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Summary report of the targeted consultation on the review of the Directive on settlement finality in payment and securities settlement systems

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 settlement finality in payment and securities settlement systems 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 Settlement Finality Directive

The Settlement Finality Directive[1] ('SFD') aims to reduce systemic risk arising from the insolvency of participants in payment and securities settlement systems (systems). It protects a designated, notified and published system (SFD system) and its participants – whether domestic or foreign – from the legal uncertainty and unpredictability inherent in the opening of insolvency proceedings against one of their number. It does so by protecting the irrevocability and finality of transfer orders entered into an SFD system, thus preventing them from being interfered with during insolvency proceedings (settlement finality). The SFD also provides for the enforceability of the netting of transfer orders, from the effects of the insolvency of a participant. The SFD also ring-fences collateral security provided in connection with participation in an SFD system or in the monetary operations of the Member States' central banks or the European Central Bank (ECB) from the effects of the insolvency of the collateral provider.

Since its adoption, the SFD was amended five times. In 2008/2009, the first review took place. The Commission's 2005 evaluation report concluded that the SFD worked well and had its intended effect. The amendments, therefore, aimed at keeping up with the latest market and regulatory developments, especially the increasing interoperability of SFD systems. Credit claims were also added to the definition of collateral security. Subsequently, there were another four amendments, the focus of which was to incorporate amendments made in other EU Regulations or Directives, which were introduced to deal with the aftermath of the financial crisis (i.e. the European Supervisory Authorities (ESAs) Directive[2], European Market Infrastructure Regulation[3] ('EMIR'), Central Securities Depositories Regulation[4] ('CSDR') and Bank Recovery and Resolution Directive 2[5] ('BRRD2'))[6].

1.2. The report and targeted consultation

During the legislative process for BRRD2, the European Parliament sought to extend the SFD protections to any non-EU system governed by the law of a third country (third-country system) where at least one (direct) participant had its head office in the EU. As a result of negotiations, Article 12a of the SFD was introduced requiring the Commission to report by 28 June 2021 on how Member States apply the SFD to their domestic institutions which participate directly in systems governed by the law of a third country and to collateral security provided in connection with their participation[7]. If appropriate, the report should be accompanied by a proposal for revision of the SFD.

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1 Directive 98/26/EC (OJ L 166, 11.6.1998, p. 45).

2 Directive 2010/78/EU (OJ L 331, 15.12.2010, p. 120).

3 Regulation (EU) No 648/2012 (OJ L 201, 27.7.2012, p. 1).

4 Regulation (EU) No 909/2014 (OJ L 257, 28.8.2014, p. 1).

5 Directive (EU) 2019/879 (OJ L 150, 7.6.2019, p. 296).

6 With the (partial) exception of BRRD2, all amendments upheld the continued application of the SFD's protections.

7 Article 12a of SFD: '*By 28 June 2021, the Commission shall review how Member States apply this Directive to their domestic institutions which participate directly in systems governed by the law of a third country and to collateral security provided in connection with participation in such systems. The Commission shall assess in particular the need for any further amendments to this Directive with regard to systems governed by the law of a third country. The Commission shall submit a report thereon to the European Parliament and the Council, accompanied where appropriate by proposals for revision of this Directive.*'

DG FISMA services took the opportunity to consider a wide range of areas where targeted action may be necessary for the SFD to continue its functioning. Such a wider review was deemed appropriate, given that the last review took place in 2008/2009. In parallel to the targeted consultation on the SFD, FISMA services also conducted a targeted consultation on the closely linked Financial Collateral Directive[8] ('FCD'). Two issues that are dealt with in the FCD targeted consultation are also important for the SFD: (i) recognition of 'close-out netting provision'; and (ii) the definition of 'financial collateral' ('cash' and 'financial instruments' the two most commonly used forms of 'collateral security' under the SFD). Even though the Commission concluded during the last review, that the SFD worked well, the impact of new developments in a changing business, technological and regulatory environment was considered worth reflecting on.

To support the review of the SFD, a targeted consultation[9] was conducted between 12 February 2021 and 7 May 2021. The Commission received 72 responses to the targeted consultation.

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[10]. Any positions expressed in this feedback statement reflect the contributions received and not the position of the Commission or its services.

This feedback statement takes into account the following:

- The number of responses received varied considerably depending on the question. The SFD impacts a wide scope of stakeholders and respondents naturally focused their contributions on the topics that affect them the most. Where stakeholders did not reply to a specific question, they were considered as a group, together with those who replied 'don't know/no opinion'.
- 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

72 stakeholders replied to the targeted consultation. The majority were company/business organisations (41 respondents) and business associations (20 respondents). Together they

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8 Directive 2002/47/EC (OJ L 168, 27.6.2002, p. 43).

9 The targeted consultation questionnaire is available at the dedicated Commission website: https://ec.europa.eu/info/consultations/finance-2021-settlement-finality-review_en

10 Replies to the targeted consultation were published on 18 June 2021 under on the dedicated Commission website: https://ec.europa.eu/info/consultations/finance-2021-settlement-finality-review_en

represented 85%[11]. In addition, nine public authorities and two academic/research institutions replied but no consumer organisations or citizens.

Table 1: Type of entity of respondents

Replying as	
Company/business organisation	41
Business association[12]	20
Public authority[13]	9
Academic/research institutions	2
Total respondents	**72**

2.1.2. Fields of activity

Among the company/business organisations and business associations replying to the targeted consultation[14] were e-money institutions (23 respondents), payment institutions (13 respondents) and credit institutions (eight respondents). Moreover, central counterparties ('CCPs' – eight respondents), central securities depositories ('CSDs' – eight respondents) and system operators (six respondents) replied.

2.1.3. Country of origin

Around 77% of the replies came from EU or EEA respondents; 55 stakeholders from 16 Member States, and one from Norway, replied to the targeted consultation, with the largest numbers of replies coming from Belgium (14 respondents) and Lithuania (14 respondents). 16 responses came from outside the EU/EEA: eight from the United Kingdom, seven from the United States and one from Switzerland.

Table 2: Country of origin of respondents

Country of origin of respondents	
European Union	(77%) 55
Belgium	14
Lithuania	14
France	6
Germany	3
Luxembourg	3
Bulgaria	2
Ireland	2
Netherlands	2

[11] Indicated percentages in this text are rounded for the ease of readability.

[12] One of these respondents categorised itself as 'other', however, due to the nature of its activities it has been listed here as 'business association'.

[13] One of these respondents categorised itself as 'other', however, due to the nature of its activities it has been listed here as 'public authority'.

[14] Multiple answers were possible.

Spain		2
Czech Republic		1
Estonia		1
Finland		1
Latvia		1
Malta		1
Poland		1
Sweden		1
EEA countries	(1%)	1
Norway		1
Non-EU/EEA countries	(22%)	16
United Kingdom		8
United States		7
Switzerland		1
Total respondents		**72**

2.1.4. Organisation size of respondents

Most respondents were either micro or small organisations (32 respondents) or large organisations (30 respondents). Ten were medium organisations.

Table 3: Size of respondents

Organisation size	
Micro (1 to 9 employees)	17
Small (10 to 49 employees)	15
Medium (50 to 249 employees)	10
Large (250 or more)	30
Total respondents	**72**

2.1.5. Feedback on the different sections of the consultation

Although 72 stakeholders provided feedback in total, the number of replies varied between the different areas covered by the targeted consultation. More specifically, the number of respondents that expressed an opinion[15] and replied to at least one of the questions in the different areas were the following:

- Third-country systems: 46
- Participation in systems governed by the law of a Member State: 62
- Technological innovation: 40

[15] Not counting those stakeholders who did not reply or replied 'I don't know/no opinion'.

- Protections for collateral security: 27
- Settlement finality moments and notification of insolvency proceedings: 40
- The SFD and other Regulations/Directives: 21
- Other issues: Eight respondents replied to questions about cross-border issues; 20 raised further points.

2.2. Key messages

The key messages from the consultation were the following:

- **Time for a major overhaul?** A number of respondents argued that there is a need to **look at SFD and its concepts differently** and to protect the transfer instead of particular entities. Others pointed to the importance of maintaining a balance between SFD finality protection and the resulting limitation to the application of national insolvency laws. Some pushed for **harmonised protection** in the EU and suggested to move towards a Regulation, or at least to remove Member State opt-outs/room for discretion in the current Directive. Others pointed to the importance of the possibility to adapt frameworks to local considerations and market conditions.
- **Is the 'one-size-fits-all' approach fit-for-purpose?** Stakeholders in different groups replied to different questions, and it was clear from the replies that issues and solutions may differ between systems, not only between payment and securities settlement systems, but also between CCPs and CSDs. Some proposed that the different needs (e.g. participation criteria, or specifications of moments of finality) should be reflected in SFD, others that it should be addressed in sectoral regulation, if needed.
- The **lack of harmonisation and legal certainty** as to how Member State insolvency rules apply to **EU participants in third-country systems** was raised by many. Respondents said it prevents third-country systems from accepting EU entities as participants; it creates an unlevel playing field between banks/firms in Member States that have extended protection to domestic participants and those in other Member States; it potentially results non-protected EU participants bring risks into the EU. While respondents generally raised issues with the current situation, views varied as to the details of how to do address them.
- There was a general **agreement to add CSDs** to the list of eligible (direct) **participants in systems governed by the law of a Member State**. A majority also **agreed or accepted to add payment institutions and e-money institutions** to that list, at least as far as payment systems are concerned, although views varied as to under what conditions and requirements. No major opposition was voiced against continuing to allow (regulated) **natural persons** to be eligible as direct participants in SFD systems.
- Most respondents viewed it t**oo early to regulate how to treat DLT systems and crypto-currencies** under SFD. Current concepts work for centralised/permissioned DLT systems, but to allow for designation of permission-less systems, the SFD would need a revision. Many suggested first waiting for the EU Pilot Regime on DLT to give results.
- On whether to extend **SFD protection to collateral security provided by a client of a (direct) participant in the event of the insolvency of that participant**, the feedback **differed depending on the kind of respondent**. Generally speaking, CSDs were content with the current situation. CCPs favoured an extended protection, in particular to ensure protection of their default management procedures;

and banks wanted the protection to be extended to any intermediary acting in the system. At the same time, respondents pointed out that the underlying purpose of SFD is to safeguard financial stability and an extension of protection to any client would have a major impact as it would concern a very large number of entities and therefore suggested that in any case, protection should not be extended to retail clients or smaller non-financial counterparties.

- **Views** were split as to **whether the SFD should specify the finality moments**, of entry into the system and irrevocability of the transfer order and when settlement is both enforceable and irrevocable. System operators strongly objected to changing current rules and argued that the system operator is best placed to specify these moments and adapt them to its systems. Banks expressed strong support for these moments to be specified to provide legal certainty. Without there being full agreement, stakeholders in both groups suggested that there could be benefits in specifying these moments for interoperable systems, although some pointed out that the SFD already requires operators to coordinate these moments, so the need may be limited.

3. SUMMARY OF RESPONSES

3.1. Third-country systems

The SFD covers systems governed by the law of a Member State but not those governed by the law of a third country ('third-country systems'). Whereas EU entities may participate in such third-country systems, as SFD does not cover such systems, transactions and collateral posted by EU participants in such systems and related netting are not protected under SFD. As recalled in Recital 7 of SFD Member States may apply the provisions of SFD to their domestic institutions, which participate directly in third country systems, and to collateral security provided in connection with participation in such systems. The targeted consultation asked several questions about whether SFD finality protection should be extended to EU institutions' participating in third-country systems, and if yes, how it should be done.

3.1.1. EU institutions participating in third-country systems

3.1.1.1. Should EU institutions participating in third-country systems benefit from SFD finality protection?

The large majority (41 respondents) thought that EU institutions that participate in third-country systems should benefit from protection under SFD; three disagreed and 28 did not reply or express an opinion.

Respondents said such an extended protection would be important for **financial stability** and **ensure that EU participants are granted access** to third-country systems.

