and uncertainty for market participants.
- The FCD should cover all systemically important market participants. However, views on how to determine systemically important entities differ. Whereas, stakeholders

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<sup>10</sup> Not counting those stakeholders who did not provide a reply or answered ‘I don’t know/no opinion’.

generally considered CSDs systemically important, views regarding payment institutions and e-money institutions differed.

- An alignment of the definition of financial instruments with the definition of MiFID financial instruments would be beneficial. In particular, emission allowances should be eligible as financial collateral under the FCD.
- Costs and legal uncertainty could be reduced by clarifying requirements and streamlining operational aspects concerning the awareness of insolvency proceedings and the concepts of possession and control for the purpose of the FCD.
- In the context of technological neutrality, some concepts of the FCD would benefit from clarification.

### **3. SUMMARY OF RESPONSES**

#### **3.1. Scope of the FCD – extension**

##### *3.1.1. Stakeholders' key messages:*

- FCD should cover all systemically important market participants. However, views on how to determine systemically important entities differ. Whereas, stakeholders generally considered CSDs systemically important, views regarding payment institutions and e-money institutions differed).
- FCD should take into account an entities' level of supervisory safeguards.
- FCD could promote policy objectives for market participants even if not (yet) systemically important.
- FCD should ensure more consistency in national implementation.

##### *3.1.2. Payment institutions and e-money institutions*

Asked on extending the personal scope of the FCD to include payment institutions, respondents gave the same reply as for e-money institutions. As such, both are summarised in this section. In total 12 of the 27 stakeholders had an opinion: 11 answered 'yes', of which 9 were industry representatives and 2 represented government bodies. One stakeholder, a national supervisory authority, answered 'no'. 15 stakeholders (56% of all respondents) did not reply or indicated that they had no opinion/did not know/did not consider the question relevant.

Stakeholders in favour of a wider scope highlighted that the netting mechanisms the FCD provides are important for EU financial markets. Netting provisions play an essential role as an effective means to directly reduce risk exposures and manage risk, which could become systemic. Ineffectiveness or even serious legal uncertainties result in immediate increases of risk exposure. These stakeholders therefore argued that the FCD should cover those entities that are or could become systemically relevant market participants with evolving markets, including payment institutions and e-money institutions. One stakeholder argued that payment institutions and e-money institutions are at the forefront of financial innovation and, in order to foster innovation, they should benefit from the FCD protection, even if not systemically important yet.

One stakeholder highlighted the importance of aligning the scope of the Settlement Finality Directive<sup>11</sup> (SFD) and the scope of the FCD so that SFD-participants can pledge collateral under the FCD. Furthermore, stakeholders also noted that in some Member

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<sup>11</sup> [Directive 98/26/EC \(OJ L 166, 11.6.1998, p. 45\).](#)

States' national implementation of the FCD, the scope is already broader and allows payment institutions to be eligible.

Another stakeholder thought that payment institutions and e-money institutions should only benefit from FCD protection if the other party of the agreement is an institution that is already eligible under the current FCD. They explained that payment institutions and e-money institutions are not subject to the same prudential supervision and regulatory obligations (such as BRRD<sup>12</sup> and CRR<sup>13</sup>) as the entities currently included in the personal scope of the FCD. Another stakeholder added that no business case for payment institutions would justify their inclusion in the scope of the FCD. This stakeholder argued that payment institutions operate mainly on pre-funded basis and do not accept collateral to ensure the fulfilment of clients' payment instructions. Furthermore, they make payments on behalf of a client only if the client has sufficient cash to fund the payment. Only if the payment institution obtains a specific license, may it provide loans, which the latter uses to make a payment. Such loans, if issued, would be uncollateralised.

### 3.1.3. *Central securities depositories*

When asked whether the personal scope of the FCD should be amended to include central securities depositories, **all respondents that had an opinion answered 'yes'** (20 respondents). The remaining 7 respondents did not provide a reply or had no opinion.

Those who replied argued unanimously that central securities depositories are systemically important and a key financial market infrastructure. They should therefore be included in the scope of the FCD. One stakeholder also highlighted the need to align the scope of the FCD with the scope of the SFD. This stakeholder also added though that it is important to note that the regulatory framework for CSDs typically prevent them from using their assets in financial collateral arrangements unless they have a banking licence.

### 3.1.4. *Other (Please specify)*

When asked, whether the personal scope of the FCD should include other entities, stakeholders made the following suggestions:

- Re-insurers;
- Alternative investment funds (AIF);
- Institutions for occupational retirement provision (IORPs)<sup>14</sup>;
- Crypto-asset service providers;
- All non-natural persons;
- non-financial market participants which regularly enter into physically or financially settled forward contracts for commodities or EU Allowances (EUAs).

Stakeholders provided the following reasons.

Two respondents stated that Member States have taken different approaches to defining the entity scope of the FCD as it applies in their jurisdictions. Stakeholders would

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<sup>12</sup> [Directive 2014/59/EU \(OJ L 173, 12.6.2014, p. 190\).](#)

<sup>13</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms: OJ L 176, 27.6.2013, p. 1.

<sup>14</sup> As defined in Directive (EU) 2016/2341.



**welcome a more consistent and homogeneous approach** in Member States to facilitate cross-border transactions, including ending of national opt-outs from the personal scope.

Two respondents suggested adding **re-insurers, investment firms, alternative investment funds (AIF) and crypto asset service providers** to the scope of the FCD. However, investment firms are already in the scope of the FCD<sup>15</sup>. Two others said that regarding AIFs, **only certain provisions of the FCD should be extended to alternative investment funds (AIFs)**. They explained that it is common to have AIFs as lenders in syndicated transactions. As AIFs are not currently in the scope of the FCD, it restricts the possibility of the lenders, which are financial institutions, to have such arrangements in place in accordance with the FCD and benefit from its flexibility and protection. According to these stakeholders, potential negative consequences should be assessed as well including: unequal competition, as AIFs do not have to comply with some of the regulatory constraints, charges or costs that financial institutions face; the inclusion of AIFs within the netting scope, as due to the lack of capital cost, AIFs will be able to beat quotes provided by financial institutions on a systematic basis, without applying the same safeguards. In that regard, according to these stakeholders, AIFs should only benefit from netting and financial collateral regime for netting agreements provided that the other party of the agreement is an institution currently already eligible under the SFD. Another stakeholder added, that specifically institutions for **occupational retirement provision (IORPs)** as defined in Directive (EU) 2016/2341 have been included under French Law and should therefore also be considered in the FCD.

Another stakeholder suggested including **non-financial market participants which regularly enter into physically or financially settled forward contracts for commodities or EU Allowances (EUAs)** including derivatives of commodities and EUAs. The stakeholder argued that these entities rely on easy access to and protection of collateral in insolvency situations in the same way as financial institutions. To reduce systemic risk and reduce the cost of market access and trading, these market participants should not be disadvantaged. Furthermore, it would support market liquidity and enable market participants to hedge and mitigate the commercial risks of the operation of energy infrastructure as well as the supply of physical energy.

Some stakeholders suggested a further broadening of the scope. One stakeholder suggested to broadening the scope to all **non-natural persons**, to support competition and innovation by enabling alternative finance providers to benefit from the protections under the FCD. Other stakeholders pointed out that the scope should comprise **all relevant types of financial market participants that are systemically important**. According to these stakeholders, to ensure that systemic risks do not increase because of the broadened personal scope, it would be appropriate to determine certain criteria that the relevant market participants should fulfil to be included in the scope, e.g. be a supervised entity, have a sufficient risk organisation and fulfil capital requirements.

One stakeholder **did not see the need to add any other type of entities** to the scope of the FCD.

### *3.1.5. Link to one party being a public authority, central bank or financial institution*

Of the 21 stakeholders who replied, 15 (71%) supported the current rationale that only financial collateral arrangements should be protected where at least one of the parties is a public authority, central bank or financial institution, while six stakeholders (29%) preferred to change it. The remaining six did not answer this question or have an opinion.

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<sup>15</sup> Art. 1(c)(ii) FCD

The stakeholders supporting a change in the rational, indicated that the scope should be broader and include non-financial entities. However, they had different views on how the scope should be broadened. Suggestions were made to cover all non-natural persons, all relevant market participants who intend to enter into financial collateral arrangements, to require at least one party of the financial collateral arrangement to be an entity currently eligible under the FCD and to allow financial collateral arrangements between non-financial market participants in commodities to be eligible under the FCD. For further details, see Sections 3.1.1, 3.1.2 and 3.1.3.

One stakeholder, a business association, who supported maintaining the rational, argued the undue extension of the FCD protection might produce the adverse effect of reducing the protection offered to financial institutions trading with each other or with professional clients (i.e. clients that are not physical persons or retail clients).

### *3.1.6. Impact of the exclusion in Article 1(3)*

19 stakeholders commented on the impact of the exclusion in Article 1(3) that allows Member States to exclude retail/SME from the scope of the FCD in a cross-border context, of which 13 answered that the exclusion was a problem and 6 that it was not. The remaining eight stakeholders did not reply or have an opinion.

When asked, why the exclusion in Article 1(3) (allowing Member States to exclude retail/SME from the scope of the FCD) presents a problem to the cross-border provision of collateral, stakeholders provided several reasons. First, it has resulted in market fragmentation. Second, it creates additional costs: (i) for legal assessment as any variance in the application of the protection provided under the FCD requires participants to individually assess the risks for each relevant counterparty in each applicable jurisdiction creating additional costs and burden, and introducing uncertainty regarding the enforceability of collateral arrangements; and (ii) for collateral as it requires non-financial counterparties, which use derivative markets to hedge their physical exposure to post collateral on a gross bases (increasing their cost of trading). Third, it limits the scope of financial products and service providers available to certain unregulated corporates, and that SMEs can be significant financial market participants and have a material interest in using netting to reduce and manage their counterparty risk in the same way as any other market participant.

When asked how this issue could be solved, stakeholders were in favour of a harmonization of the scope in the EU. However, they had different opinions on how the scope should be aligned.

Five stakeholders sought to delete the opt-out option. They argued that retail/SMEs may be operating as borrowers and counterparties of derivative transactions. In their opinion, a harmonized inclusion in the scope would remove administrative burdens and additional costs for retails/SMEs and would, therefore, be beneficial for the real economy. In

addition, the view was expressed that removing the exclusion regarding Articles 7 (6)<sup>16</sup> and 31<sup>17</sup> of the Second Chance Directive was recommended<sup>18</sup>.