Respondents said SFD protection should not only apply to EU participants in third-country systems, but to the third-country systems. The aim of SFD is to protect systemically important systems and EU insolvency laws should not lead to different results when EU entities submit transfer orders to third-country systems. It is key to ensure legal certainty that the operation of the system will not be affected by the insolvency of an EU participant, to ensure that EU participants can access such systems. An extension of SFD protection to the system would ensure legal certainty as the operator of the system would only have to consider a single country's law. That would ensure a coherent and non-discriminatory approach where transfer orders submitted to third-country systems and transfer orders submitted to EU systems are treated in the same way.

An operator of a third-country system explained that the current lack of harmonisation makes resolution planning difficult. A third-country system operator might decide not to admit an EU participant if it does not have confidence that the Member State insolvency laws will not undermine its system's determination of settlement finality in case of the insolvency of the EU participant. Others also pointed out that to **comply with the CPMI-IOSCO Principles for Financial Market Infrastructures ('PFMIs')**, systems must ensure the effectiveness of settlement finality[16]. For third-country CCPs, this means they are required to have legal opinions supporting their rules' enforceability.

Respondents also pointed out that in the event of an insolvency in the system, the lack of harmonised protection of EU participants opens up to **unequal treatment of EU participants and give raise to risks of contagion** of systemic risks from EU participants to which SFD does not apply to other EU participants. Insolvency proceedings might also benefit if rules on finality were clear.

Others highlighted that **continuous access** to systems is necessary for banks to perform critical functions and designating third-country systems would ensure continued access in stress scenarios, including in the run up to and in resolution.

One respondent said SFD designation is a question of level playing field between competing systems in different jurisdictions and two respondents that SFD is inconsistent with comparable third-country legislation, which do not impose requirements in respect of a system's governing law, thereby preventing the protections of settlement finality in third-country systems.

As to CCPs in particular, respondents argued that both EU and recognised third-country CCPs should benefit from SFD protection for their default management rules and procedures[17].

Others however, argued that an extended protection is **not needed as Member States already may apply the provisions of SFD to their domestic institutions**. Whereas an extended protection could be interesting if there is a large presence of EU institutions, the impact of different legal set-ups should be carefully assessed. To ensure equal treatment and a level playing field, all participants should be subject to the same rules. More clarity on the implications for creditors of defaulting EU participants is needed as **derogations from EU insolvency law might be acceptable in pursuit of EU financial stability, but not if it only benefits third-country financial systems**. From the perspective of the third country, an extended protection could also be considered as an extraterritorial application of EU law.

Two respondents highlighted the importance of **transparency** about which Member States have extended SFD protection to domestic institutions.

3.1.1.2. Should all EU institutions benefit from protection?

The majority (38 respondents) were in favour of extending the scope of SFD to all EU-institutions participating in third-country system without discrimination; three disagreed and 31 did not reply or express an opinion. Stakeholders said that to ensure a level playing field, all EU-institutions should be able to participate when the participation criteria are met. One argued that as the types of EU entities that can benefit from SFD

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16 Principle 8: '*An FMI should provide clear and certain final settlement, at a minimum by the end of the value date. Where necessary or preferable, an FMI should provide final settlement intraday or in real time.*'

17 View further developed in Sections 3.2.5 and 6.1.

protection in EU or third-country systems will depend on the implementation of SFD in the Member State, no further criteria are needed.

3.1.1.3. Possible selection criteria

The targeted consultation asked those that had indicated that SFD finality protection should not be extended to all EU institutions, to comment on the selection criteria. Only a few replied, as most stakeholders had replied that they were in favour of extending SFD protection to all EU-institutions without selection. Views on possible criteria were the following:

- Size of the institution: Five respondents rather or fully agreed; nine rather did not agree or disagreed; 10 were neutral and 48 did not reply or express an opinion.
- Systemic relevance for the financial market of the Member State in which the institution is located: Five respondents rather or fully agreed; eight rather did not agree or disagreed; 2 were neutral and 57 did not reply or express an opinion.
- Amount with which the institution is participating in the system: Six respondents rather or fully agreed; nine rather did not agree or disagreed; nine were neutral and 48 did not reply or express an opinion.
- Type of participant (e.g. only banks, investment firms): Eight respondents rather or fully agreed; 15 rather did not agree or disagreed; one was neutral and 48 did not reply or express an opinion.
- Other risk-based criteria: 10 respondents rather or fully agreed; five rather did not agree or disagreed; 10 were neutral and 47 did not reply or express an opinion. One respondent suggested that the size of the participant (volume and value of transactions effected) in the system could be relevant. Another suggested to evaluate the potential impact of the participation of an EU institution in a third-country system on other EU systems.
- Other criteria: Three respondents rather or fully agreed; one rather did not agree or disagreed; one was neutral and 67 did not reply or express an opinion. One respondent argued that only participants that fulfil the participation requirements should be eligible to participate in third-country systems.

3.1.2. Third-country systems and SFD

The targeted consultation asked if the scope of SFD were to be extended to EU institutions participating in third-country systems, how this should be done.

3.1.2.1. How should a third-country system be considered, if the scope of SFD is extended to EU institutions?

A majority (24 respondents) said that the provisions of SFD should apply directly to the third-country system in their entirety; 12 said that SFD should rely on the protections conferred by the third-country law and six that some SFD provisions should apply directly to the third-country system, whilst some other should rely on the protections conferred by the applicable third-country law. 30 respondents did not reply or express an opinion.

Respondent argued that to **avoid conflict of law**, SFD protection should be provided by **relying on the third-country law**. That would incentivise third countries to protect SFD-designated systems and allow EU SFD-designated systems to benefit from a level playing field with systems in such third countries.

Of the respondents that indicated that **some SFD provisions should apply directly**, **whilst some provisions should defer to the protections conferred by the applicable third-country law**, one said that the SFD should establish a common standard for the recognition of third-country systems contributing to much needed harmonisation whilst still granting national supervisors and settlement systems a degree of flexibility to reflect different needs, risks and sizes of different settlement systems operating in Europe. Importantly, such rights should not be granted where the third country is on an EU blacklist, deemed to be a non-cooperative jurisdiction or otherwise financially unstable.

Another stakeholder suggested that the applicability of SFD provisions should be conditional on provisions enshrined in the third-country law. Some provisions may be set but in all cases it should not lead to conflict of laws and a disadvantageous position of EU participants towards other participants and the system governed by third-country law. Other respondents however, pointed to risk of increased legal uncertainty under this option. They pointed out that such an approach would depend on Courts and insolvency officers, and raise complex questions in respect of conflicts of law 'characterisation issues' as to whether the third country system is comparable and the need to prove foreign law in legal proceedings, (e.g. in some jurisdictions, e.g. the US, there is no prescribed settlement finality regime and general insolvency law protections for CCPs and settlement systems apply). Deferral to the law of third countries would therefore increase litigation risk and costs.

One respondent to the contrary argued that the SFD should not apply directly to third-country systems as it would give extraterritorial effect of SFD, while the result should rather be an EU insolvency officer looks to the rules and law of the third-country system to determine the obligations of the insolvency EU participant. Article 8 clearly states that in the event of insolvency proceedings, the rights and obligations arising from, or in connection with, the participation of the participant shall be determined by the law governing that system, and Recital 4 implies the principle whereby the participant's law should not create any disruption to the system. SFD should therefore rely on the protections conferred by the applicable third-country law which is the sole option to grant a protection which seems valid, enforceable, and consistent with the initial spirit and current letter of SFD.

3.1.2.2. Payment systems versus security settlement systems

All those that expressed an opinion (41 respondents) replied that if the scope of the SFD were extended to EU institutions participating in third-country systems, it should be to both third-country payment systems and third-country security settlement systems. Respondents argued that the benefits of extending SFD designation to third-country systems are comparable for payment systems and security settlement systems or that to the extent systems must comply with the PFMIs, they should be protected under SFD, regardless of whether they are payment systems or securities settlement systems.

3.1.3. Scope of assessment

The targeted consultation asked respondents theirs view on the scope of a possible assessment and the areas most concerned.

3.1.3.1. SFD and the third-country system rules and third-country legal framework

The large majority (37 respondents) viewed that it would be important to assess whether the applicable third-country law is comparable to SFD. However, 15 said that such an assessment should be limited to certain cases (e.g. certain systems or certain third countries) and eight to certain law provisions. Nine respondents thought that there is no need for an assessment. 26 respondents did not reply or express an opinion.

Several respondents said that SFD should not regulate third-country systems or pointed out that many jurisdictions with robust finality legislation do not have 'line-by-line' equivalent rules to the SFD and may have different standards for eligibility of participants. Others said that SFD only needs to prescribe the types of finality rules which are protected and there is therefore a need to assess if the third-country rules are equivalent to SFD, as the effect of designation would be that the finality rules of the third-country system prevails over the insolvency law applicable to the EU participant.

Other stakeholders pointed out that a variety of different default management or insolvency concepts apply in other jurisdictions and conflicting regulations and resulting legal uncertainty should be avoided. If additional requirements were imposed on third-country systems, for the only reason that they have EU participants, such systems may be forced or decide not to accept EU participants.

Most stakeholders agreed that an assessment should relate to broader policy considerations concerning the safety and efficiency of the third-country system and the public interest in designating the third-country system under SFD. Some proposed that an assessment could be made to ensure that the rules of the system and the third-country law is compliant with the PFMIs or that it would be important to ensure that the national insolvency law respects the finality of the third-country system. An assessment should be limited to the legal enforceability of transfer orders and to whether the rights to collateral provided within a system are protected against insolvency proceedings.

One stakeholder argued that the need for an assessment would depend on whether SFD would apply directly to the third-country system or whether the SFD would defer to the third-country law. In the latter case, protections should be equivalent.

One respondent said that an equivalence assessment should be carried out at least for countries in which EU institutions have a relevant market share. Another thought that an assessment should be limited to systemically important systems active in the EU and be part as part of the recognition process of such systems (e.g. under CSDR for CSDs).

Some respondents argued that in any case, participants would have to undertake a basic assessment of the legal setup of the third-country system before joining it, and that it should be at their discretion to decide if they want to participate in a third-country system offering less security compared to EU systems.

3.1.3.2. Possible areas concerned by an assessment

Those stakeholders that replied that only certain provisions should be subject to an assessment were asked to provide further feedback as to the areas concerned by a potential assessment. The large majority of respondents (65 to 69, depending on the question) did not provide any further explanations on the proposed criteria. Views on possible criteria were the following:

- Eligibility to participate in the third-country system directly: Four respondents considered the area rather relevant or fully relevant; two were neutral and 66 did not reply or express an opinion.
- Eligibility to participate in the third-country system indirectly: Three respondents considered the area rather relevant; two were neutral and 67 did not reply or express an opinion.
- The moment of entry into the system, the moments of irrevocability and settlement finality within the system (notably whether such moments are left to the rules of the system or are mandated by the third country law governing the system): Five

considered the area as fully relevant; one was neutral and 66 did not reply or express an opinion.

- The settlement finality provisions (notably the extent to which transfer orders and collateral security as well as their netting are protected from being interfered with): Five considered the area as fully relevant; one was neutral and 66 did not reply or express an opinion.
- The definition of a system: Seven respondents considered the area as fully relevant; 65 did not reply or express an opinion.
- Provisions regarding interoperability of systems: Two respondents considered the area rather or fully relevant; four were neutral and 66 did not reply or express an opinion.
- The application of the settlement finality provision without discrimination between domestic and foreign participants: Six respondents considered the area as rather or fully relevant; 66 did not reply or express an opinion.
- The compatibility of any provisions on conflict of laws: Seven respondents considered the area as rather or fully relevant; 65 did not reply or express an opinion.
- Other: One respondent considered other points as relevant, arguing that an assessment of the third-country law should take place at EU level to avoid conflicts of law (by relying on the law applicable the system and cooperation between authorities) and ensure reciprocity (to the extent necessary e.g. to avoid conflict of laws and dual oversight). Moreover, a meaningful similarity between the concept of a 'system' under the law of the third country and SFD (aligned to the PFMIs) should avoid a backdoor access to the EU and reduce regulatory arbitrage between EU and non-EU regimes. Two respondents were neutral. One argued that from a resolution perspective, the applicable third-country law should make a similar qualitative distinction between traditional insolvency (winding up/administration following a default) on the one hand, and 'BRRD-style' resolution on the other.

3.1.4. Possible assessment criteria

The targeted consultation asked respondents to give their views on a number of possible assessment criteria.

3.1.4.1. Reciprocity

Views were mixed on whether SFD protection should only be extended to third-country systems, if the third country extends protections towards SFD systems. 22 respondents rather agreed or fully agreed; 17 disagreed or rather did not agree; five were neutral and 28 did not reply or express an opinion.

Some respondents said that reciprocal protection for EU systems is not necessary as what matters is that EU participants will benefit from SFD protection. A determination made on the basis of reciprocity creates a risk that the decision is delayed due to external considerations. Settlement finality is a specific EU concept and some jurisdictions, like the United States, do not have bespoke settlement finality regimes but still offer insolvency law protections for key aspects, including to EU systems. Other respondents said that reciprocity in terms of finality of transfer orders and protection of netting and collateral arrangements would ensure a level playing field with systems in third-country jurisdictions.

3.1.4.2. Third-country system should provide information about insolvency

A majority (30 respondents) rather or fully agreed that information about the insolvency of a participant in the third-country system should be provided in a timely manner by the third-country system operator; 11 disagreed or rather did not agree; four were neutral and 27 did not reply or express an opinion.

Respondents in favour argued that timely and complete information is essential to ensure that EU institutions can assess the impacts on their activity and to adopt appropriate risk mitigation actions and pointed to the PFMIs which stress that 'timely communication' with stakeholders, in particular with relevant authorities, is of critical importance. The FMI, to the extent permitted, should clearly convey to affected stakeholders information that would help them to manage their own risks.' Other respondents pointed out that no such obligation lies upon EU institutions and that third-country systems are not likely to have more, or more timely information, than the relevant EU authority. A third-country CCP argued that the proposal should be the other way around: the participant should have a responsibility to inform the third-country system operator if the participant is insolvent or intends to wind down its activities.

3.1.4.3. Third-country authorities should provide information about insolvency

A majority (23 respondents) rather or fully agreed that information about insolvency of a domestic participant should be provided in a timely manner by the third-country authorities; six disagreed or rather did not agree; 15 were neutral and 28 respondents did not reply or express an opinion.

Respondents argued that as information exchange and timely information about the insolvency of a domestic participant is important, it should be provided by both the system operator and the third-country authority. They said that cross-border information exchange would help manage risks and the PFMIs requirement that '…an FMI should effectively measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes.' In this vein, one stakeholder noted that it has such arrangements in place with certain authorities and advised that such practice should be expanded. Other respondents said that the third-country system could be expected to provide the information about the insolvency of a participants, and therefore there would be no need to require the third-country authority to provide such information, although a memoranda of understanding between competent authorities could be helpful. Another respondent claimed that information exchange between authorities should not be a criterion, as it does not lie within the control of the third-country system. Two respondents argued that if SFD protection were available when EU institutions participate in a third-country system, the notification of the insolvency of a domestic participant would not be relevant. A third-country CCP thought that a balance should be struck between the need to ensure information exchange and the burden on the system and pointed out that for CCPs, an enhanced supervisory and reporting framework has been established under EMIR 2.2[18] and argued that no further requirements on third-country CCPs are necessary.

3.1.4.4. Systemic importance of the third-country system

A majority (27 respondents) rather or fully agreed that the systemic importance of the third-country system should be prerequisite; 14 rather did not agree or disagreed; two were neutral and 29 did not reply or express an opinion.

[18] Regulation (EU) 2019/2099 (OJ L 322, 12.12.2019, p. 1).

Respondents pointed out that the purpose of SFD is to reduce systemic risk and related risks of contagion, and that the criterion of systemic importance is inherent in the identification of any 'system' for SFD purposes. One respondent added that while systemic importance could be a reason to recognise a third-country system as an SFD system, it should not be a legal requirement explicitly laid down in SFD.

Other respondents argued any system with EU participants should be eligible and any third-country system that meets the relevant criteria should qualify for designation under SFD. Requiring systemic importance for SFD designation would prevent smaller systems from growing and might also prevent EU participants from using third-country systems, including new systems or start-ups, as these systems might be reluctant to admit EU participants unless they have legal certainty in relation to settlement finality issues. Three respondents pointed to the difficulty in establishing clear and objective criteria to determine a system's systemic importance and to assess systemic risk beforehand.

3.1.4.5. Adequacy of the rules

A majority (34 respondents) rather or fully agreed that adequacy of the rules of the system should be given; five rather did not agree or disagreed; two were neutral and 31 stakeholders did not reply or express an opinion.

One respondent said that – as for EU systems, which can only be designated if a Member State is satisfied as to the adequacy of the rules – the adequacy criterion should apply to third-country systems.

Other respondents suggested that an adequacy assessment should look at several factors, e.g. whether the rules are enforceable under applicable law; if there are cooperation arrangements between competent authorities; and if the system complies with the PFMIs, in particular the requirement that '..an FMI should have effective and clearly defined rules and procedures to manage a participant default.'[19]

Another stakeholder argued that a SFD third-country system regime should rely on the law of the designated third-country system, rather than apply or carry an adequacy assessment under the SFD.

3.1.4.6. Participation

The targeted consultation proposed two criteria relevant to participation: (i) about the third-country system's rules on direct participation; and (ii) about the third-country system's rules on indirect participation.

Regarding the rules on direct participation, a majority (20 respondents) rather or fully agreed that only systems that are as strict as the SFD about (direct) participation should be eligible for designation; 14 did not agree or disagreed; eight were neutral and 30 did not reply or express an opinion. Some stakeholders suggested it important to impose certain requirements to ensure comparability, but allow discretion for particular cases or that as a minimum only supervised entities should be allowed to participate. A benefit of good quality and consistent eligibility standards would be that it ensures that direct members of SFD designated system are less likely to fail. Other respondents argued that different jurisdictions have implemented robust finality and netting protections in a manner that differs materially from the SFD, including with respect to participants, and that SFD standards should therefore not be prerequisite.

As to the third-country rules on indirect participation, replies were similar those on direct participation. A majority (20 respondents) rather or fully agreed that only systems that

[19] Principle 13.

are as strict as the SFD regarding the provisions about indirect participation should be eligible for designation; 12 did not agree or disagreed; seven were neutral and 33 did not reply or express an opinion.

Some respondents argued that an assessment of participant requirements would reduce the number of eligible third-country systems, given the restrictive approach of SFD and the difficulties to apply EU concepts to third-country frameworks. Some jurisdictions, e.g. the US, do not have bespoke settlement finality regimes in place but still offer key insolvency law protections to EU CCPs in other ways. Another respondent argued that Member States should have the right to grant SFD protection to additional entity types. Other respondents, while underlining that criteria for participation should not necessarily be the same as for SFD systems, said that there should be minimum, objective criteria for participation in a third-country system, notably that participants should be supervised entities or sponsored by supervised entities. One respondent underlined that in the future, the typology of direct participants could evolve.

3.1.4.7. Non-discrimination of EU institutions

A majority (31 respondents) rather or fully agreed that no discrimination between EU institutions and other institutions should be made by the third-country system; five rather did not agree or disagreed; seven were neutral and 29 did not reply or express an opinion.

Some said that discrimination would hamper the establishment of a level playing field between EU and third-country jurisdictions, that the third-country system should comply with the PFMIs[20] on fair and open access and that the risk management procedures of third-country systems should be checked regularly to ensure that EU participants are not discriminated against. Other respondents however noted that some flexibility must be available as third-country authorities may impose different requirements on domestic and foreign institutions and systems have risk-related participation requirements that can be specific to certain jurisdictions and that this is in line with the PFMIs. System operators should be able to reject participants from other jurisdictions where no clarity exists as to if the insolvency law applicable to that participant respects the finality rules of the system.

One respondent said it did not see any nexus of discrimination to the question of SFD protection and pointed out that the criteria would be difficult to assess.

3.1.4.8. Knowledge of participants

A majority (33 respondents) rather or fully agreed that all participants have to be known to the system operator; four did rather not agree or disagreed; five were neutral and 30 did not reply or express an opinion.

In general, respondents differentiated between indirect and direct participants. Two said that full identification of all participants has to be a precondition to assess impacts and mitigate risks associated to an insolvency scenario. Another added that not only all participants should be known to the system operator but the necessary 'KYC' checks should be carried out before on-boarding new members. Several respondents however, pointed out that a system operator would often not know the identity of indirect participants (e.g., a CCP would not know the identity of all clients of clearing members).

[20] Principle 18.

3.1.4.9. Country of establishment

17 respondents rather or fully agreed that the country of establishment of the third-country system would be a relevant criteria; seven did rather not agree or disagreed; 17 were neutral and 31 did not reply or express an opinion.

Three respondents said that an assessment should look at whether the country of establishment of the system operator is a high-risk third country according to the Financial Action Task Force, and whether there is a framework for cooperation in place between the competent authorities of that country and those of the EU. Another stakeholder stated that the country of establishment (in isolation) should not be a relevant factor, but rather the governing law. Two respondents said that they did not see how the country of establishment should be a criteria relevant for the assessment.

3.1.4.10. Country of infrastructure

16 respondents rather or fully agreed that the country where the infrastructure is located, maintained or operated should be considered; eight rather did not agree or disagreed; 16 were neutral and 32 stakeholders did not reply or express an opinion.

The detailed responses provided were identical or similar to the previous question on country of establishment. Respondents did not differentiate between the country of establishment of the system operator and the country where the infrastructure is located. However, it was highlighted by one respondent that the location of the infrastructure should be a factor assessed within the consideration of compliance of the system with the PFMIs on operational risk[21].

3.1.4.11. Third-country legal framework

A majority (33 respondents) rather or fully agreed that the third-country law governing the system should fulfil the assessment criteria; seven rather did not agree or disagreed; two were neutral and 30 respondents did not reply or express an opinion.

Three respondents argued that the third-country insolvency law must respect the irrevocability and finality rules of the system, and should accept the extent to which transfer orders and collateral security as well as their netting are protected from being interfered with as stipulated by the third-country system. Another respondent thought that the rules of the third-country system should ensure SFD protections can be effectively enforced. Two other respondents said that in any case, assessment criteria should be proportionate and remain under the control of the third-country system.

3.1.4.12. Volume and value of transactions

A majority (24 respondents) rather did not agree or disagreed that the volume and value of transactions either cleared, settled or otherwise executed through the third-country system in the three calendar years preceding this year should be considered; 11 rather or fully agreed; six were neutral and 31 did not reply or express an opinion.

Respondents opposing considering the volume or value of transactions argued that the designation of third-country systems would deliver benefits to EU investors and intermediaries therefore there should be no minimum thresholds or that such thresholds

[21] Principle 17: '*An FMI should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Systems should be designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. Business continuity management should aim for timely recovery of operations and fulfilment of the FMI's obligations, including in the event of a wide-scale or major disruption.*'

could unfairly exclude systems in smaller financial markets. Others pointed out that also small systems and small participants may trigger a domino effect in clearing and settlement systems or that volumes and values are subject to fluctuation and more static criteria are more appropriate. One stakeholder suggested that volume-based criteria should only play a role as a benchmark in assessing the adequacy of the system's rules and arrangements but should not serve as an independent criterion.

Those in favour of a volume and value based approach highlighted that volume and value of transactions are a key indicator of systemic significance of a payment system and therefore must be a factor to be considered when evaluating a third-country system.

3.1.4.13. Cooperation arrangements

A majority (24 respondents) were in favour of cooperative oversight arrangements between authorities; eight disagreed; 10 respondents were neutral and 30 did not reply or express an opinion.