Some stakeholders supported including **SMEs from the financial sphere** in the scope of the FCD or **all SMEs in the scope of the SFD, as long as the other party to the financial collateral arrangement is an entity currently eligible under the FCD**. Another stakeholder suggested either expanding the personal scope to include **all non-financial market participants** or abandon the opt-out-provision completely.

Two stakeholders suggested a homogenous cross-border approach for a **favourable treatment on a product or activity basis**, focusing on the product rather than on the entities involved. One of those stakeholders suggested limiting the opt-out and extending the scope to certain financial markets activities only if they are entered into by financial institutions with unregulated corporates. This stakeholder considered that these should include, without limitation, derivatives, transactions in financial instruments, prime brokerage services, repo, securities lending, margin lending, clearing, custody together with any ancillary or related fees, expenses and overdrafts.

### *3.1.7. Limiting the scope of the FCD to the wholesale market*

Most stakeholders did not support limiting the scope of the FCD to wholesale markets (i.e. turning the national opt-out for retail/SME granted under Article 1(3) into a binding FCD provision), 17 stakeholders had an opinion, of which 15 answered ‘no’ and 2 ‘yes’. 10 stakeholders did not reply or have an opinion.

One stakeholder, a public authority, highlighted that the FCD grants an exception from normal insolvency proceedings, and as such it should be precisely narrowed and justified. For the wholesale market, each individual transaction is often large scale. However, at the level of the relationship financial institution with its ordinary customers this is not the case. Thus, the latter will most likely not represent a threat to the financial system and does not justify the dis-appliance of equal insolvency proceedings.

Other stakeholders focused on the relationship between the parties of a collateral agreement. They argued that turning the SME opt-out into a binding provision would adversely affect the cross-border provision of collateral in Europe. The application of the FCD to companies that are not credit institutions is to the advantage of all parties directly involved in the financial collateral arrangement. It simplifies the provision of collateral throughout the EU from a formal point of view (the collateral taker does not have to check the different specifics of national property laws), which makes it possible to grant credit quickly in order to improve the borrower's liquidity. Furthermore, stakeholders highlighted that the protection of netting arrangements was important because not only financial institutions have an interest in having an effective tool to reduce and manage risk from derivatives and securities financing transactions. Two stakeholders pointed out that the national opt-out for retail/SMEs is only used in some Member States today.

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<sup>16</sup> [Directive \(EU\) 2019/1023 \(OJ L 172, 26.6.2019, p. 18\)](#); Art. 7(6): Member States may provide that a stay of individual enforcement actions does not apply to netting arrangements, including close-out netting arrangements, on financial markets, energy markets and commodity markets, even in circumstances where Article 31(1) does not apply, if such arrangements are enforceable under national insolvency law. The stay shall, however, apply to the enforcement by a creditor of a claim against a debtor arising as a result of the operation of a netting arrangement.

<sup>17</sup> [Directive \(EU\) 2019/1023 \(OJ L 172, 26.6.2019, p. 18\)](#); Art. 31(1): Relationship with other acts and international instruments 1. The following acts shall apply notwithstanding this Directive: (a) Directive 98/26/EC; (b) Directive 2002/47/EC; and (c) Regulation (EU) No 648/2012.

<sup>18</sup> [Directive \(EU\) 2019/1023 \(OJ L 172, 26.6.2019, p. 18\)](#).

Amending the FCD to be exclusively applicable to the wholesale market would limit the scope compared to how the rules are currently applied.

If opt-outs are considered to be necessary, one stakeholder highlighted that in their view they should be limited to retail clients.

## 3.2. Provision of cash and financial instruments under the FCD

### 3.2.1. Stakeholders' key messages:

- Need for clarification: concepts of possession and control, and the provision that financial collateral has to be evidenced in writing.
- No need for clarification: notion of a good faith acquirer, and the way in which financial collateral could be evidenced in writing when provided separately from its financial instrument.

### 3.2.2. Ways in which financial collateral could be evidenced in writing when provided separately from its financial instrument

The majority of stakeholders who provided an opinion **did not see the need to specify** the ways in which financial collateral, e.g. dividend or interest (“claims relating to or rights in or in respect of”) could be evidenced in writing when it is provided separately from its financial instrument. 13 stakeholders did not see the need for further clarification and preferred flexibility. four stakeholders indicated that an explicit provision would be helpful. 10 stakeholders had no opinion or answer.

Several stakeholders said however that **the general FCD provision stating that the FCD applies to ‘financial collateral once it has been provided and if that provision can be evidenced in writing’<sup>19</sup>, should be modernised**. Especially in the context of digitalisation, they saw the need to make it future proof and allow for other forms of evidence of the arrangement that are commonly accepted in the market including e-contracts legislation of the Member States and technical methods guaranteeing unchanged reproduction. The requirement regarding how the financial collateral could be evidenced should in these stakeholders’ opinion not take the form of an exhaustive list. Instead, it should focus on the qualitative aspects of the evidence, in whichever format they are presented in order to allow for new and other market/commonly accepted forms of evidence of the arrangement and to encompass all eligible types of collateral. Two of these stakeholders proposed substituting the term "in writing" by “durable medium” and to specify the requirements a mean/medium should comply with to be considered a “durable medium”. One stakeholder expressed the opinion that a specification would not be particularly purposeful since the proper documentation of financial collateral arrangements is determined under national civil law. Two other stakeholders pointed out that there is sufficient clarity on this point and that amending the FCD to specify this further would risk unintended consequences, e.g. excluding some types of financial collateral that are currently eligible. Two other stakeholders pointed out that there should be flexibility, allowing parties to freely agree on this aspect on a case-by-case basis. In their opinion, formal requirements should be flexible and freely agreed.

### 3.2.3. The concepts of 'possession' and 'control'

The consultation asked whether stakeholders thought that the concepts of 'possession' and 'control' in the FCD require further clarification. **The majority of respondents (17**

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<sup>19</sup> Art. 1(5) FCD

**stakeholders) indicated that the concepts should be clarified.** Seven said that this is not necessary and three did not answer.

Several stakeholders thought there is a **need to clarify and provide high-level guidance**, as there has been litigation, to provide additional protection to financial institutions entering into 'security financial collateral arrangements'. Although it remains appropriate for detailed guidance to be provided at a national level, as each jurisdiction has its own laws on security and insolvency procedures, some stakeholders consider that further high-level guidance could be provided at the EU level.

Two stakeholders pointed out that these notions have been interpreted by the Court of Justice of the European Union in case C-156/15 of 10 November 2016 where the Court specified that "*the taker of the collateral (...) may be regarded as having acquired 'possession or control' of the monies only if the collateral provider is prevented from disposing of them*". This should allow a uniform interpretation within the EU. However, although the Court of Justice of the European Union decision provided in principle for a uniform interpretation of the concepts of "control" and "possession", they argued that it may be useful to incorporate this into the FCD for both securities and cash collateral. Another stakeholder said that in the US, only post-default possession control is assessed, not the ongoing situation and whether the level of possession or control suffices. According to this stakeholder, as a result, security financial collateral is essentially close to unused in the EU, thus the need to clarify 'possession and control'.

One stakeholder, representing a Member State, said that these terms are widely used in Member States' property law and harmonising them could have problematic and unpredictable consequences.

Another stakeholder argued that, even though the terms 'possession' and 'control' may be defined and applied slightly differently under different national laws, this poses no problem as long as the governing law itself is unambiguous.

Stakeholders expressed their views on what a clarification should address and how the FCD could provide further high-level guidance. In their view, the FCD could be amended to give the Commission the power to define these concepts further in level 2 legislation. These stakeholders considered that the concepts should be clarified in several ways:

- Confirming, consistent with market practice, that it is possible to have possession or control where there is no delivery, transfer or holding of the collateral by the collateral-taker. The collateral remains in the possession of the collateral-provider but on terms, which give a legal right to the collateral taker to ensure that it is dealt with in accordance with its instructions and, in such circumstances, how the collateral taker can demonstrate that it has possession and control.
- Whether it is always necessary to demonstrate control throughout the course of the arrangement. It may be sufficient that the collateral is clearly in the possession or control of the collateral taker at the point of enforcement.
- How parties can demonstrate possession and/or control of intangible assets.
- What steps need to be satisfied beyond mere custody of financial collateral for a collateral taker to have possession and/or control.

In their opinion, the FCD could be amended to make it clear that the collateral-provider has the following rights set out below, will not prevent the collateral-taker from having "possession" or "control" of the collateral whether the collateral is held in the collateral-taker's accounts or held via a third party custodian:

- account name: the collateral may be held in an account in the name of the collateral-provider or the collateral-taker;
- income: the collateral-provider will be entitled to withdraw any income accruing from the financial collateral from the account;
- notices: if any notices are received in respect of any collateral in the form of securities, the collateral-provider will be entitled to receive a copy of them;
- voting rights: to the extent that any voting rights attached to any securities forming part of the collateral become exercisable (if the security has not become enforceable), the collateral-provider will be entitled to exercise voting rights;
- valuation: if the value of the collateral or the secured obligations are not readily observable, the collateral-provider may be responsible for determining the value of the collateral or the secured obligations;
- insolvency: if the collateral-taker becomes insolvent, the collateral-provider will be entitled to require the custodian to return the collateral to the collateral-provider (after certifying that it has discharged the secured obligations);
- automated collateral management services: the provision of a standing instruction to a third-party custodian or collateral manager to provide automated substitutions, return of excess collateral or transfers or reinvestment of income (e.g. interest, coupons or dividends).

Additionally, stakeholders proposed the following amendments:

- A non-exhaustive definition of "collateral taker".
- Amend the term 'excess financial collateral' to clarify that an "excess" arises where the value (or estimated value) of the collateral exceeds the amount of collateral required to be posted from time to time under the agreement between the collateral provider and the collateral taker.
- Amend the definition of 'security financial collateral arrangement' and "security interest" to include the words "(including upon the default of the collateral-taker)" after the words "withdraw excess financial collateral".