One respondent said that the relevant EU authorities should rely on supervision by the third-country to avoid duplicative oversight. Another underlined that as the designation of third-country systems will benefit EU investors and intermediaries, it should not depend on unrelated actions by third-country actors. Another respondent, which disagreed that cooperative oversight arrangements should be a prerequisite, stated that according to the PFMIs, market regulators and other relevant authorities should cooperate, also on an international level and explore and, where appropriate, develop cooperative arrangements. A third-country CCP stated that the extensive and enhanced cooperation obligations under EMIR 2.2 should suffice to ensure the necessary information exchange. It was highlighted that settlement systems are increasingly diverse and global in nature. Therefore, oversight, minimum standards of supervisory practices and information sharing among third countries should be supported.

3.1.4.14. CCPs

Only a few stakeholders replied to the question if the recognition by ESMA of a CCP under Article 25 of EMIR should be a prerequisite for it to become a designated third-country system. Ten respondents rather did not agree or disagreed; eight rather or fully agreed; eight were neutral and 46 did not reply or express an opinion.

Several respondents argued that as EU participants may only access third-country CCPs that are recognised by ESMA, it would not be necessary to make SFD designation conditional upon recognition. In any case, they said, it would be important to allow a third-country CCP to apply for EMIR recognition and SFD designation in parallel to avoid the risk of having to operate without key insolvency law protections. Another respondent said that EMIR recognition should not be a condition for SFD designation as the purpose of and requirements are different. However, it argued, SFD designation could be a condition for recognition by ESMA.

One respondent however, proposed that if designation were made at EU level, SFD designation could be part of the recognition process. Another respondent said that third-country CCPs that are recognised by ESMA should (automatically) be recognised as systems under SFD.

3.1.4.15. CSDs

A majority (15 respondents) rather did not agree or disagreed that the recognition of a CSD by ESMA under Article 25 of CSDR should be a prerequisite for it to become a designated third-country system; six respondents rather or fully agreed; eight were neutral and 43 did not reply or express an opinion.

Respondents noted that recognition by ESMA is only required for central maintenance and notary services in relation to financial instruments constituted under the law of a Member State. Recognition by ESMA is not needed for a third-country CSD to have EU participants. A requirement to be recognised would therefore limit in an important manner the number of third-country CSDs which could benefit from SFD protection. It also pointed out that such recognition has not played a role for Member states extending SFD protection to third-country systems. Another respondent said that third-country CSDs that are recognised by ESMA should also be recognised as a system under SFD.

3.1.4.16. One set of criteria

The large majority of stakeholders replying (33 respondents) rather or fully agreed that the criteria should be the same for all third-country systems regardless by which third-country law they are governed; two rather did not agree or disagreed; five were neutral and 32 did not reply or express an opinion. It was highlighted that provisions of the law and the level of equivalence with European law is relevant, to uphold a similar standard across all systems and participants benefiting from SFD protections.

3.1.4.17. Other assessment criteria

The vast majority (57 respondents) did not propose any other assessment criteria.

Three respondents proposed that designated third-country systems should have clear and legally effective rules on settlement finality in place. They should specify (i) which transfer orders arise, (ii) which persons are bound by the transfer orders, (iii) when transfer orders arise; (iv) how and when transfer orders may be amended or revoked prior to becoming irrevocable; (v) when transfer orders become irrevocable; (vi) when transfer orders are completed or terminated; (vii) the finality of the holdings in their systems; and (viii) which collateral security charges are in scope of their rules and relevant protections.

Other respondents also referred to criteria e.g. which kinds of transfer orders arise in the systems, participants involved and the system rules on irrevocability of transfer orders and finality of settlement, as well as the recognition of the system rules by the applicable third-country insolvency law. Some argued that while such criteria should be the same for all third-country systems, the criteria for the assessment of the systemic importance of the system could differ.

Further respondents thought that while some assessment of the adequacy of the system could be appropriate, the rules of the third country should not need to be equivalent to SFD. A high-level assessment of the rules against the PFMIs could be appropriate.

One respondent suggested a public interest perspective, considering, from the point of view of the Member State, the importance of an EU participant in resolution to maintain access to the third-country system and if designation of the system would ensure such continued access.

Some respondents said that if criteria or designation process is to be made at the EU level, it would be important to introduce grand-fathering rights for protections currently granted by Member States to EU participants in third-country systems.

Another respondent argued that UK systems should be fast-tracked for equivalence assessments and decisions given that the national rules are based firmly on EU standards.

3.1.5. Possible procedure

The targeted consultation asked for feedback as to the possible procedure to designate third-country systems.

3.1.5.1. Designation at Member State or EU level?

Only two respondents indicated that decisions should be taken by the Member States on criteria set by them, as they know best their national markets and possible implications and interactions with national laws. Three respondents indicated that this option would be their third choice and 19 respondents said it was the least suited option.

17 respondents considered that decisions to extend SFD protection to third-country systems should be taken at EU level on the basis of EU-wide criteria, as it would ensure a level playing field in the EU and predictability for market participants. 21 other respondents did not exclude this option, but preferred other solutions. One respondent suggested that an EU-wide recognition could be either country-specific (list of equivalent countries) or system-based (systemically important third-country systems).

22 respondents favoured a solution where **criteria for SFD protection are set at EU level, but the decisions to extend SFD protection are taken at the level of the Member States**, as it would ensure greater harmonization within the EU but give the possibility to consider national market characteristics and laws. 15 respondents indicated that this solution would be their second or third preference solutions. In this vein, two respondents were in favour of **a two-step process**: first, assessing the law of the third country at EU level; second determining whether to designate a system at national or EU level, and provided that a level playing field is ensured.

Two stakeholders indicated that – if no protection at EU-level is introduced – that implementation of **domestic protections granted by a Member State in all EU jurisdictions should be mandatory**.

One stakeholder proposes that the most suited option would be that the third-country authority sets the criteria.

3.1.5.2. Designation and review of designation

A majority (30 respondents) said that yes, the assessment for designation of a third-country system be done on a case-by-case basis; 11 replied no, as in their view it is sufficient to assess the third-country law in general regarding comparability; 31 did not reply, did not consider the question relevant or express an opinion. Views were mixed on whether a regular evaluation of the requirements for designation are still met. 22 were in favour and 19 disagreed; 31 did not reply or did an opinion.

Several respondents proposed that the third-county systems should keep EU authorities updated of relevant changes. One said that as far as it was aware, no jurisdiction requires a regular review of protected systems, however many require systems to give notice of changes and some have the power to request information from the system. Similar provisions could be included in SFD.

Other stakeholders argued that a regular assessment would be appropriate, as the underlying facts might change over time. One respondent suggested ESMA, and another the Commission, could do it. Others said that the evaluation should not necessarily be regular, but could be done by the designating authority if it has reason to believe that the system no longer meets the criteria (on an ad-hoc basis). It was also pointed out, that such an assessment is not in place for domestic systems, and therefore not needed for third-country systems.

Views were mixed as to the frequency of a possible evaluation. 11 stakeholders favoured an annual review; six a review every three years; 11 a review at the discretion of the designating authority; four replied ‘other’ and 40 did not reply or express an opinion. Three stakeholders suggested that the review should be prompted by actual changes.

3.1.6. Questions addressed to third-country authorities

The targeted consultation included questions addressed to third-country supervisory authorities. They concerned the protection to foreign payment systems or security settlement systems or domestic participants in such systems from national insolvency law. No replies were provided to the questions.

3.2. Participation in systems governed by the law of a Member State

The SFD lists the participants that are eligible to participate directly in an SFD system and benefit from the protection offered by SFD (e.g. credit institutions, investment firms, public authorities, CCPs, system operators and CCP clearing members). Furthermore, Member States may decide that an 'indirect participant' (that has to fall under the categories eligible for direct participation) may be considered a 'participant', if justified on the grounds of systemic risk.

Under the SFD, both natural and legal persons may be eligible participants, except for CCPs which must be legal persons. Moreover, although investment firms must be legal persons under Markets in Financial Instruments Directive 2[22] ('MiFID2'), Member States may authorise natural persons as investment firms subject to conditions. E-money institutions under the Electronic Money Directive[23] and payment institutions under the Payment Services Directive 2[24] ('PSD2') are not currently eligible participants under the SFD. In the Retail Payment Strategy[25], the Commission announced that it would consider, in its SFD review, extending the scope of the SFD to payment institutions and e-money institutions, subject to appropriate supervision and risk mitigation. Some Member States have introduced national solutions that allow e-money and payment institutions direct or indirect participation in payment systems, provided they fulfil certain criteria.

Currently, the operator of a payment system that has not been designated under the SFD is not eligible to be an SFD participant. That prevents them from participating in TARGET2[26], where payment orders in euro are processed and settled in central bank money.

Whereas CCPs are eligible (direct) SFD participants, CSDs are not explicitly included, although their participation is implicitly covered in their function as 'settlement agent' and 'system operator'. Adding them to the list of (direct) participants would clarify that they benefit from SFD protection also where they participate in a system in the function of 'settlement agent' or 'system operator'.

The targeted consultation asked respondents for their views as to whether the participation in systems governed by the law of a Member State should be extended or modified.

3.2.1. General remarks

A majority (56 respondents) replied that the **list of eligible SFD participants should be extended**; four said that the list of participants should be modified and two did not see any need for modifications. 10 did not reply or express an opinion.

22 Directive 2014/65/EU (OJ L 173, 12.6.2014, p. 349).
23 Directive 2009/110/EC (OJ L 267, 10.10.2009, p. 7).
24 Directive (EU) 2015/2366 (OJ L 337, 23.12.2015, p. 35).
25 COM/2020/592 final
26 TARGET2 is the real-time gross settlement (RTGS) system owned and operated by the Eurosystem.

Some stakeholders, mainly representing banks, stated that SFD **concepts, e.g. protection of the finality of transfer orders and the enforceability of the collateral, should be reconsidered**. They pointed out that the SFD covers two types of systems (payment systems and securities settlement systems) operated by three types of market infrastructures (payment systems, CCPs and CSDs). In their view, **each system would require different types of modifications** of SFD. The protection of the **finality of transfer orders should apply to any transfer executed within an SFD-designated system** and to all direct participants should be considered as falling within the scope of the protection, and therefore within the SFD definition of 'participant'.

One stakeholder mentioned that the eligible participants in SFD and FCD should be aligned and certain low risk institutions, e.g. **supranational institutions** should also be added (e.g. the European Investment Bank and the Bank for International Settlements).

Another respondent argued that if third-country systems were not eligible for designation under SFD, it would be important to amend the definition of 'participant' to **include operators of third-country systems to which Member States have extended the SFD protection** or operators of systems that are protected under the Alternative Option.

3.2.2. Legal versus natural persons

A majority (31 respondents) said that only legal persons should be allowed to participate; 10 did not consider such limitation useful and 31 did not reply or express an opinion.

Those opposed to such a limitation, argued that **natural persons should be eligible as participants if they meet the criteria under SFD (**e.g. if they are authorised under MiFID2). Others said that it would **not be justified to limit the possibility to take up certain activities based only on the legal nature of the entity.** A better alternative would be to set **specific criteria** addressing potential issues with the participation of natural persons in SFD systems, although recognising that such specific criteria could result in complex and burdensome legislation, whilst the value added could be limited, as participation of natural persons is unusual. In this context, the default in 2018 in Nasdaq Clearing of a Norwegian trader was mentioned.

Some said that participation of natural persons will in any event be exceptional **as they are normally unable to meet the rules and requirements of systems** (e.g. capital, organizational and technological requirements) and argued that there is **no need to limit participation to legal persons**. Others however argued that limiting participation to legal persons would be appropriate as it **would reflect current practice**, adding that that position might be revisited if and when a digital euro would allow natural persons to open accounts and get direct access to central bank money.

With respect to payment systems in particular, respondents arguing that access should be limited to legal persons said that to ensure the stability, robustness and trust in payment systems **only entities regulated under EU legal frameworks should be allowed access**. In their view, natural persons would not need SFD protection, as they would not send transfer orders directly to the system and their insolvency would not affect the operation of the system as such.

Regarding systems based on Distributed Ledger Technology ('DLT'), some respondents pointed out that novel systems, potentially fostered by DLT, might render designated systems accessible to natural persons too.

3.2.3. Payment institutions and e-money institutions

3.2.3.1. Participation in SFD systems

The **large majority** of those that replied to the question were **in favour of adding payment institutions and e-money institutions to the list of participants** (35 and 36 respondents, respectively). 14 and 13, respectively, replied 'other', 1 said that they should not be direct participants, 1 said they should only be indirect participants who may be considered direct participants, if that is justified on the grounds of systemic risk and 21 did not reply or express an opinion.

An operator of a non-SFD designated system pointed out that the long-term successful operation of its system, which includes payment institutions, e-money institutions and other unregulated entities (agents of, or intermediaries between, other regulated entities), is evidence that the participation of a wider range of entities can work. Stakeholders representing payment institutions and e-money institutions stressed that access to SFD systems, e.g. Target2, was important. Another added that access is important and explained that 'de-risking' – whereby **banks refuse to open accounts for certain sectors, including some payment service providers, due to a perceived higher risk of money laundering and terrorist financing –** has increasingly become a problem.

One respondent added that until 2011, e-money institutions had been assimilated to credit institutions and could be participants in designated SFD payment systems. To extend the list to e-money institutions would be a return to the original situation.

While one respondent said that payment and e-money institutions should not only be allowed to be direct participants, but **systems should be obliged to accept them** as direct participants, others said that **the system operator should have the power to assess whether it wants to grant participation in its system**.

It was also argued that if the list of participants is extended, it should not affect the current Member State option in Article 2(b) to extend the SFD list. Any options exercised by a Member State pursuant would have to be grandfathered to ensure legal certainty and stability to current businesses relationships, models and services.

Certain respondents would also be in favour of extending the definition of participant to ensure that the current protection to collateral takers also applies to collateral givers and thus covers all actors in the intermediary chain.

3.2.3.2. Direct or indirect participation

Of the respondents in favour of adding payment institutions and e-money institutions to the list of participants, the larger part (22 for payment institutions and 23 for e-money institutions) said that they should be allowed to be direct participants or indirect participants who may be considered direct participants if justified on the grounds of systemic risk. A smaller part (13 respondents for both payment institutions and e-money institutions) thought they should only be allowed to be direct participants. One respondent said that they should only be allowed to be indirect participants. One respondent was against payment institutions being direct participants.

Two respondents argued that payment institutions and e-money institutions should have some **flexibility to choose the level of participation** that is appropriate to their business, as some may want to access a system via a bank.

Several respondents, mainly representing banks, argued that the **existing limitation on participation**, which do not allow payment institutions and e-money institutions to be

direct participants, **does not hinder innovation and is not an obstacle for market access** for such entities, as under the PSD2[27], banks offer services to payment institutions and e-money institutions and therefore guarantee access to payment systems. One stakeholder **argued that** although there have been a lot of advances in regulations for the provision or payment services by payment institutions and e-money institutions, there are still **differences in the prudential requirements and in the capacities to mitigate risks, and more experience** would be required to understand the impact of payment institutions and e-money institutions in payment systems and in the payments market itself.

3.2.3.3. Participation if warranted on grounds of systemic risks

More than half of those that replied to the question (28 respondents) were **against limiting** participation **to where it is warranted on grounds of systemic risk**; 21 considered that such a limitation would be appropriate and 23 respondents were neutral, did not reply or express an opinion.

Respondents argued that **limiting participation to where warranted on the ground of systemic risk** would result in a lack of consistency across between Member States, unequal treatment of transfer orders in cross-border scenarios and barrier to cross-border services. It would be important to create a level playing field, and payment institutions and e-money institutions should not be discriminated compared to banks. A distinction based on systemic risk is not made with respect to banks.

Another respondent also pointed out that the Bank of England in December 2019 had found that innovation stemming from expanded access to UK payment systems for non-banks payment service providers could promote financial stability (fewer single points of failure; identifying and developing new risk-reducing technologies; and expanding range of transaction that can take place electronically and settled in central bank money).

One respondent pointed to a **systemic risk in the current situation**, as some non-banks are larger than the banks that provide access to payment systems. Moreover, non-bank payment service providers are increasingly clustered around a handful of banks that are large enough or have the risk appetite to offer such services.

3.2.3.4. Participation in CCPs and CSDs specifically

With regard to **CCPs** specifically, two respondents stated that payment institutions that are integrated in the payment flow and settlement in CCPs should be able to participate in the system. In their view, that would be important for derivatives clearing, considering the recent introduction of settled-to-market model as a margining method (exposures are fully and finally settled by daily payments for margining methods). Payment institutions that are not SFD participants have to provide their services via an SFD participant, which complicates the integration of payment services into the process flows of CCPs.

A CSD did not see a need to extend the list, but underlined that SFD also applies to other types of systems and an extension may be appropriate for other systems. It also argued that if the list of participants is extended, it should not trigger any additional layer of obligations or specific risk assessment for securities settlement systems.

3.2.3.5. Level of risk assessment

For payment institutions and e-money institutions, a **broad majority (35 respondents) rather or fully agreed that payment institutions and e-money institutions should be subject to a risk assessment**; a smaller part (15 respondents) rather did not agree or

[27] Article 35(2)

disagreed with a specific risk assessment; four were neutral and 18 did not reply or express an opinion. Moreover, a majority (29 respondents) rather did not agree or disagreed that payment institutions and e-money institutions should be subject to a particular risk assessment, adapted to their particular risk profiles; 11 agreed with such a particular risk assessment; 13 were opinion and 19 or did nor reply or express an opinion.

Many respondents said they **could not see the logic for differentiated requirements.** Requirements should mitigate risks (financial, operational and reputational) to other direct participants and ensure trust in payments and payment institutions and e-money institutions should abide by the same requirements as other participants. In their opinion, the **criteria should be the same for all different types of participants**.

Other respondents pointed out that **payment institutions and e-money institutions are regulated payment service providers.** Moreover, they stated that payment institutions and e-money institutions **pose significantly smaller risks than banks** (credit and liquidity risks can be much lower depending on the business model), and argued that they should not be subject to any more rigorous risk assessments than banks. Some of these respondents thought **a harmonised risk assessment which is proportionate to the more limited risks** posed by payment institutions and e-money institutions could help cross-border services and prevent the fragmentation of the single market for payments, and which could be made on an individual basis.

Other respondents said that SFD should not lay down **participation requirements**, but it should be for the **system operator to design its rules** and determine who should be able to participate in the system. That **would** be compliant with the PFMIs and would **allow a wider range of settlement systems to benefits from SFD-designation (**including novel systems available to natural persons) and permit 'sandbox' style regulation (e.g. a Member State could approve a designated system with restricted activities and participation to test new technology). In this vein, a CSD added that it would be important that SFD **does not interfere with obligations of CSDs to provide fair and open access** based on defined risk criteria.

3.2.3.6. Scope of risk assessment

The targeted consultation asked respondents to give their opinion regarding which risks should be considered in a specific risk assessment of payment and e-money institutions. A number of specific risks were proposed. Table 4 displays how respondents replied.

Table 4

	IT risks	**Operational risks**	**Credit risks**	**Liquidity risks**
Agree	31	35	32	31
Disagree	7	7	8	6
Neutral/no opinion /no reply	34	30	32	35

Respondents argued that mitigation of **IT risk** and **operational risk** (other than IT risk) **are of high importance**. However, several respondents said it **should be up to the system operator to define these criteria and assess the related risk**. Regarding operational risks (other than IT risks) one stakeholder added that the setup and operations need to be deemed secure and resilient. Additionally, an infrastructure test, including connectivity checks, functional testing and load testing, would help mitigate operational risks. Change and incident management should also be part of this process. Uptime should be measured on an ongoing basis and should not just be part of the initial risk assessment or joining process.

Several stakeholders highlighted that payment institutions and e-money institutions carry **credit risks that are different** from those of banks and argued that they should be assessed differently. For example, one stakeholder explained, payment institutions and e-money institutions generally have to safeguard customer money. That means they are unable to lend out money and funds are generally sitting in segregated accounts, available when customers request it. Another said that in payment card schemes, payment institutions are liable for a transaction as soon as card transactions are processed and cleared in the card scheme. Payment companies will settle the merchant a few days after the transaction, effectively pre-funding the merchant and offering a 'line of credit', on the premise that it will deliver the purchased good as promised. If the merchant goes bankrupt before the delivery date, consumers can request a chargeback from its bank.

As to **liquidity risks**, respondents said that as payment institutions and e-money institutions generally safeguard customer money in segregated accounts, available when customers request it, they should not be required to hold extra reserve funds or collateral above the funds available for settlement of current exposures. One respondent also said that any payment card scheme specific settlement/liquidity risk should be managed by the payment card scheme rules and operation.

3.2.3.7. Frequency of risk assessments

Two respondents believed that the frequency of risk assessments should be determined by the competent national authorities, and in principle be the same for banks, payment institutions and e-money institutions. Another said that the size of a participant and the systemic risk it poses should dictate how often a risk assessment is carried out. Others said that the risk assessment should not be too frequent nor unduly burden the entity, but take place whenever deemed necessary by the central bank. One respondent thought the frequency may differ depending on the system, and said that the system operator is best placed to judge.

3.2.4. CSDs

All respondents that replied to the question (24 respondents) **agreed to add CSDs** to the list of participants. No respondent disagreed and 48 did not reply or express an opinion.

Respondents noted that although CSDs are covered as 'settlement agents' and 'system operators', **they should added to the list of participants in SFD to provide clarity and transparency,** especially when a **CSD participate in another CSD as an investor CSD or in a third-country system**. Some respondents, mainly representing banks, thought that SFD finality should apply to any transaction settling in a CSD, including CSDs acting as participants in other CSDs. A CCP viewed that it would increase the protections for all systems to add CSDs to the list of participants and it would be important to minimise conflicts between different settlement finality provisions.

3.2.5. CCPs

Although no specific question was asked about CCPs, two respondents argued that SFD protection should apply to direct participants (clearing members), indirect participants and to the CCP itself.

Moreover, given developments in the area of derivatives clearing, particularly margining methods (e.g. the settled-to-market model), a clarification would be needed as to the extent to which payments and deliveries of securities to and from the CCP are covered by the SFD protection. SFD protections should apply also to intermediaries (through which market participants access clearing) to cover the entire access channels and the payments and deliveries made via these channels, to protect other participants and the CCP itself, in case of an insolvency of an intermediary.

3.2.6. Operators of non-SFD designated EU payment systems

A majority (24 respondents) thought that **operators of EU payment systems that are not designated under the SFD** should be eligible participants if risks for SFD systems are adequately mitigated; five considered another option more suitable; one replied that participation should only be possible based on the grounds of systemic risk and 42 did not reply or express an opinion. Stakeholders said that, if operator or non-designated EU systems were to be added, **proper risk-mitigation measures** would be required. One respondent argued that to avoid unequal treatment of systems, all system operators should be eligible as participants, others said that a thorough analysis on the implications for the participants in both systems should be performed.

3.2.7. Risk based approach for participation

On replacing or complementing the current list of eligible participants **by a risk-based approach to determine** participation, 19 respondents replied that it would be too difficult operationally and would jeopardize a risk-based approach; 12 respondents thought that it could be a good idea as it would ensure that only entities which are systemically important benefit from SFD protection, notwithstanding their legal form (bank, investment firm, payment or e-money institution). 14 respondents considered another option more suitable and 27 respondents did not reply or express an opinion.

Two stakeholders said that a risk-based approach could lead to a disarranged application and protection in the event of an insolvency. One respondent suggested that a way to address concerns about changing risks (e.g. credit risk) might be to provide for sponsorship of SFD participants by credit institutions or investment firms.

A CCP said that from its perspective, the current list is appropriate. CCPs have rigorous, transparent and non-discriminatory membership requirements and all participants should benefit from SFD protection. A further level of CCP participation criteria for SFD purposes would be costly and unnecessary. A risk-based approach would reduce the ability of CCPs to mitigate systemic risk.