One stakeholder pointed out that in a third-country, protection was claimed for secret assignments of book debts that are unknown to creditors until a company becomes insolvent. The book debts are then claimed by the holder of the collateral who claims control and possession over them as legal owner. According to this stakeholder, in order to be under the control or possession of the collateral holder, a public registration as a security interest should be compulsory.

Two other stakeholders said that if emission allowances were included within the definition of 'financial instrument', the Commission should do a review to confirm that the current conditions of "control" and "possession" are suitable.

One stakeholder pointed out that based on their cross-border experience the concepts of 'possession' and 'control' do not present any specific concerns. However, they highlighted an issue arising due to different national implementation of the FCD. In one Member State, the key aspects are to ensure that the financial instruments are held in book-entry form during the lifetime of the relevant financial collateral arrangement and that the Member State's creation and perfection formalities are complied with. According to them, in other jurisdictions under the relevant laws of which the financial instruments are initially issued – and in particular where the financial instruments are not issued as dematerialised financial instruments from the outset – there is a tendency to also want to

comply with local creation / perfection formalities. This comes on top of the formalities related to the book-entry nature of the financial instruments and can include registration of the collateral in the local register and notification of the local register agent. This is, in their view, not in line with the idea of Article 9 FCD (as confirmed by Recital (8) FCD).

Two stakeholders highlighted issues regarding crypto-assets and DLT systems and asked clarity on where an account should be and in whose name. Furthermore, they considered it useful to clarify the form of crypto-assets that can be provided and how the collateral taker could demonstrate that it has ‘control’ of the collateral. These stakeholders believed that the European Commission should have the authority to adopt Delegated Acts, if the current applicable FCD needs to be adapted to cover further developments in the crypto-asset market. For instance, the MiCA Regulation<sup>20</sup> should be considered, once in force.

#### 3.2.4. *The notion of a good faith acquirer*

**The majority of respondents that replied** (12 stakeholders) **did not see a need for clarification** of the notion of a good faith acquirer within the EU, while 6 were in favour of a clarification. 9 stakeholders did not express an opinion or reply to the question.

Several stakeholders pointed out that the concept of good faith acquisition is closely related to national legislation and principles of law that may differ between Member States, and therefore may be difficult to harmonise. As such, any clarifications should be flexible enough to accommodate the Member States’ national legislation or be limited to the scope of FCD. One stakeholder, representing a Member State, said that the term is widely used in Member States’ property law and that harmonising them could have very problematic and unpredictable consequences.

Some stakeholders pointed out that in the context of title transfer of financial collateral arrangements, the lack of harmonised rules on good faith acquisition may create legal uncertainties. One of them explained that acquirers of fungible financial instruments can never know who the previous owners were or whether previous acquisitions are legally valid and therefore, an acquirer needs to be able to rely on the law applicable to its acquisition, even if a previous acquisition turns out to be invalid.

### 3.3. ‘Awareness’ of (pre-) insolvency proceedings

#### 3.3.1. *Key message:*

Stakeholders suggested reversing the standard of proof. In their opinion, the burden of proving the awareness of (pre-) insolvency proceedings should lie with any party contesting the effectiveness of the collateral transfer, as it is very difficult to prove a negative.

#### 3.3.2. *‘Awareness’ of (pre-) insolvency proceedings under Article 8(2) FCD*

16 stakeholders saw the need to clarify at least one or both of the following concepts:

- how a collateral taker can ‘prove that he should not have been aware’
- how a collateral taker can ‘prove that he was not aware’.

11 stakeholders did not answer this question. Of the 16 who answered, five indicated a need to clarify both concepts, seven said that the first should be clarified, and four that solely the second needed clarification.

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<sup>20</sup> Proposal for a Regulation on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM/2020/593 final.

Several stakeholders recommended reversing the standard of proof. In their opinion, the burden of proving the awareness of (pre-) insolvency proceedings should lie with any party contesting the effectiveness of the collateral transfer, not least because it is difficult to prove a negative. The issue of suspect periods and the possibility to repudiate transactions, including collateral transfers, ex-post based on the contention that the other party had knowledge of or should have been aware of the impending insolvency is a key concern. This is because it can result in the risk that transactions, including collateral transfers, which had been deemed protected, being contested and unwound. According to these stakeholders, a clearer definition and understanding may ensure legal certainty and allow for a more uniform regime across the EU taking into account that each Member State has specific laws for the conditions of the avoidance and ineffectiveness actions. Two stakeholders highlighted in this context, that in certain Member States, subjective states of ignorance may not be eligible for proof in court, due to applicable civil law principles. One stakeholder suggested that it should be presumed unaware if the financial collateral has been provided before the commencement of insolvency proceedings has been made public (i.e. through the publication in an official gazette or public registry).

One stakeholder pointed out that the feasibility for the collateral taker to effectively make sure that there is no ongoing (pre-) insolvency proceeding varies depending on applicable insolvency legislation and the practical set-up for insolvency proceedings, e.g. the level of system support for publishing insolvency decisions. Another stakeholder believed that, in the absence of any public announcements about commencement of, winding-up proceedings or reorganisation measures at the relevant time, it is important to clarify how the collateral taker can prove that he was not aware under Article 8(2) of the FCD. In that context, one stakeholder suggested a central point for information, possibly a public authority, requiring the involved parties to communicate information about the start of proceedings, which would be made available on a dedicated web page. The date and time of such publication could be deemed the point in time when everyone becomes aware of initiated insolvency proceeding. However, this does not address situations where the collateral taker becomes aware based on bilateral communication.

One stakeholder suggested that for CCPs, awareness could be achieved by having the relevant National Competent Authority provide written notice to the CCP of any (pre-) insolvency proceedings.

One stakeholder, representing a Member State, said that the terms concerned by this question are widely used in Member States' property law and harmonising them could have very problematic and unpredictable consequences.

### **3.4. 'Close-out netting provisions' in the FCD and impact on SFD systems**

#### *3.4.1. Stakeholders' key messages:*

- One third of total respondents indicated that they have encountered problems with the recognition/application of close-out netting provisions.
- Problems were related to different transpositions of scope and national opt-out provisions.
- Stakeholders who saw problems were in favour of a harmonisation.

#### *3.4.2. The recognition/application of close-out netting provisions*

The consultation asked if stakeholders had encountered problems with the recognition/application of close-out netting provisions. Views on this were split. 17 respondents had an opinion: nine stakeholders answered 'yes' and eight stakeholders answered 'no'. Ten respondents did not have an opinion or did not answer the question.



The nine stakeholders who encountered problems with the recognition/application of close-out netting provisions were asked whether these problems were related to the use within one Member State, cross-border use or both. All nine stakeholders indicated 'both'. Moreover, the nine stakeholders who encountered problems with the recognition/application of close-out netting provisions were asked whether the problems concerned OTC transactions, transactions carried out on an SFD system or both. Six stakeholders indicated 'both', two stakeholders 'OTC transactions' and one stakeholder 'transactions carried out on an SFD system'.

Stakeholders noted that the diverging implementation of the FCD by Member States, especially concerning the scope and opt-out provisions, has resulted in a fragmented framework for netting arrangements in the EU which causes considerable legal uncertainties and risks for market participants. Because of the fragmentation, market participants must review each Member State's FCD regime and adjust their transactions and risk management procedures accordingly. Stakeholders pointed out that European netting legislation would provide legal certainty and avoid different legal regimes across the EU, enhancing cross border activity among EU entities and investment from third country firms. Two stakeholders suggested turning the FCD into a Regulation to maximise harmonisation across the EU, albeit acknowledging the challenges given the differences in insolvency legislation across the EU.

Regarding concrete problems, stakeholders pointed out that the effectiveness of netting provisions varies depending on the counterparty type between different Member States as there are differences in treatment of different counterparties between Member States. The same stakeholders highlighted differences in treatment of contract, transaction and product types in different Member States, mentioning as examples credit default swaps and open/on demand repos. These differences can mean that the effectiveness of netting provisions for a specific type of entity can vary due to different Member States treating that entity differently, or that the same type of contract might not be offered the same protection across the EU as it is treated differently. This results in uncertainty and legal risks for market participants, as the rules in each Member State need to be analysed and potentially apply differently.

In addition, stakeholders suggested that the scope of protection provided by the FCD should be extended to include close-out netting without financial collateral arrangements as the FCD does not currently provide any protection to close-out netting arrangements without a collateral arrangement. Two stakeholders added that any agreements that contain master netting arrangements and allow for the set-off or netting of multiple close-out amounts that are determined under separate netting agreements should also benefit from the close-out netting provisions of the FCD across all Member States<sup>21</sup>.

Three stakeholders highlighted **difficulties in obtaining legal opinions** because of differences across Member States.

Two of those stakeholders indicated high costs to obtain and update legal opinions. The stakeholders said that some EU banking associations have tried to promote the use of the European Master Agreement, but with little success due to the reluctance from market participants to pay for new legal opinions for each EU jurisdiction and keep them updated. One stakeholder also highlighted that the potential move away from the use of English law in netting agreements for cross border activity faces the problem of a lack of a EU single legislation for netting.

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<sup>21</sup> These master netting arrangements may cover different product types and provide the benefit for financial institutions and their clients to mitigate credit exposures across multiple product agreements.

Another stakeholder indicated that the problems encountered are related to what they consider partly conflicting objectives between the FCD and the BRRD and the resulting legal complexity. The complex regulatory situation gives rise to legal uncertainty, with the effect that it is hard for market participants to get sufficiently clean and/or understandable legal opinions. This may cause regulatory risks to increase, in turn affecting institutions' capital requirements. The stakeholder anticipates similar legal uncertainties in the interaction of the FCD and the framework for the recovery and resolution of central counterparties.

One respondent indicated that most jurisdictions stipulate certain **requirements for the wording and effectiveness of the actual contractual wording** to effect timely close-out netting in insolvency. The respondent thought that usually there are just few or non-binding precedents available and insolvency administrators might use loopholes and apply discretion to exercise avoidance and cherry-picking rights. The stakeholder explained further that some jurisdictions require the **exchange of collateral** for close-out netting to become effective, other jurisdictions view credit support annexes between non-financial counterparties as non-nettable and not an insolvency proof collateralisation.