3.3. Technological innovation

As explained in the targeted consultation, the SFD is meant to be technologically neutral. Key requirements (e.g. regarding the moments of entry into the system and irrevocability) refer to the rules of system, and are not laid down in SFD itself. This approach has allowed SFD systems to develop as needed, without major legislative change, so far.

Some SFD requirements or key concepts (e.g. system, transfer order, book-entry, settlement account and agent, conflict of laws, links with other financial market infrastructures) may however create obstacles to the use of distributed ledger technology (DLT) and crypto-assets[28], in particular in decentralised permission-less DLTs, where

[28] On 19 December 2019, FISMA services launched a consultation on markets in crypto-assets (see link for consultation and results). A part of the respondents gave replies to one or more SFD related questions (e.g. around 40% of overall respondents had an opinion on the application of SFD definitions). The responses were mixed and conflicting. Some thought that the SFD as it currently stands or with minor changes is sufficiently tech neutral to accommodate DLTs and crypto-assets, whilst others thought further clarification or specification was needed. The reasons for further changes and how to make them were not always clear. See ESMA's 'Advice - Initial Coin Offerings and Crypto-Assets', January 2019; '30 recommendation on regulation, innovation and finance' by the 'Expert Group on Regulatory Obstacles to Financial Innovation' (ROFIEG), December 2019 and 'The potential impact of DLTs on securities post-trading harmonisation and on the wider EU financial

there is no centralised operator, and unidentified participants can enrol without restriction with functions being attributed simultaneously to several participants. Clarifying certain concepts or definitions in the SFD could avoid diverging national interpretations and transpositions in the Member States, resulting in legal uncertainty.

To gain further experience in the benefits and risks of the use of DLT, the Commission proposed a Pilot Regime on DLT market infrastructures[29] which was adopted in 2021 and entered into application on 23 March 2023. CSDs may operate DLT securities settlement systems outside the scope of SFD. The Pilot Regime does not preclude CSDs from operating DLT securities settlement systems which are fully SFD compliant. The Pilot Regime regulated DLT market infrastuctures, i.e. DLT multilateral trading facilities (DLT MTF), DLT settlement systems (DLT SS) and DLT trading and settlement systems (DLT TSS).

The targeted consultation asked a number of questions on the SFD in light of DLT and crypto-assets.

3.3.1. Distributed Ledger Technology ('DLT') systems

A majority (21 respondents) replied that they do not know how to apply certain concepts or definitions of the SFD for specific technologies and that this creates legal uncertainty; 12 considered SFD to be technologically neutral and 39 did not reply or express an opinion.

Regarding permission-less DLT systems specifically, 28 respondents said that SFD does not work in such environments, while 11 did not see a problem. 33 did not reply or express an opinion. **No respondent specified how the SFD could work in a permission-less DLT environment**.

23 respondents agreed that the scope of the current review should be **limited to considering the technology neutrality of SFD in the context of permissioned DLTs** where the system operator designs the system and rules; 12 disagreed to such a limitation and 37 did not reply or express an opinion.

Respondents that viewed the **SFD as technology neutral** argued that SFD does not regulate technology, but overrules national insolvency rules in the case of an insolvency of a participant, **and allows the designation of any payment or security settlement system that complies with the requirements, irrespective of the underlying technology. They said that permissioned DLTs could fall into the SFD logic from a legal and technical point of view**, while expanding settlement finality concept to environment without a central entity with the defined responsibilities would require a thorough and comprehensive legal assessment.

Respondents representing CSDs thought that SFD should **remain technology neutral and future-proof,** thus not restrict the use of any type of technology. In their view, the SFD should define in a technology neutral way the requirements that must be complied with by a designated system, however, the requirements specific to the features of different types of system should be laid down in sectoral legislative texts, e.g. CSDR. For DLT systems, such features could include the ability to reach finality and clarity about the moments of entry and irrevocability of transfer orders. Systems should also be regulated and supervised, able to correct mistakes and perform customer due diligence of participants and there should be legal certainty as to the applicable law. They should be

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market integration' by the 'Advisory Group on Market Infrastructures for Securities and Collateral' (AMI-Seco), September 2017.

29 COM/2020/594 final; https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022R0858

compatible with the PFMIs, e.g. governance arrangements that '*provide clear and direct lines of responsibility and accountability*', risk-management frameworks that are reviewed periodically and enable it to '*identify, measure, monitor, and manage the range of risks that arise in or are borne by the FMI*' and a clear legal basis. In this vein, one respondent, pointed out some EU CSDs already operate DLT-based systems.

Several other respondents argued that **for any system to be SFD designated, it would need a central point of contact that remains legally responsible for the operation of the system** and accountable for its design, rules and regulatory compliance. Respondents representing banks thought that only systemically important DLT systems should be considered under SFD, i.e. only systems that function through participants or registrars, who do not only act on own account (proprietarily) and not systems which connect end investors (e.g. retail clients or in a permissionless DLT environment). Others pointed out that there can be trade-offs between different types of DLT networks and consensus protocols. A centralised system operator or authority would not necessarily require the complete centralisation of the system itself. In hybrid solutions, multiple actors could be approved to access the system and provide settlement services, in a way that is akin to permissionless systems. It could therefore be too early to draw the conclusion that a permissionless environment is incompatible with SFD. Also respondents representing CSDs, expressed the view that permissionless DLT networks in the current stage of development cannot comply with SFD, but added that the SFD review could be an opportunity to balance the fundamental incumbents' roles and that of any new business models. Another respondent said that there is no argument to allow permissionless DLT technology to be used for SFD system.

Several respondents pointed to issues around determining finality in permissionless systems. One respondent claimed that if there is no operator or authority to decide on finality, only a probabilistic finality could be reached and could therefore never be guaranteed. However, another explained that **finality can be reached in both permissioned and permissionless systems**, although it can be technically probabilistic or longer to establish, as transactions are validated by consensus by a network of nodes. Moreover, it explained, the lack of legal tender in the DLT environment prevents full delivery versus payment, as each security token transaction on the system must be associated with the payment on a bank account. Several respondents expressed a similar view and said that is too simplistic to distinguish between permissionless and permissioned networks, as finality is based upon participants in a system agreeing to a set of minimum standards and binding rules that defines the moment of settlement finality. An alternative governance framework than a centralised one could be used to reach such agreements. One argued that what matters is that there is a **clear definition of who declares finality and what the criteria are**.

Some respondents pointed out that there may be a need to make some targeted adaptations to SFD. The definition of 'participants' would have to be amended to allow DLT-systems to be SFD designated. One of these respondents added that, for electronic money, due consideration should be paid to whether data entries recorded in a DLT system can be considered to be e-money in the meaning of the Electronic Money Directive, and how to identify what a 'token' is. The SFD review should take into account fundamental functions of the existing systems to provide efficient and reliable trade and post-trade transactions services to assure investor protection, markets integrity and financial stability, while at the same time ensuring that system operators benefit from a sufficient flexibility to develop and keep up with innovations.

Regarding DLT-systems, some respondents expressed scepticism about an application of SFD protection to permission-less DLT-systems, which aim to connect end investors.

3.3.2. The EU Pilot Regime for DLT systems

A majority (28 respondents) replied that **experience with the Pilot Regime for market infrastructures based on DLT should be gained before considering possible issues in the SFD**. 12 did not consider that such experience necessary and 32 had no opinion or did not reply to the question.

Several respondents said that the SFD review should take a long-term vison and take into account any issues identified by market participants or in **the Pilot Regime,** including difficulties identified with regard to the application of the SFD to permissionless DLT systems. The Pilot Regime and the SFD review should take each other into account. Some respondents said that other issues may be identified throughout the course of the Pilot Regime, as further DLT use-cases are developed, which will require a further targeted review of the SFD as the Pilot Regime progresses.

Other respondents emphasised it would be valuable to **first gain more experience from the Pilot Regime**, or with new technologies in a laboratory or sandbox approach. Two of these suggested a testing approach could be proposed for the SFD, broadening the definitions to make it compatible with DLT systems. Although the current Pilot Regime for DLT is a good example, it would not be sufficient, as it does not cover payment systems, or clearing and netting systems. Another respondent, encouraged **further inquiries into whether and how DLT based systems** are used today and to issue a report on how DLT systems can be used to better understand the benefits and potential risks of such systems. In any case, several respondents thought that certain aspects, e.g. the conflict of law rules in SFD based on the location of the system, the enforceability of the applicable Member State law, or concepts (e.g. securities account and transfer orders), needs to be clarified independently from the Pilot regime, to enable entities willing to use DLT under the existing regulatory framework not to be unduly constrained.

One respondent pointed out that market players **are already able to deploy new products and services based on DLT while being compliant with SFD** and do not see a dependency between the SFD and possible experiences gained in the context of the Pilot Regime.

One respondents, representing the digital payments industry, also pointed to the fact that the Commission's proposal for a DLT Pilot Regime was being discussed by the co-legislators at that point, and therefore argued that **only permissioned DLT operators should be considered** for the time being. Another stakeholder pointed out that there is **still uncertainty about permission-less DLTs** and hence it might be beneficial to be fully aware of the implications before regulating such DLTs.

Another respondent thought that the **SFD should be amended as issues exists** (e.g. stablecoins or decentralised finance developments), even though it would be too early to consider that enough experience has been gained under the DLT Pilot Regime. The SFD amendment should be flexible enough to allow for a **quick adaptation** taking into account the Pilot Regime and any other market experiences outcomes.

One respondent highlighted that **the aim of SFD is achieving financial stability**. Any possible change in regulation should fully consider implications to this aim. There is no need at any cost to allow every new technical solution.

3.3.3. SFD concepts and DLT

The targeted consultation asked whether there was a need to clarify some SFD concepts.

3.3.3.1. ‘System’

22 respondents thought the concept and definition of ‘system’ should be clarified or amended to apply explicitly in a permissioned DLT context; nine said that no such clarifications or amendments are necessary and 41 did not reply or express an opinion. 14 respondents replied that this issue could be dealt with by the system operator in the rules of the system; four disagreed and 54 did not reply or express an opinion.

Two respondents argued that SFD concepts should be adapted to (e.g. describe entities, roles and responsibilities) and include permissioned DLT systems to provide legal certainly. However, two others, who also agreed that some changes would potentially be required, said it is too early to identify specific areas of SFD to be modified to accommodate DLT-based infrastructures. One of the latter said the assessment of the Pilot Regime for DLTs should be considered first.

One respondent explained that the definition of ‘system’ sets out when arrangements are caught by SFD, but DLT is not itself a system and can take many different forms. The nature of settlement, for the purposes of SFD, does not change using a DLT or other form of ledger. In its view, not all DLTs should be permissible systems, nor should there be confusion about who is operating or responsible for the system. A principal requirement must be that an entry can be authenticated and is irrevocable.

One stakeholder said that with the application of DLT, especially in a permissioned system, the role of the system operator to provide governance and control over a system could be maintained while allowing for a model that allows multiple approved actors to access and provide settlement services, akin to unbundling.

Several respondents said that some of terms used within the definition need clarification. One said that concepts, e.g. **‘participants’**, ‘**settlement agent**’ and ‘**transfers orders**’ should be broadened. Another pointed to ‘**system operator**’, which is unlikely to capture permissionless systems but likely to work for permissioned systems. It also said it would be helpful to clarify the level of ‘**adequacy’** required, to understand whether DLT/digital systems are able to rise to this standard (whether they have to be in written form, or can they rely on the chain code of the system; what other rules are needed, for example around endorsement and validation of transaction data). It is also unclear what is required to be a ‘**formal arrangement’** and whether the transfer of digital assets may constitute ‘**transfer orders**’, as concepts, e.g. ‘**money’**, ‘**book entry**’ and ‘**accounts’,** were not drafted with DLT and crypto-assets in mind.

3.3.3.2. ‘Transfer order’

13 respondents replied that the concept and definition of ‘transfer order’ should be clarified or amended to apply explicitly in a permissioned DLT context; eight said that such clarifications or amendments are unnecessary and 51 did reply or express an opinion.

One stakeholder argued that the definition of ‘transfer order’ does not reflect that payments on a DLT are not executed via a book entry on the accounts of a credit institution, a central bank, a central counterparty, or a settlement agent. It suggested the follow definition: ‘”*transfer order” shall mean: any instruction by a participant to place at the disposal of a recipient an amount of money or alike by means of a book entry on the accounts of a credit institution, a central bank or a settlement agent, or otherwise, or any instruction which results in the assumption or discharge of a payment obligation as defined by the rules of the system, or an instruction by a participant to transfer the title to, or interest in, a security or securities or alike by means of a book entry on a register, or otherwise’*.

Another stakeholder argued that it was premature to amend the definition. Nonetheless, it pointed to the ECB' opinion on a proposal for a Regulation on Markets in Crypto-assets[30] ('MiCA'), where systems hosting transactions on tokens are not defined as funds, but still act as money substitutes, such 'money substitutes' will have to be assimilated in the scope of the SFD. To ensure that such '**money substitutes**' are within the scope of SFD, a review of the SFD definition of '**funds'** might be needed. Another respondent argued that references to '**an amount of money**' or '**title to, or interest in, a security or securities**', is too narrow and that concepts of '**money**', '**securities**' and '**interests in'** money, create uncertainties in the context of digital assets, e.g. certain money-like instruments, including stablecoins and stablecoin arrangements, and token arrangements. In this view, allowing systems of money-like instruments, e.g. e-money (under the Electronic Money Directive), e-money tokens (under MiCA, when it comes into effect), stablecoins and other digital assets to benefit from SFD designation, should be allowed if the financial stability and consumer protection risks each system creates are addressed.

Three respondents argued that the definition in SFD is broad enough to accommodate transfers on DLT systems, but ideally, it should be clarified that an entry on a DLT ledger can constitute a '**book entry on a register**' or '**otherwise'**, through an SFD amendment or guidance.

3.3.3.3. 'Book-entry'

16 respondents replied that the concept of '**book-entry'** should be clarified or amended to apply in a permissioned DLT context; five said that such clarifications or amendments are not necessary; 51 did not reply or express an opinion.

Most respondents said that the current definition of 'book-entry accounts' covers digital entries in DLT system, but a clarification or guidance by EU authorities could be useful. One respondent underlined that ESMA, in a report on Initial Coin Offerings and crypto-assets in 2019, had noted that the legal nature and effects of book entries are embedded in national law. It also pointed out that some Member States (e.g. France, Luxembourg) have amended their legal framework to explicitly recognise the recording of securities on a distributed ledger to be equivalent to (or having the same effect as) recording on an account in a book-entry form, in terms of transfer of ownership. another respondent pointed out that guidance would be helpful as the concept of book-entry is used also in other legal texts, e.g. CSDR.

Another respondent thought the SFD should be amended. It pointed out that book-entry is interpreted as the point at which a transaction is entered into the ledger and accepted by a participant. In DLT systems, multiple book entries may be required and the SFD should accommodate that for permissioned DLT. In addition, amendments should clarify how finality is determined in such systems, and the minimum criteria for when a transfer order is deemed entered into the book (i.e. how to deal with situations where a transaction is entered into the system but is not accepted by all required parties).

One respondent thought that an amendment to the definition of 'transfer-order' would also address the concept of book-entry.

3.3.3.4. 'Settlement account'

13 respondents replied that the definition of 'settlement account' should be clarified or amended to apply explicitly in a permissioned DLT context; seven said that no such clarifications or amendments are necessary and 52 did not reply or express an opinion.

[30] OJ C 152, 29.4.2021, p. 1.

Six respondents said that SFD should be amended, while two said that clarifications in the rules of the system, by EU authorities or in level 2 legislation could be sufficient.

Respondents in favour of a clarification argued that positions in a DLT system are not necessarily reflected in an account and the definition needs to be clarified. More specifically, some pointed to how data recorded to a DLT ledger can be reconciled with the concept of 'account' (e.g. must the DLT system also record account balances and not only transactions outputs), others said that a distinction needs to be made between account-based DLT systems and a transaction-based DLT systems. Respondents thought that amendments should cover future technological developments, without compromising the initial concept. One respondent proposed the following definition: *"Settlement account" shall mean an account at a central bank, a settlement agent or a central counterparty used to hold funds or securities or alike and to settle transactions between participants in a system"*.

Another respondent however said that the fact that the definition of 'settlement account' refers to intermediaries (central bank, settlement agent or central counterparty), constrains market structures and is not technological neutral. In its view, there is no reason to oblige DLT systems to create account structures; commercial parties should have freedom to structure their arrangements as they deem most efficient and appropriate, without being constrained by arbitrary regulatory requirements.

3.3.3.5. 'Settlement agent'

13 respondents replied that the definition of 'settlement agent' should be clarified or amended to apply explicitly in a permissioned DLT context; eight said that such clarifications or amendments are not necessary and 51 did not reply or express an opinion.

One respondent pointed that the use of DLT may introduce new actors and change the role of intermediaries (e.g. settlement agent providing access to the system via a settlement account), then the definition of settlement agent would also have to change. Another respondent explained that the term settlement agent does not map directly to DLT, the closest equivalent being miners and DLT participants. One respondent proposed the following definition: "*settlement agent" shall mean an entity providing or administering to institutions and/or a central counterparty participating in systems, settlement accounts or alike through which transfer orders within such systems are settled and, as the case may be, extending credit to those institutions and/or central counterparties for settlement purposes."*

Another respondent however said that in some DLT systems, settlement may be automated via smart contracts and there may be no single entity responsible for providing settlement accounts. To promote technological-neutrality, 'settlement agent' should be amended not to require (directly or indirectly) that a settlement agent participate in the system. The decision as to when a settlement agent may or may not be required, would be left for the Member State's assessment of the adequacy of the system.

One respondent argued that some activities may be added to the traditional role of settlement agent, either by the system operator or through guidance by ESMA, but that there is no need to amend the definition in SFD, which is broad enough. another said that while some of those functions (e.g. admission of participants and granting credit), could be performed by other participants, the function of validating and settling securities transactions should remain with the settlement agent (CSD) to comply with the regulatory framework and reduce systemic risk. It proposed that the concept of 'settlement agent' could be replaced by '**system operato**r'.

3.3.3.6. Links with other financial market infrastructures and trading venues

Nine respondents replied that the links with other financial market infrastructures and trading venues (traditional or DLT based) should be clarified or amended to apply explicitly in a permissioned DLT context; seven said that no such clarification or amendment are necessary and 56 respondents did not reply or express an opinion.

One stakeholder indicated that supervision should have a role when it comes to links with other financial market infrastructures and trading venues.

Another respondent said that it has consistently advocated in favour of efficient interoperability arrangements for financial market infrastructures and platforms and pointed to a risk that how DLT is developed may reinforce existing systems and complexity, rather than create simplification, increasing technology and operational fragmentation within the industry, illustrating the need for interoperable solutions. Cybersecurity concerns for DLT, e.g. potential vulnerabilities in key management and access to systems, were also cited as a challenge. With specific reference to DLT-based infrastructures, the key aspect to be considered would be the definition of common rules and standards for SFD terminology as well as common legal and operational principles for crisis management activities (e.g. the simultaneous suspension or cancellation of pending instructions in case of the insolvency of a participant). An example of this is the collective agreement in T2S for a harmonized definition of the moments of enforceability and irrevocability of transfer orders. Interoperability arrangements should be created across different DLT systems and between DLT-based systems and traditional ones to ensure full interoperability and flexibility. It noted that in the case of CSD-links outside the T2S platform, securities settlements are possible but with ad-hoc protection (e.g. conditional settlement procedures), which create delays and inefficiencies to settlement.

3.3.3.7. Conflict of laws

23 respondents replied that the concept of 'conflict of laws' should be clarified or amended to apply explicitly in a permissioned DLT context; seven said that such clarification or amendments are not necessary and 42 did not reply or express an opinion.

Several respondents pointed to the fact that conflict of law issues in the DLT context could arise from challenges in **identifying the location** of the asset (e.g. for exchange or transfer crypto-assets), or **the participants** (e.g. in permissionless DLT system) or **the location of the register or account** (in which Member State; where the relevant entries are made or maintained, are not meaningful concept, as the register or account could be stored on every node in a DLT network). Instead, they argued that governing law should be **determined by the location of the central authority** (Place of the Relevant Operating Authority approach, Place of the Relevant Intermediary approach set out in Article 9(2) of SFD) and one said that if there is no central operator, by the rules of the system.

One respondent consider it best to enable participants in a system to agree on the governing law, but to avoid forum shopping there may be a need for regulatory constraints. That position is supported by the Financial Markets Law Committee. One respondent argued for conflict of laws to be specified at a pan-European level in SFD and another highlighted the 2019 report by the Expert Group on Regulatory Obstacles to Financial Innovation (ROFIEG), in which the Commission was encouraged to legislate a relevant conflict of laws rule.

Other respondents pointed out that this area of uncertainty has implications beyond the SFD and may require attention at an international level. Another respondent said that any

legislation should consider existing conflict of law rules in the EU acquis and national laws to provide consistent application and certainty in terms of jurisdiction.

3.3.3.8. Other concepts

Six respondents replied that other definition or concept should be clarified or amended to apply explicitly in a permissioned DLT context; nine said that there were no such other concepts and 57 did not reply or express an opinion

Two respondents pointed to issues with **Article 4 of the SFD,** as positions in a DLT ledger are not necessarily reflected on a settlement account. One proposed that an amendment should balance the need to ensure that SFD remains technologically neutral and in a position to cater for DLT and future technological developments, but without compromising the initial concept enshrined in Article 4 SFD. The other respondent proposed the following: *'Member States may provide that the opening of insolvency proceedings against a participant or a system operator of an interoperable system shall not prevent funds or securities or alike available on the settlement account or alike of that participant from being used to fulfil that participants obligations in the system or in an interoperable system on the business day of the opening of the insolvency proceedings. Member States may also provide that such a participant's credit facility connected to the system be used against available, existing collateral security to fulfil that participant's obligations in the system or in an interoperable system*.'

Another stakeholder argued that the definition of '**system operator**' should be amended to cover arrangements in which system operators are not formally designated or all participants share this role. Another said that **several other concepts** (participants' roles in DLT, participant requirements, minimum criteria for transfer order acceptance, risk measures, privacy/GDPR, traceability/confidential information, oversight, minimum security requirements, number of transactions per seconds managed, latency, etc.) should be **addressed before and during the Pilot Regime.**

3.3.3.9. Other amendments to deal with opportunities or risks specific to permissioned DLT-based SFD systems

Four respondents replied that **other amendments to the SFD** should be considered to deal with opportunities or risks that are **specific to a permissioned DLT based SFD system;** eight said that there were no such other amendments and 60 did not reply or express an opinion.

One respondent suggested clarifying whether the definition of '**system operator**' could cover distributed governance structure, e.g. in a permissioned-based DLT system. Another argued that it would be relevant to **revisit the finality moments** (SF1-moment of entry, and SF2-irrevocability) taking into account the temporary gap that exists in the operation of DLT platforms, through level 2 regulation. One respondent said that the definition of '**transfer order'** includes more than one possible definition, which should offer sufficiently flexibility for system rules to be designed in a compliant way. Additionally, many DLT-based systems assume an integration between trading and settlement and further consideration should be given as to the implication of combining the '**trading order**' and '**transfer order**'. One respondent stated that the SFD should remain technologically neutral, but systems with decentralised features, e.g. those using DLT today or any other technologies in the future, should only be designated if they respect SFD principles. Key questions are whether a DLT-based system could cause systemic risk, such that there is a strong public interest in extending settlement finality protection to this system, to the detriment of creditors and ensuring that all SFD-designated systems are subject to the same requirements, not to upset the level playing

field for payment systems. The principle of 'same business, same risks, same requirements' should be respected.