Two stakeholders said that Member States' courts have sometimes interpreted the FCD protection of netting agreements narrowly or failed to consider the FCD when interpreting Member State insolvency and/or netting laws. As such, counterparties relying on the FCD protection were exposed to substantial risks, e.g. impediments to the right for early termination. The two stakeholders emphasised the uncertainties between Member States' law was due to differences in implementation and in the personal scope due to opt-outs. They highlighted that the default protection mechanisms of central counterparties (CCPs) depend on their own netting mechanisms as well as the netting mechanism in the contractual arrangements between clearing members and the clients of the clearing members.

Another stakeholder noted that the FCD and the SFD could be more aligned to provide further legal certainty and facilitate the enforceability of close-out mechanisms in the EU.

#### *3.4.3. Enforceability of legal opinions for close-out netting in light of CCP Recovery and Resolution*

Seven stakeholders replied to this question, of which five said 'yes' and two said 'no'. The remaining 20 stakeholders did not answer the question, indicated that they had not collected legal opinions or had no opinion. Asked why and how collected legal opinions were changed, stakeholders indicated that the introduction of resolution regimes for CCPs has been reflected in the opinions largely in the same way as the introduction of resolution regimes (and suspension, transfer and bail-in powers) for banks under the BRRD. They referred to their responses to question 3.4.3.

#### *3.4.4. Enforceability of close-out netting in light of the BRRD*

Most stakeholders did not answer a question on legal opinions in light of BRRD. Of those who answered, the large majority answered 'yes'. Eight stakeholders answered this question, of which seven said 'yes' and one said 'no'. The remaining 19 stakeholders did not answer the question, indicated that they had not collected legal opinion, or had no opinion.

Asked why and how the collected legal opinions were changed, one stakeholder said that it has updated its netting opinions following the transposition of BRRD2 (revising BRRD) into the national law of relevant Member States. The netting opinions have been amended to reference BRRD2 and in particular, the possibility for resolution authorities to suspend, for a limited period, certain contractual obligations before an institution is

placed into resolution and the requirement for parties to include a contractual clause recognising the effect of stays in resolution. However, as the respondent explained, this has not resulted in any additional qualifications to these opinions or in these opinions no longer being upheld.

Two other stakeholders answered that since the implementation of bank resolution regimes in the EU and in third countries, legal opinions address the effects these regimes and specifically the impact suspension, transfer and bail-in powers can have on the netting provisions in master agreements in two ways:

- The opinions contain detailed descriptions of the powers and effects, and analyse the legal protections the resolution regimes provide for netting agreements. The key elements are the limitation of stays/moratoria to no more than two days, the requirement to transfer netting portfolios as a whole (no cherry picking) and the requirement that a bail-in only occurs following a close-out under the terms of the applicable netting agreement. They also point out existing gaps and uncertainties in the interpretation of the legal protection, e.g. the treatment of netting agreements for SFTs which, in contrast to netting agreements for derivatives are not always expressly covered or not covered as clearly as one would expect by Member State laws. The stakeholder added that the RTS on the valuation of derivative liabilities (RTS), Art. 49 and Art 4 BRRD only apply to derivatives transactions and thus not to SFTs. However, since liabilities under SFT netting agreements are fully collateralised, they are not eligible for bail-in to the extent they are collateralized. In addition, in their view, the ‘No credit worse off’-principle of the BRRD further protects these agreements.
- Where the legal protection under EU resolution regimes relies on references to the FCD and SFD, the opinions set out the legal uncertainties or potential gaps in the protection from uncertainties and differences in implementation of the FCD.

However, stakeholders added that the opinions do not set out a binary assessment that netting is or is not effective because of the existence of resolution powers affecting netting arrangements. The opinions do, however, give insight into the risks institutions are exposed to in a resolution action. Because of the protections in the EU resolution regime for netting agreements institutions have been able to conclude that resolution regimes as such do not prevent regulatory netting. However, in stakeholder’s views uncertainties exist and the risks emanating from these uncertainties have to be assessed and weighed by institutions with regard to each jurisdiction.

The stakeholders continued, that it should be noted that Art. 44 (2) BRRD provides that a resolution authority may not exercise bail-in powers to secured liabilities (e.g. by a charge, pledge, lien, or collateral arrangements including liabilities arising from repurchase transactions and other title transfer collateral arrangements). There is also currently no specific exclusion/protection in the BRRD relating to derivative transactions cleared by a CCP. EBA does not address client-clearing.

Another stakeholder explained that the effect of BRRD2, as implemented into applicable national law, will be considered, including any stay or moratorium on termination and/or enforcement of security and firms will consider the implications of these qualifications when considering any contractual arrangement with a potential counterparty.

One stakeholder indicated that legal opinions on the enforceability of close-out netting provisions for credit institutions and investment firms were changed following the revision of the BRRD. In some cases, this meant legal opinions were no longer sufficiently clean and/or understandable, causing more regulatory risk.

### 3.4.5. *Legal uncertainties in close-out netting provisions in relation to the application of national avoidance actions*

Stakeholders saw legal uncertainties related to close-out netting provisions due to the FCD's silence about the application of national avoidance actions to such provisions. Ten respondents indicated to see legal uncertainties, while four respondents did not see legal uncertainties. 13 stakeholders did not answer the question or have an opinion.

Three stakeholders argued that the application of national avoidance actions for the execution of transactions, the agreement on close-out netting provisions including termination rights and the exchange of collateral is a **major area of legal concern** in legal opinions. National avoidance actions may vary from applying to actions immediately preceding the insolvency filing or its opening but may also go back up to 10 years ahead of such event in the presence of **bad faith** at the collateral taker. It raises the possibility that transactions, which had been deemed to be protected, might subsequently be contested and have to be voided.

Two stakeholders indicated that the introduction of the **EMIR-margin requirements**<sup>22</sup> have significantly increased the importance of harmonised, effective and clear protections of collateral arrangements to reduce systemic risks.

Another two stakeholders mentioned that **Member States' asset protection laws are not always aligned with the FCD.**

One respondent pointed out that issues may arise when close-out netting agreements are governed by a law (*lex contractus*) different from the law of the jurisdiction in which insolvency is opened (*lex fori*). **Variations in the substantive law** can make a considerable difference to the enforceability of close-out netting provisions wherever cross-jurisdiction elements are present in the event of an insolvency. Even "netting-friendly" jurisdictions may have inconsistent laws regarding the scope of eligible parties allowed to use close-out netting, the eligible types of contracts and the extent to which close-out netting is compatible with the *pari passu* principle (i.e. the principle under which all unsecured creditors in an insolvency must equally share any available assets of the insolvent company). Four stakeholders therefore thought that an explicit provision stating that national avoidance provisions are not applicable to close-out netting provisions (including any single amounts that become part of the close-out netting) would be appropriate, as it would strengthen the much needed legal certainty regarding the enforceability of close-out netting provisions.

One stakeholder suggested conducting a study on national avoidance laws which apply irrespective of the bad faith of the collateral taker and cases where the burden of proof is with the collateral taker. Furthermore, cases where it excludes the application of national avoidance actions should be identified (including where banks are subject to an obligation to collect and post collateral). Another stakeholder suggested investigating national laws in this respect and considering introducing common and consistent rules on the onus of proof to evidence such bad faith and on the maximum length of such claw back period, as well as further consider excluding avoidance actions relating to the provision of collateral which was legally mandatory, such as margining under EMIR for the in-scope counterparties. The stakeholder noted that a European Netting Regulation providing for the recognition of close-out netting would be the most effective way to solve current legal concerns and related commercial risks.

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<sup>22</sup> requirement to exchange variation margin and post initial margin

#### *3.4.6. Do you see legal uncertainties related to close-out netting provisions by virtue of the introduction of Article 1(6) of the FCD?*

Views on legal uncertainties related to close-out netting provisions by virtue of the introduction of Article 1(6) of the FCD were split. Four stakeholders indicated that they see legal uncertainties by virtue of the introduction of Article 1(6) of the FCD. Seven stakeholders did not see any legal uncertainties. 17 stakeholders did not answer the question or express an opinion.

Two stakeholders pointed out that legal uncertainties in connection with resolution primarily result from the limited scope of the FCD and from the resolution regimes in question. They said that legal uncertainties could be avoided by ensuring that protections under FCD and SFD are consistent with BRRD and the FSB recommendations with respect e.g. to close-out netting. However, in their view, the FCD should not be the primary place to address and clarify the protection of netting and collateral arrangements in case of resolution measures, especially regarding third-country resolution regimes.

Similarly, other stakeholders said that partly conflicting objectives between the FCD and the BRRD creates legal complexity and legal uncertainty, as pointed out in the EPTF report. In the view of one of these stakeholders, clarification in the relevant capital requirement legislation, such as CRR, that the close-out netting provisions are enforceable and recognized for capital adequacy purposes despite the application of the BRRD and the framework for the recovery and resolution of central counterparties would reduce the complexity and the regulatory risks.

One stakeholder thought that the carve-outs to BRRD do not go far enough, when many CCPs have long-dated derivatives settling years into the future, given that only obligations of seven days or fewer maturity are covered. The stakeholder suggested that Article 1(6) of the FCD should be amended to exclude from the resolution authority's powers the possibility to suspend rights related to SFD designated systems or operators, CCPs and central banks.

A CCP argued that legal uncertainties related to BRRD provisions should be addressed consistently also in the context of the SFD, and asked for an explicit recognition of protection of CCPs in regard to the enforcement of close-out netting arrangements even in a resolution scenario (i.e. where a clearing member has defaulted for causes other than as a result of its own resolution process).

#### *3.4.7. Further harmonisation of contractual and close-out netting*

A majority of the stakeholders that provided an opinion (13 out of 17) favoured further harmonisation of the treatment of contractual netting in general and close-out netting in particular. Four stakeholders said that no such further harmonisation is needed. Ten stakeholders did not answer this question or expressed no opinion.

Several stakeholders stressed that the lack of harmonisation across Member States creates legal uncertainties and regulatory risks, which require complex and costly case-by-case assessments of the enforceability of the arrangement or legal opinions, which are often inconclusive. In particular, stakeholders pointed to issues with respect to the concept of 'possession and control', the personal scope of FCD protection, types of entity and counterparty or contract types, that the protection of netting arrangements is contingent on the combination of a netting and a financial collateral agreement, that Member State courts have interpreted the FCD protection narrowly or failed to take into account the FCD when interpreting Member State netting laws, thereby exposing the counterparties relying on the FCD to substantial risks.

Some stakeholders suggested that the Commission carry out a comparison of netting legislation in Member States to assess where discrepancies or gaps lie and how these could best be addressed (e.g. by guidance from the Commission, amendments to the FCD or by new EU legislation on netting).

Other stakeholders suggested extending the personal scope to all relevant market participants (ie. update the references to IFD/IFR, CSDR, AIFMD) including re-insurers; eliminating opt-outs; protecting netting arrangements that are not contingent on the netting provisions in or concluded together with a financial collateral arrangement (change of definition Art. 2(1)(n)); or introducing netting regulation.

Three stakeholders proposed harmonisation through a regulation would reduce the need for expensive legal opinions and decrease costs.

One stakeholder explained that currently, without additional protection under Member State legislation, the FCD only safeguards close-out netting in connection with financial collateral arrangements. The benefits of close-out netting also for broader netting sets are recognised elsewhere, e.g. in the CRR and BRRD. Further harmonisation and expansion of the legal framework for close-out netting would be helpful.

CCP representatives argued that clarifications should consider CCPs' risk management and default management operations, and repeated that CCPs' default rules and procedures, in particular close-out arrangements, should be protected even in a resolution scenario of a clearing member. In this regard, Article 1(6) of FCD could be amended protect of CCPs' default management under Articles 70.2 and 71.3 of BRRD and Articles 55 to 57 of CCP Recovery and Resolution Regulation, which exclude payment and delivery obligations owed to rights related to SFD designated systems, operators of such systems, other CCPs and central banks from the resolution authorities' powers.

### **3.5. Financial collateral**

#### *3.5.1. Stakeholders' key messages:*

- Several stakeholders suggested aligning the FCD definition of financial instruments with the MiFID definition of financial instruments.
- Stakeholders suggested adding emission allowances to the list of eligible financial collateral under the FCD.

#### *3.5.2. Collateral other than cash, financial instruments and credit claims*

The consultation asked if stakeholders see a need to make assets other than cash, financial instruments and credit claims eligible as collateral under the FCD. Views on this question were divided. 11 respondents answered 'no', while nine respondents answered 'yes'. Seven stakeholders did not answer this question or have an opinion.

Those stakeholders, who supporting allowing a broader range of assets as eligible as collateral under the FCD, expressed the following opinions.

One stakeholder highlighted that the FCD should allow for new types of collateral, to be future-proof and give enough leeway to allow **technical advancements and other developments**. At the same time, the stakeholder noted that the general acceptance for new types of collateral takes time. Another respondent argued that positions in a DLT may have the same function as cash, financial instruments and credit claims but do not necessarily fall under the respective definitions under the FCD. Therefore, the definitions should allow for future developments. Another stakeholder added that recent developments in distributed ledger and smart contract technology are providing alternative, and potentially more effective, means of exercising mechanical control over

digital assets (which, for the purpose of this consultation response includes cryptoassets, stablecoins and tokenised assets). In the view of this stakeholder, such developments have the potential to increase efficiency and reduce risks in collateral management. In order to facilitate these developments and avoid fragmentation, the stakeholder considers it important to clarify the criteria under which those assets might be eligible under the FCD, including governance considerations and the risk profile of the asset. The stakeholder noted that some digital assets may qualify as cash or financial instruments even though considerable uncertainty would remain as to how these terms should be interpreted in the context of digital assets. According to the stakeholder, it is important to ensure that the use of new technologies in relation to such assets does not alter their characterisation for the purposes of the FCD. In determining what new types of collateral should be added to the list, the reasons why financial collateral eligibility is currently limited to cash, financial instruments and credit claims should be considered. In the view of this stakeholder, many digital assets (including but not limited to stablecoins) share these features, irrespective of their regulatory status.

In contrast, another stakeholder noted that a specific FCD recognition for crypto-assets (including e-money tokens and asset-referenced tokens) might be premature. They argued that the FCD might not be the right place at present to set out specifications regarding ownership and provision requirements related to crypto-assets, as these aspects are still debated, also amongst national courts, while at the same time the EU regulatory landscape is still under development and evolution. Nonetheless, regarding possession and control requirements, the stakeholder considered it useful to explore potential solutions to how FCD definitions and requirements could apply to crypto-asset and DLT in general. This stakeholder also considered that an assessment of a potential extension of FCD protections to other assets useful, in particular taking into account the current **MiFID<sup>23</sup> definition of financial instruments** and the list of **assets which are currently accepted by CCPs as collateral** pursuant applicable regulations. The stakeholder believed an extension should capture assets, e.g. **commodities and commodities instruments** (not currently captured by MiFID), which are financially traded, including emission allowances.

Another stakeholder noted that the list of collateral eligible under the FCD should be broadened to cover all assets accepted by CCPs as collateral<sup>24</sup>, **including bank guarantees, emission allowances, commodities and commodities instruments**. According to the stakeholder, CCPs are aware that this may have implications under the European Market Infrastructure Regulation (EMIR) for what concerns the eligibility of such collateral.

Two respondents said that as long as any payment obligation can be secured by a financial collateral arrangement, all securities granted to secure such payment obligation should benefit from the provisions of the FCD. The respondent highlighted the importance of transactions where there are several securities and, in accordance with the current FCD, only certain types of securities can be considered financial collateral arrangements. This increases complexity (at the time of setting up the security package and on enforcement) as there are securities subject to different legal regimes. According to these two stakeholders, **shares, quotas or any type of credit rights** should be considered eligible as collateral of a principal secured obligation under the scope of FCD.

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<sup>23</sup> [Directive 2014/65/EU \(OJ L 173, 12.6.2014, p. 349\)](#). Article 4(15) defines financial instrument.

<sup>24</sup> [Commission Delegated Regulation \(EU\) No 153/2013 \(OJ L 52, 23.2.2013, p. 41\)](#).

### 3.5.3. Definitions of currently eligible collateral

When asked whether they see a need to update the definitions of certain types of eligible collateral, 17 respondents replied<sup>25</sup>, while ten did not reply. In total, 16 respondents saw a need to update the definition of financial instruments, 12 saw a need to update the definition of cash. Eight saw a need to update the definition of credit claims. More precisely, stakeholders answered as follows:

- Seven out of the 17 respondents replying indicated that they see a need to update the definitions of **all types of currently eligible collateral**, i.e. cash, financial instruments and credit claims.
- Four stakeholders saw a need to update only the definition of **financial instruments**.
- Another four stakeholders saw the need to update the definitions of **cash and financial instruments**.
- One respondent considered an update to the definition of **cash** relevant.
- Another respondent saw the need to update the definition of **financial instruments and credit claims**.

#### 3.5.3.1. Definition of cash

Regarding the definition of cash, stakeholders proposed the following updates:

Four stakeholders pointed out that financial markets participants including prime brokers, agent lenders and others routinely take security over certain contractual rights, e.g. close-out amounts determined under a close-out netting arrangement. These are important components of credit protection packages used when the financial collateral arrangement is intended to benefit more than one secured party and the lack of mutuality of obligations does not permit such lenders to rely on close-out netting or set-off rights alone. According to these stakeholders, this has caused challenges in some jurisdictions, e.g. Ireland and the Netherlands, where these types of claims, that they believe to naturally belong in many financial collateral arrangements, do not benefit from the protections under domestic Member State implementation of the FCD. **Security arrangements that include a mixture of financial and non-financial collateral may cause a degree of unnecessary legal uncertainty** as to whether the FCD protection applies to the arrangements (in whole or in part). Another stakeholder noted that cash-like positions in a DLT may not be represented in an "account" and may not actually represent a repayment of money even though they may have the same function. In the view of stakeholders, one way of addressing these concerns would be to define cash as *"money in any currency, credited to an account, or a similar claim for repayment of money and includes money market deposits and sums due or payable to, or received between the parties in connection with the operation of a financial collateral arrangement or a close-out netting provision"*.

In addition, the stakeholders proposed to state that an arrangement that covers mixed financial collateral and non-financial collateral should still qualify for the protections of the FCD where the majority of the collateral constitutes financial collateral. These stakeholders argued that this would reduce the bad apple risk that a broadly drafted credit protection package may fall outside the scope of the protections due to some residual claims or interests that do not technically qualify as financial collateral.

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<sup>25</sup> Multiple answers were possible.



Another stakeholder expressed the opinion that the definition of “cash” referring to “money credited to an account” is unclear and **not technologically neutral**: an “account” generally amounts to a series of rights in personam, and notably rights against the person maintaining the account to liquidate the balance or to instruct transfers up to an agreed amount. The phrase “money credited to an account” conflates the asset (rights) and the operational processes evidencing that asset (the recording of the account balance). In their view, the latter should not be a factor limiting the type of asset acceptable under the FCD provided that its policy objectives are met. In some DLT-based arrangements, there is no “account”. For example, the underlying ledger may record transactions and not account balances; the value may exist in the form of an “unspent transaction output” that can be unlocked by the holder of the associated private key, rather than being credited to any account. Likewise, a person may be entitled to spend value through the operation of one or more smart contracts, again without any account structure being in place. Whilst it may be possible to create account structures within DLT and smart contract arrangements, the stakeholder does not see any policy rationale for requiring this under the FCD. The respondent further argued that it is important that commercial parties have the freedom to structure their arrangements as they deem most efficient and appropriate, without being constrained by arbitrary structuring requirements. In their opinion, references to an “account” are currently not technologically neutral, as they refer to a specific means of recording value transfers (in accounts), to the potential exclusion of other mechanisms. The stakeholder added that the meaning of “money” can also be difficult to interpret in the context of certain **money-like instruments** (including stablecoins and stablecoin arrangements). Whereas a **central bank issued digital currency or a digital representation of commercial bank money** should readily meet this definition, other structures may be more debatable. For the stakeholder, it is unclear whether this would include a token that qualifies as **e-money** (under the Electronic Money Directive) and/or an **e-money token** (under MiCA) and/or a **token that is minted algorithmically and artificially pegged to the value of fiat currency without any right of redemption**. In this stakeholder’s view, these points should be clarified via Level 2 measures and/or interpretative guidance rather than under primary legislation.

#### 3.5.3.2. Definition of financial instruments

One stakeholder highlighted the **need to harmonise and align across all Member States** which assets are eligible as financial collateral. Several stakeholders said that the definition of financial instruments should be updated to **align more closely with the definition under MiFID**. Two stakeholders suggested considering the **list of assets, which are currently accepted by CCPs** as collateral pursuant applicable regulations.

More specifically, stakeholders provided the following suggestions and explanations:

- **Emission allowances**: Eight stakeholders elaborated that in particular the definition of financial instruments should be updated to include **emission allowances**. According to two stakeholders, emission allowances are often a form of collateral held against exposures under futures and options contracts and other derivatives where the underlying deliverable asset is itself an emissions allowance. They highlighted that there is an **active exchange-traded and cleared marketplace in emissions allowance derivatives where such collateral is commonly used or desired** and where use of this asset class as collateral, and certainly as security collateral, may be inhibited by a lack of designation of this asset class under the Financial Collateral Directive. Two stakeholders pointed out that primary and secondary emission allowance markets have seen a **steady increase in liquidity and could be considered as relatively mature**. Accepting emission allowances as collateral would allow market participants to make more productive and economic use of their

allowances. This could lead to substantial cost savings for market participants, by **avoiding the costs of raising other collateral and by freeing up capital for investments**. However, according to these stakeholders, based on the current legal framework it might be difficult to use these allowances as collateral under EMIR as the ETS transfer period (usually up to four business days) is not aligned with the timeframe a market participant has under the standard terms and conditions to provide collateral, like ISDA CSAs (settlement period: T+1/T+2). Three other stakeholders commented that including emission allowances into the definition of financial instruments in the FCD is an important step into the good direction. However, this would require a subsequent amendment of the Section 1 of Annex 1 of the Commission Delegated Regulation (EU) No 153/2013 on requirements for CCPs<sup>26</sup>. These stakeholders add that there is currently no mechanism (neither technically, nor reflected legally in the EU Registry Regulation) available within the Union Registry which would allow for registering a security interest.

- **Commodities and commodities instruments:** Four stakeholders suggested adding commodities and commodities instruments which are financially traded, even though they are not MiFID financial instruments.
- **(Bank) guarantees:** Four stakeholders suggested including (bank) guarantees in the definition of financial instruments.
- **Fund units:** Two stakeholders suggested that in addition to including the types of financial instruments listed in MIFID, Section C (Financial instruments), which already includes “units in collective investment undertakings”, other types of “**fund units**” that may be redeemed for cash at a future point in time should also be included.
- **Derivative transactions:** Two stakeholders said that the scope of the FCD should include **claims under derivative transactions or a master agreement for derivative transactions, including a potential close-out netting claim**.
- **New digital instruments:** Two stakeholders indicated that the scope should also include new digital instruments, **e.g. crypto-currencies/e-money**, where appropriate and performing the same function and legal quality as the other financial instruments. Another stakeholder thought that there is a lack of certainty on whether some **token arrangements** qualify as financial instruments. The stakeholder argued that this uncertainty stems from a number of sources. For example, various concepts within the definition of financial instruments, e.g. “shares”, “bonds” and “debt instruments” are construed under national law by reference to legal rights and obligations. Many token arrangements, however, give rise to transferable tokens, which embed hybrid rights that are not capable of straightforward categorisation under the current definition under the FCD, or rely on smart contracts to automate value movements in circumstances in which the legal characterisation of the value movement may be uncertain due to a lack of contractual provisions. Similarly, some token arrangements may not have an issuer or other characteristics of conventional securities. The stakeholder further argued that the meaning of “**negotiable on the capital market**”, which is part of the current FCD definition of financial instruments, is also ambiguous. For example, in their view, it is not clear how the concept of a “capital market” is assessed in the context of decentralised blockchain platforms. The stakeholder proposed that clarifications should be made under Level

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<sup>26</sup> [Commission Delegated Regulation \(EU\) No 153/2013 \(OJ L 52, 23.2.2013, p. 41\)](#).

2 measures and/or interpretative guidance rather than under primary legislation given the nascent and evolving nature of the market. Regarding the use of DLT, two other respondents argued that financial instruments and alike positions in a DLT may not qualify as shares in companies, other securities equivalent to shares in companies, bonds, or other forms of debt instruments even though they may have the same function. One of these stakeholders suggested to amend the definition of financial instruments in the FCD to: *"Financial instruments" means shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments or alike if these are negotiable on the capital market, and any other securities or alike which are normally dealt in and which give the right to acquire any such shares, bonds or other securities or alike by subscription, purchase or exchange or which give rise to a cash settlement or alike (excluding instruments of payment), including units in collective investment undertakings, money market instruments and claims relating to or rights in or in respect of any of the foregoing.*

One stakeholder pointed out that the FCD should cater for future regulation of cryptocurrencies by having a general wording covering such matters as new regulation comes into force. For example, delegated regulations could be used to adapt to cover further developments in the crypto asset market.

Three other stakeholders underlined that there is a broad spectrum of DLT-based platforms and crypto-assets, of which some may qualify as financial instruments, and others not. The imprecise definitions or taxonomy makes it challenging to determine if a DLT-based collateral system falls within or outside the scope of the FCD. In their view, where assets do not fall within the existing framework (e.g., because they are not financial instruments under MiFID, there is no "account" or "relevant account"), the answer is not necessarily to broaden the scope of the FCD, as that may result in unintended consequences, and it may be inappropriate to include them. They encouraged a detailed review and assessment to understand the issues.

#### 3.5.3.3. Definition of credit claims

One stakeholder noted that there is uncertainty as to how the term **"pecuniary claims"** should be construed in relation to the definition of credit claims. There are, for example, questions about whether this captures ancillary non-monetary claims in respect of a credit agreement. According to this stakeholder, in the context of technological development, there could also be questions as to whether and when debt claims denominated in a particular stablecoin would be caught, depending on the features of that coin.

Another stakeholder expressed the opinion **that positions in a DLT may be equivalent to "credit claims" but do not necessarily qualify as such**. According to this stakeholder, the definition should be amended as follows: *'Credit claims' means pecuniary claims or alike arising out of an agreement whereby a credit institution, as defined in Article 4(1) of Directive 2006/48/EC, including the institutions listed in Article 2 of that Directive, grants credit in the form of a loan.*

Two respondents had the opinion that with respect to credit claims, it **should include any type of credit rights**, although certain exemptions could be considered taking into account the fact that the debtor of the relevant credit rights may deserve a specific protection, as provided for in the FCD.

#### 3.5.4. Emission allowances

When asked whether emission allowances should be added to the definition of financial instruments in the FCD, 16 respondents replied 'yes' indicating that they are commonly used as financial collateral and should be eligible as collateral under the FCD. Two

respondents answered ‘no’ as emission allowances do not provide a sufficiently stable value to be used as financial collateral under the FCD. Nine stakeholders did not answer or have an opinion. For further explanations, see section 3.5.2.2.

### 3.5.5. *Crypto-assets qualifying as financial instrument*

Stakeholders were asked whether they see the need for crypto-assets qualifying as financial instruments to specify the ownership, provision, possession and control requirements of the FCD in a DLT context to provide legal certainty as to whether they are covered by the FCD. Views on this question were split. 12 respondents replied ‘no’, while nine respondents replied ‘yes’. Six stakeholders did not answer or have an opinion.

When asked to elaborate on how this might be done in a manner that is compatible with national laws regarding securities, companies, contracts, property and book-entry, stakeholders answered the following:

One stakeholder explained the concepts of “book-entry” and “booking to an account” are well established for securities and cash. However, they cannot easily be transferred or applied to financial instruments in the form of contractual agreements, e.g. derivative contracts, which are mostly covered by a master agreement resulting in one single agreement, as well as financial collateral arrangements. Any attempt to clarify these concepts or rely upon them should be carefully considered and would need to take into account the fundamental differences between (1) transactions involving securities and comparable materialised or non-materialised rights being the object of transactions; and (2) contractual agreements producing claims/rights e.g. derivatives. This is related to the need to differentiate between clearing of derivatives and securities settlement in the SFD.

Two stakeholders noted that DLT and smart contract technology use novel means of ensure that these methods are capable of meeting the possession and control requirements for security financial collateral arrangements. For instance, stakeholders replied that digital assets are capable of being possessed or controlled through the **exclusive control of the private keys** associated with those assets. Similarly, according to the stakeholder, it is possible to control, and in some cases possess, those assets through their effective immobilisation, subject to the occurrence of certain trigger events, in a **smart contract meeting the policy objectives** motivating the “possession or control” criterion. Smart contracts may be designed in a range of different ways. For example, the collateral assets may be coded to ensure they are automatically transferred to the collateral taker or provider in accordance with the terms of the collateral arrangement. Stakeholders believed that this type of arrangement could amount to control. Equally, the collateral assets may be coded in a way that allows them to be transferred in accordance with the sole instructions of the collateral taker. In the view of these stakeholders, such arrangements should be capable of amounting to either possession or control. Alternatively, the smart contract may not govern the collateral asset, but may be used to immobilise a digital asset. The stakeholder commented that it should be possible, without undermining national laws, to clarify at EU level that these types of arrangements could be capable of meeting the possession and control requirements under the FCD. However, stakeholders thought that **other related questions will need to remain matters of national law** – e.g. whether it is possible to own crypto-assets and how ownership may be evidenced. One of these stakeholders believed that these clarifications should, where possible, be provided at EU level to promote harmonisation, notwithstanding potential national law differences with respect to the ownership rights or nature of digital assets. The other stakeholder added that given the nascent and evolving nature of the market, it may be preferable for such clarifications to be made under Level 2 measures and/or interpretative guidance rather than under primary legislation.

Another respondent suggested that the notions of 'account' and 'book-entry' should be amended to explicitly recognize the use of DLT. According to them, for the notion of 'account' and 'relevant account', this would translate in recognising that a DLT security wallet on which DLT securities are recorded (the private key of which is being kept by the securities holder itself or by a custodian) would constitute an 'account'.

However, another respondent highlighted that currently CCPs are not allowed to use crypto-assets as collateral, as they are not included in the list of eligible collateral under the Commission Delegated Regulation (EU) 2016/2251<sup>27</sup>. The stakeholder noted that including crypto-assets in the FCD's scope would **create inconsistencies in the system**. Furthermore, the **high volatility of crypto-assets could potentially increase the risk for collateral to be ineffective** as to its purpose, as well as inefficient as to its functioning, since the need for rebalancing the collateral amount would arise. Extending the FCD only to specific crypto-assets maintaining a stable value (stable-coins/e-money tokens) could be a solution to the abovementioned issue. Nevertheless, the FCD may not be the right place to set out specifications regarding types, ownership and provision requirements related to crypto-assets. As to asset-backed tokens, the stakeholder highlighted that they could be highly volatile, depending on the backing asset or basket. In addition, the stakeholder pointed out that the risk of creating overcomplex collateral goes together with a higher operational complexity.

One stakeholder considered the FCD to be the wrong piece of legislation to address civil law concepts relating to DLT. In the stakeholder's opinion, this topic should be addressed in Member States' law. In addition, the stakeholder pointed out that the FCD is already technologically neutral. Notwithstanding, a clarification on how the possession and control requirements could be applied to crypto assets would be advantageous.

Two other stakeholders said that the provisions of the FCD that relate to ownership, provision, possession and control of other financial instruments are already sufficient as they apply to crypto-assets. In their opinion, it is unnecessary to specify these concepts further in the context of distributed ledger transactions. DLT is ultimately a mechanism for transferring and recording the transfer of assets. It does not confer additional or different rights regarding ownership, possession or control that would need to be reflected in the FCD. In addition, the stakeholders highlighted that, prior to amendments to the FCD or any similar or related legislation to facilitate or promote the use of either DLT or crypto-assets within the EU, a thorough review and impact assessment on the potential impact of any such modifications on financial transactions not making use of DLT or crypto-assets would be required. One of these stakeholders noted the following should be considered: does the DLT system's operational set-up provide for the creation of an 'account' or 'relevant account'; do crypto-assets constitute 'cash' or 'financial instruments'?; how is collateral in the form of crypto-assets provided and how does the collateral taker demonstrate that it has sufficient 'control' of the collateral?

Another stakeholder pointed out that crypto-assets should not be accepted as financial collateral due to the **legal uncertainties regarding their possession and enforcement** as well as the fact that their **value is not sufficiently stable**. In addition, the stakeholder argued that valuation of crypto-assets happens on unregulated and unsupervised markets, where market manipulation and speculation can happen. Accepting them as collateral could have significant negative effects on financial stability.

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<sup>27</sup> [Commission Delegated Regulation \(EU\) 2016/2251 \(OJ L 340, 15.12.2016, p. 9\)](#).

### 3.5.6. *Notions of ‘account’ and ‘book-entry’*

The consultation asked whether the notions of ‘account’ and ‘book-entry’ should be retained, replaced or further clarified/specified for the purposes of evidencing the provision of cash or securities collateral provided through DLT. Stakeholders’ views were divided for both notions, with around half the respondents providing an opinion in favour and the other half against a further specification.

Regarding the **notion of ‘account’**, eight respondents indicated that the notion should be retained, while seven answered that the notion should be further clarified/specified. 12 did not answer or have an opinion. One stakeholder argued that there is no need for a modification as the notion of ‘account’ is used in the FCD and in SFTR<sup>28</sup>. The stakeholder referred to the minimalistic definition of ‘account’ in the Geneva Securities Convention, indicating that it shows that a more precise definition is not required for the legal provisions to produce effects. The stakeholder believed civil law questions related to ownership, provision, possession, control should not be harmonised at EU level. Regarding crypto-assets, the stakeholder noted that this should be addressed under a general regime and not in a potential amendment of the FCD.

Three other stakeholders, who did not see the need for clarification, explained that **the definition is sufficiently broad to cover a register or account that may be maintained using DLT**. Another stakeholder agreed and elaborated that, because the notions “book-entry securities collateral” and “account” do not only refer to “account” but also to “register”, they are sufficiently broad to cover collateral entered into a DLT register irrespective of whether such DLT register qualifies as an “account”. Nonetheless, the stakeholder considered it **helpful for the sake of legal certainty to clarify what “account” means in a DLT context and whether the DLT system used should be account-based** (as opposed to transactions based models, also referred to as UTXO). Yet another respondent agreed that the definition of “relevant account” seems to be compatible with a DLT environment, if a distributed ledger is considered a register. However, for the avoidance of doubt, this stakeholder also considered it useful to **refer clearly to DLT** in the definition. Two other stakeholders agreed with this view, but did not see the need to clarify. However, they would not object if it is done (e.g. in recitals) for the sake of clarity. Another stakeholder who agreed that a clarification of the use of the term “account” in a DLT context would be advantageous, underlined that this concept is **not exclusive to the DLT universe** and also that analogous terms in a DLT system might not be covered.

One stakeholder, who saw the need for a clarification, indicated that in some DLT-based arrangements, there is no “account”, and they did not see a compelling policy reason to require parties to structure their arrangements around this concept. In relation to book entry securities collateral, the stakeholder noted that the definition of “relevant account” refers to “register or account”, which could be interpreted as including a transaction-based ledger. However, this could be clarified. The stakeholder also pointed out that the concept of an “account” arises elsewhere, e.g. in relation to conflicts of law. Therefore, the Commission should clarify and ensure that no provisions of the FCD are dependent on there being an account in the traditional sense. Two other stakeholders indicated that the notions should be further specified and cover the following: books and records, permissioned platform of system with identifiable participants, e-wallet or token wallet, or options without the creation of an account (private keys). One respondent, who also

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<sup>28</sup> [2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse \(OJ L 337, 23.12.2015, p. 1\).](#)

saw the need for clarification, said that the notions of 'account' and 'book-entry' should be amended to explicitly recognize DLT technology. The stakeholder indicated that for the notion of 'account' and 'relevant account', this would translate into recognising that a DLT security wallet on which DLT securities are recorded (the private key of which is being kept by the securities holder itself or by a custodian) would constitute an 'account'. However, given the distributed nature of a DLT ledger, it is not clear where a wallet operated on a distributed ledger would be deemed to be located for the purpose of conflict of laws under the FCD. In addition, depending on the participants to the distributed ledger and the type of distributed ledger at hand, that location could change over time. The physical location of such a ledger and wallets is thus not a meaningful concept, as the ledger could be stored on every node in the DLT network and private keys over an account could change locations (not considering the concept of cold storage wallets having physical private keys). The stakeholder's view is that the governing law for the provisions on conflict of laws (Article 9.2 FCD) for DLT securities kept a DLT account should be determined by either (i) the location of the central authority who operates a permissioned DLT network or (ii) the chosen law of the rules and regulations of the said system. However, as a fall-back solution, the stakeholder suggested that the governing law should be determined by the governing law of the instruments over which security is to be taken or the location of the issuer of such instruments.

Regarding the **notion of 'book-entry'**, eight respondents indicated that the notion should be kept, eight others answered that the notion should be further clarified/specified. 11 stakeholders did not answer or have an opinion.

Five stakeholders explained that the FCD notion of 'book-entry' is sufficiently broad to cover a register or account maintained using DLT. One of these pointed out that the concept of book-entry form is principle based, looks quite straight-forward and is thus sufficiently flexible to be applied in DLT context. Another stakeholder agreed and added that the definition of 'book entry securities collateral' seems to be compatible with a DLT environment, **if a distributed ledger is considered a register within the meaning of this definition**. However, for the avoidance of doubt, according to this stakeholder, it might be useful to clearly refer to DLT in the definition. Another stakeholder said that a clarification of the term 'book entry' in a DLT context would be advantageous. Nonetheless, the stakeholder underlined that **this concept is not exclusive to the DLT universe** and also that analogous terms in a DLT system might not be covered. Another stakeholder argued that there is no need for modification as the notion of 'book-entry' is used in the FCD and in SFTR<sup>29</sup>. As commented above, the stakeholder was of the opinion that civil law questions related to ownership, provision, possession, control should not be harmonised at EU level.

One stakeholder noted that the meaning of 'book-entry' is not entirely clear in a DLT context. The definition of 'book entry securities collateral' suggests that title must be evidenced 'by or on behalf of an intermediary'. In decentralised structures, a ledger may be maintained on a distributed basis and there may be no intermediary. According to the stakeholder, there may under certain systems be a system operator; however, it may be inaccurate to describe the entries on the distributed ledger as maintained 'by or on behalf of' that intermediary, e.g. where the nodes on the network are operating as principals and not as service providers to the operator. More generally, the term 'book-entry' is typically associated with traditional accounting methods and there may be some doubt as to whether it captures records on a distributed ledger. The stakeholder added that the term

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<sup>29</sup> [Regulation \(EU\) 2015/2365 \(OJ L 337, 23.12.2015, p. 1\)](#).

‘book-entry’ is not used in the context of cash in the FCD. However, in the respondent’s opinion similar technology-neutrality considerations should apply.

### 3.5.7. *Any other issues regarding FCD financial collateral in a DLT environment*

When asked if there are any other issues stakeholders would like to address regarding FCD financial collateral in a DLT environment, six respondents answered ‘yes’. Eight answered ‘no’ and 13 stakeholders did not answer or have an opinion.

One stakeholder noted that the FCD covers various matters in relation to book-entry securities collateral, e.g. their legal nature, proprietary effects and requirements for perfection and enforcement, governed by the law of the country in which the relevant account is maintained. However, in many instances in a DLT environment there may be no account in which the securities are held. Moreover, the situs of assets held solely through a multijurisdictional distributed ledger (which by definition is distributed and can span several jurisdictions) is unclear under current conflicts of law rules. Whilst according to the stakeholder this issue cannot be resolved by virtue of amendments to the FCD, the respondent supported efforts to develop a common **conflicts of law** rule internationally (e.g. by the Hague Conference on Private International Law) and referred to the ongoing work in this regard by the International Institute for the Unification of Private Law (UNIDROIT) and the United Nations Commission on International Trade Law (UNCITRAL). In the stakeholder’s view, it would be optimal to enable the participants in a system to agree the choice of law to be used as the situs of any tokens native to the system. Given concerns around the risks of forum shopping, the respondent expected there may need to be some regulatory constraints around the choice of law.<sup>30</sup>

Another respondent also answered that the FCD **conflict of laws** rule<sup>31</sup> is difficult to apply in a DLT context. The location of an asset constituted on a DLT ledger which by definition is distributed and can span several jurisdictions is unclear. Locating the register on a DLT ledger is not meaningful, as a DLT ledger is stored and reproduced at every node in the blockchain. Therefore, in the stakeholder’s view, it is advisable that specific conflict of laws rules for this particular situation are adopted. In case of a permissioned DLT system with a centralized validation model, the respondent believed that the PROPA approach (place of the Relevant Operating Authority) would be most suitable: the applicable law governing the proprietary aspects of securities transactions on DLT is the law of the place where the relevant operating entity is situated.

A third stakeholder also considered the **conflict of laws rules** in Article 9 of the FCD problematic in a DLT context. According to the stakeholder, the *lex rei sitae* remains accurate, but should be assessed. For instance, the FCD may refer to (i) the law of the country of the operator of the blockchain; but this would be inadequate for public blockchains; or (ii) the law of the "custodian", i.e. the holder of the cryptographic key (if such activity could be seen as similar to the holding of a securities account).

One respondent highlighted again **that in relation to crypto-assets, including e-money tokens and asset-referenced tokens, a specific FCD recognition may be premature**. According to this stakeholder, the FCD might not be the right place to set out specifications regarding ownership requirements related to crypto-assets, as these aspects are still debated, also nationally, and the regulatory landscape is still evolving. The stakeholder added that, even though the meaning of ‘possession’ and ‘control’ could

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<sup>30</sup> The stakeholder added that this position is supported by the Financial Markets Law Committee and provided the following link: [http://fmlc.org/wp-content/uploads/2018/05/dlt\\_paper.pdf](http://fmlc.org/wp-content/uploads/2018/05/dlt_paper.pdf).

<sup>31</sup> i.e. the PRIMA (Place of the Relevant Intermediary) rule



potentially be clarified and harmonised, these concepts would remain uncertain with regard to crypto-assets. In this context, the eligibility of crypto-assets under the FCD could also potentially enhance **regulatory and contractual arbitrage**.

One stakeholder highlighted that currently, **most crypto-assets do not provide a sufficiently stable value to be used as financial collateral under the FCD**. Therefore, they should not be accepted as collateral under the FCD. The stakeholder added that the valuation of crypto-assets happens on unregulated and unsupervised markets, where market manipulation and speculation can happen. Accepting them as collateral could have a significant negative effect on financial stability. As such, crypto-assets should be excluded from the scope of the FCD or there should be additional criteria to ensure the necessary stability of their value as well as possession and enforcement.

#### *3.5.8. Credit claims as collateral - set-off provisions*

When asked whether existing provisions on set-off create a problem for the provision of credit claims as collateral, no stakeholder answered 'yes'. Seven replied 'no' and 20 did not reply or have an opinion. One stakeholder pointed out that there is no need to statutorily restrict set-off-rights, considering that the existing contractual limitations already achieve an adequate outcome in this regard.

### **3.6. The FCD and the interaction with other Regulations/Directives**

#### *3.6.1. Insolvency Regulation*

Eight stakeholders replied. Six replied that there are no provisions in the Insolvency Regulation which are not sufficiently clear in their interaction with the FCD or the other way round. Two stakeholders replied that there are unclear provisions, with one explaining that the FCD appears to act outside the Insolvency Regulation but should include a requirement for registration of assignments of book debts so that there is transparency. 19 stakeholders did not reply or express an opinion.

#### *3.6.2. Second Chance Directive*

Six stakeholders commented on the interaction with the Second Chance Directive. Three replied that there are no provisions in the Second Chance Directive which are not sufficiently clear in their interaction with the FCD or the other way round. Three stakeholders replied that there are unclear provisions and that the Second Chance Directive introduced a moratorium but failed to provide for adequate safeguard for netting agreements (leaving this to the Member States). They argued that this should be remedied to ensure a minimum harmonized level of protection for netting agreements by way of exemptions for netting and collateral agreements and/or clear limitation on the stays (as in the BRRD). 21 stakeholders did not reply or express an opinion.

#### *3.6.3. BRRD*

Of the nine stakeholders which responded, four replied that there are no provisions in the BRRD which are not sufficiently clear in terms of their interaction with the FCD or the other way round. Five stakeholders replied that there are provisions that are not sufficiently clear. They repeated the issues raised in reply to questions 4.3. and 4.4.1 of the consultation regarding possible legal opinion or legal uncertainties related to netting provisions in relation to BRRD and by virtue of the introduction of Article 1(6) of the FCD. 18 stakeholders did not reply or express an opinion.

#### *3.6.4. Framework for the recovery and resolution of central counterparties*

Of the eight stakeholders which responded, seven replied that there are no provisions in the framework for the recovery and resolution of CCPs which are not sufficiently clear in their interaction with the FCD or the other way round. One stakeholder replied that there

are provisions that are not sufficiently clear. 19 stakeholders either did not reply or express an opinion.

#### *3.6.5. Other*

Nine stakeholders replied that they had identified other legislation where provisions are not sufficiently clear in terms of their interaction with the FCD or the other way round.

Three of these stakeholders suggested that if FCD definitions of possession and control are not clarified, then Article 16(10) of Directive 2014/65/EU (MiFID II) should be repealed (at least in respect of derivative transactions). They explained that that provision prohibits investment firms from concluding title transfer financial collateral arrangements with retail clients. That forces them to replace effective and established collateral arrangements based on title transfer (e.g. for the exchange of variation margin in connection with derivative transactions) by more complex and burdensome arrangements, such as security financial collateral arrangements or pledge arrangements.

Four stakeholders in favour of including emission allowances into the definition of financial instruments in FCD, said that such amendment would require a subsequent amendment of Section 1 of Annex 1 of the Commission Delegated Regulation (EU) No 153/201 on requirements for CCPs, to make full benefit of the advantages for market participants. They also pointed out that there is no mechanism available within the Union Registry which would allow for registering a security interest.

Several stakeholders said that as the principal-to-principal clearing model at CCPs come into effect, a clarification in FCD that client clearing agreements (e.g. those developed by ISDA) benefit from the close-out netting provisions and that a single netting set can include various sub-netting sets.

One stakeholder replied that it had not identified any such other provisions that are not sufficiently clear in terms of their interaction with the FCD or the other way round, and 17 stakeholders did not reply or express an opinion.

### **3.7. Other issues**

#### *3.7.1. Cross-border issues due the transposition of the FCD*

Six stakeholders provided input and suggestions when asked whether they had identified any cross-border issues due to inconsistencies in the transposition of the FCD, which would merit further harmonisation.

Some stakeholders said that the FCD does not give an equal level of protection for transactions involving third-country counterparties where these are collateral/security takers. That exposes them, and indirectly their EU counterparties, to risks, which not only is an impediment to the inflow of capital into the EU, but also fall back on EU counterparties. An equal level of protection for third-country counterparties is in the interest of EU market participants. Other stakeholders repeated arguments in favour of more harmonisation of FCD or some of its concepts to reduce legal uncertainties and the need for case-by-case assessments.

One stakeholder repeated its concern about the lack of harmonisation of close-out netting in case of insolvency due to the limited scope of FCD. It said that improvements in some Member States (Italy, Denmark and Germany) have limited value to traders with commercial activities across multiple markets, as the situation is unresolved in other countries. As a result, counterparties must shoulder the credit risk and will be more cautious with exposures. That hampers the development of liquidity in some countries and increases compliance costs. It therefore strongly supports an EU Netting Regulation

and refers to a draft for a European Netting Regulation presented to the Commission in 2008 by various associations (EFET/ISDA).

One stakeholder said that it had not experienced any cross-border issues, and 19 stakeholders did not reply or express an opinion.

### 3.7.2. *Further enhancement of cross-border flows of financial collateral*

Four stakeholders commented on how cross-border flows of financial collateral across the EU could be enhanced. They suggested that the conflict of law provision in Article 9 of FCD should be revised to consider the potential involvement of branches/head offices or intermediaries holding accounts. Three suggested improving the protection of the provision of collateral from clearing client through intermediaries in the clearing chain up to the clearing member and from there to the CCP and vice versa. Another stakeholder said that adding Eurobonds to T2S coverage would enhance cross-border flows across the EU. Some stakeholders repeated their views on the need to modernise or harmonise the FCD or some of its concepts, or the insolvency legislations. One stakeholder did not have any suggestions; 22 did not reply to the question or express an opinion.

### 3.7.3. *Other issues*

11 respondents provided further input; some repeating views already provided to previous questions in the targeted consultation. This is not repeated here.

One stakeholder said that in the context of the temporary equivalence provided by the European Commission to CCPs located in the UK, the enforceability and validity of collateral posted in these CCPs should be ensured vis-à-vis counterparties based in the EU27 area and conflicts between UK and EU laws should be avoided.

One stakeholder argued against harmonisation through a regulation, as in its view a certain flexibility for the Member States is needed when it comes to the implementation of financial collateral related questions and topics. In its view, most of the issues discussed in the targeted consultation do either not constitute actual concerns under, and/or are not relevant in light of, the existing provisions of the Luxembourg Collateral Act, which has been working well.

Another stakeholder explained that title transfer financial collateral arrangements covered by the FCD should be expanded. The stakeholder argued that, currently title transfer financial collateral arrangements encompassed by the FCD protections are limited to those that secure or otherwise cover the performance of ‘relevant financial obligations’. According to this stakeholder, certain transactions under one collateralised master agreement may deprive the entire collateral arrangement, and any related close-out netting provisions, of FCD protections. The stakeholder explained further that to obtain any FCD protection, industry participants have to segregate into FCD eligible and non-FCD eligible arrangements portfolios of transactions that, from the perspective of business, risks management and collateral optimisation, should comprise a single arrangement. Therefore, the stakeholder suggested amending the definition of ‘relevant financial obligations’ and proposed the following definition: “‘*relevant financial obligations*’ means the obligations which are secured or otherwise covered by a financial collateral arrangement. Relevant financial obligations may consist of or include: (i) present or future, actual or contingent or prospective obligations (including such obligations arising under a master agreement or similar arrangement); (ii) obligations owed to the collateral taker by a person other than the collateral provider; or (iii) obligations of a specified class or kind arising from time to time”.