3.4. Protection for collateral security of clients of participants

The definition of 'collateral security' under SFD covers 'all realisable assets', including financial collateral covered by FCD, e.g. cash, financial instruments and credit claims and covered by the targeted consultation on FCD.

Article 9(1) of the SFD insulates collateral security given in connection with participation in an SFD system or with monetary operations involving the national central banks of the Member States or the ECB, from the effects of the insolvency of the collateral giver when the collateral giver it is a participant in a system or in an interoperable system; a system operator of an interoperable system that is not a participant; a counterparty to the national central bank or ECB; or a third party that provided the collateral security. However, that protection does not apply when the collateral giver is a client of a participant in an SFD system (e.g. a counterparty clearing derivatives), beyond any protection afforded by sectoral legislation. The targeted consultation asked a number of questions about whether the protection of collateral should be extended when the collateral giver is a client of a participant, and if so, how that should be done and under what conditions.

3.4.1. Protection of collateral security given by clients of participants in the event of the insolvency of that participant

15 respondents replied that protection in Article 9(1) of SFD should be extended to clients of participants in an SFD securities settlement system in the event of the insolvency of that participant; three agreed that protection should be extended, but only to certain clients of participants; nine disagreed and 54 did not reply or express an opinion.

Some respondents pointed to a need of **harmonisation of SFD protection of collateral in EU**. Today, indirect participants benefit from SFD protection in some Member States (e.g. Italy and Germany), but not in others. One of these respondents suggested harmonising key SFD concepts, removing Member State opt-ins, defining expectations as to insolvency procedures and establishing a set of technical functionalities (hold/release mechanisms, late settlement penalties should not apply to insolvent party, pending transfer orders remaining unsettled after close of business on the day of the insolvency should be removed, etc.).

Several respondents, mainly representing banks, argued that the aim of the collateral is to protect the participant in case of the default of the collateral giver, and that collateral should be protected. The **protection should apply to all collateral linked to the activity in the system** (including collateral placed by the client with the intermediary ('on stock') and collateral that the intermediary receives in the system through the execution of the client's transfer orders ('on flow')). In this vein, a banking association claimed that **SFD creates discrimination**. First between **intermediaries at the top of the chain**, who benefit from protection, and lower-level intermediaries, who do not; and second, between **securities held on a single securities account**, for which the intermediary can be a direct participant and therefore benefit from protection, and securities for which sub-custodian are involved, and for which it would not benefit from protection. One of these respondents added that for a participant to be able to immediately realise the collateral security, incoming financial instruments that the participant has settled using its own assets for the account of the client should be considered equal to collateral security given by the client to the participant (typically cash, paid for a securities receipt).

Regarding **CCPs** specifically, respondents argued that it would be important for indirect participants to benefit from protections to **protect CCPs' default management rules and procedures** (e.g. porting, transfer of assets and direct return, leapfrog payments or transfer of margin securities to a transferee clearing member). Protection could be extended to protect clients (or other third parties) directly providing collateral to a CCP (i.e. fulfilling the margin obligation of the clearing member). One of these respondents explained that SFD protection in CCPs should **also cover non-securities contracts** (e.g. derivatives), open derivatives contracts and ensure enforceability by participants in SFD systems of non-title transfer collateral arrangements with their own (non-participant) clients.

Other respondents explained that collateral arrangements between participants and clients are made through multiple arrangements and that operators can run a broader system which involves **designated and non-designated systems** and argued that **SFD protection should apply to both** when such operators take the same collateral in both systems. However, if protection is extended to clients of participants, the meaning of **'in connection with a system' should be clarified**, given its potentially broad impact.

Two respondents pointed to the potentially broad impact of an extended protection and said that clients should be differentiated. One said that to extend protection to final clients (consumer and enterprises) would **operationally be almost impossible, due to the large number of clients** and their different characteristics. It would also distract from SFD's main goal to ensure financial stability. The other said that an extended protection could be explored for institutional clients whose collateral is passed on to the system (recognising the challenge involved in determining whether the collateral has been passed on to the system). As institutional clients would not provide excess collateral and **considering close-out netting agreements between participants and their institutional clients, there may also be no need for an extended protection in SFD**.

Several other respondents argued that there is no need to amend the SFD as **protection should follow contractual obligations** between the parties. Two of them pointed out that CCPs do not have direct contractual relationships with clients of participants. One said that from the point of view of the system, the collateral security is posted by the participant; it added the objective of SFD is **not to protect the client but to protect the system and financial stability,** and that is an issue for sectoral legislation ensuring the necessary robustness of the institutions.

Another respondent said that an extension is neither warranted nor appropriate as SFD **protects the collateral taker in the insolvency of the collateral giver** and added that the question appeared geared to CCP structures, which are already covered by EMIR.

Some respondents said that SFD already offers adequate protection for collateral transfers, as they are bankruptcy remote when made in connection with a participation in an SFD system, regardless which entity is the collateral giver. The aim of collateral is to secure SFD system operators and participants as collateral takers and to **reduce systemic risks (not the counterparty risk)** and therefore SFD does not need to be amended.

Other respondents argued that from a systemic risk point of view, **SFD should focus not only on the 'horizontal' relationship between a defaulting participant and its counterparties, but also on the 'vertical' relationship between a defaulting participant and its clients (including indirect clients**), considering protections already existing in 'sectoral' or other relevant legislation (EMIR, CSDR, FCD). In its view, preventing insolvency officials from interfering with collateral security provided in systemically important payment, clearing or settlement systems could serve an important financial stability objective.

Another respondent pointed to financial stability risks if an extended protection would **compete with the collateral available to the system and expose the system to additional risk**. However, it said, a **clarification for segregated accounts** could be useful.

3.4.2. Possible additional requirements

Respondents generally did not see any reason to link an extended protection with **additional requirements**. In particular, a requirement for segregated accounts would contradict Article 38 of CSDR and Article 39 EMIR, and create additional costs and complexities. Respondents also did not think that system operators should perform an additional risk assessments of the client and stressed that the risk assessment is the responsibility of the intermediary. Nevertheless, if the protection in Article 9(1) of the SFD were extended to clients of participants in an SFD system, respondents assessed the **usefulness of certain conditions** as following:

3.4.2.1. The client should be known to the system operator.

10 respondents agreed that the client should be known to the system operator; nine disagreed; 2 were neutral and 51 did not reply or express an opinion.

Several respondents did not see any reason to make an extended protection conditional on the collateral giver being known to the system operator. The collateral is a matter for the collateral giver and taker; the system operator (CSD or CCP) is not necessarily impacted or know who the client is. One respondent also pointed out that from a competition perspective, it may be sensitive to ask participants to share information about their client base with the operator of the system.

One respondent (a CCP) however argued that as protection aims at limiting systemic risks, the extended protection should apply only as long as the client is known. One respondent suggested that clients could become known to the system operator through the onboarding process. Another highlighted that would depend on the type of client; while some clients (financial entities with significant positions) could be known, there is no added value to combat systemic risk in the system operator getting to know details of non-financial clients (not to speak of GDPR and competition issues that could arise). One respondent stated that as it would be for an administrator/NCA/insolvency officer to give instructions to return collateral, and not for the system operator, it would be enough that the individual client is identifiable in the participant's book; at system level, collateral provided by clients could be identifiable at omnibus level.

3.4.2.2. Criteria imposed by the system operator

Eight respondents agreed that client should have to fulfil criteria that are predefined by the system operator, e.g. regarding the client's credit/risk assessment; five disagreed; three were neutral and 51 respondents did not reply or express an opinion. One respondent highlighted that risk assessments of clients (e.g. KYC and customer due-diligence) are important to mitigate risks. Another stakeholder mentioned that this kind of measures is not possible and it should be up to the participants to define their own risk polices according to prudential rules. One stakeholder thought it would be for the law to define such criteria, not the system operator.

3.4.2.3. Segregated account

13 respondents agreed that the client should have its own segregated account; eight disagree; five were neutral and 46 did not reply or express an opinion. Two respondents stressed that different systems are set up differently and that client segregated accounts are not always necessary. While the use of individual segregated accounts or omnibus

segregated accounts make sense in relation to CCP and CSD in relation to derivatives and securities, the way that credit entities work with their customer's cash does not seem to imply the segregation of funds. Another respondent however, indicated that the use of segregated accounts should be considered as it would be more certain for collateral in form of securities, however less relevant for collateral in form of money.

3.4.2.4. Collateral security for centrally cleared transactions

Five respondents agreed that the client should provide collateral to secure transactions exceeding the threshold under EMIR (whereupon they are obliged to centrally clear their transactions); six disagreed; five were neutral and 56 did not reply or express an opinion. One respondent said that in relation to cleared trades, collateral is posted with the CCP, not with other SFD systems implicated in the fund flows. Collateral posting may be decided upon by payment systems connected to CCPs, but it can be done in their rulebooks, and there would be no need to specify that in SFD.

3.4.2.5. Value of centrally cleared transactions concerned and collateral posted by clients; CCP awareness of clients

The targeted consultation asked respondents that are clients of an SFD-designated CCP to indicate the aggregated value of their clearing transactions and related collateral security entered into the system in 2020. No respondent replied. The targeted consultation also asked CCPs how many clients of clearing members they were aware of. No respondent replied.

3.5. Settlement finality moments and insolvency notifications

Regarding settlement finality, SFD refers to two specific moments that must be defined in the rules of the system: entry into the system and irrevocability of the transfer order. The targeted consultation asked several questions about settlement finality and in particular if SFD (i) lacks of clear provisions on the legal duty of SFD systems to specify the moments of entry into the system and irrevocability of the transfer order, as well as where settlement is both enforceable and irrevocable; (ii) accommodates specificities of clearing systems under business-as-usual and market stress conditions; and (iii) should ensure that the moment of settlement finality is identical for the cash and securities legs of transactions settled based on 'delivery-versus-payment'.

3.5.1. Settlement finality moments

A majority (20 respondents) agreed that the **SFD should clearly stipulate the legal duty for SFD systems to specify** the moments of entry and irrevocability and when settlement is enforceable and irrevocable; eight disagreed; two were neutral and 42 did not reply or express an opinion. Several respondents argued that SFD is sufficiently clear and has provided a strong and stable legal framework that has worked so far. The objective of SFD is to ensure that the settlement in a system can continue despite a participant's insolvency. The system therefore needs to have clear rules to which insolvency law can refer, but the SFD should not design those rules. On the basis of the SFD, system operators have developed robust technical and legal systems, and a change would involve more than changing rules (e.g. technical developments, reassessments). One respondent argued that clarifications in sectoral regulation would be more proportionate. Other respondents considered the SFD should specify the moment of entry into the system and irrevocability, and where the settlement is enforceable and irrevocable to avoid uncertainty, in particular with respect to third-country systems and interoperable systems (which are increasingly important) where irrevocability of the cash and security legs is not simultaneous. Regulation could incentivise system operators to establish such rules.

A majority (20 respondents) agreed that settlement finality provisions of the SFD should **accommodate the specificities of clearing systems under business-as-usual and market stress conditions more clearly**; eight disagreed; four were neutral and 40 did not reply express an opinion. Respondents said that although some flexibility is important, system rules should not, or would not be able to, prescribe any differences between situations. Such rules would risk being struck down by regulators or resolution authorities. Settlement finality rules need to be non-discriminatory and equal in all situations. Another stakeholder stated that the specificities should be left to the systems' rules.

A majority (24 respondents) also agreed that **SFD needs a provision ensuring that the moments of settlement finality is the same for the cash leg and the securities leg** in a 'delivery-versus-payment' transaction. Six disagreed, six were neutral and 36 did not reply or express an opinion. 17 respondents agreed that SFD needs to be amended to ensure that **different times of finality do not cause problems in interoperable systems**; nine disagreed; four were neutral and 42 did not reply or express an opinion. Many respondents found that it may be helpful to address the finality and moments in interconnected systems point through SFD. Other respondents pointed to the fact that the SFD already requires systems to ensure that rules are coordinated. One respondent said it would cause significant disruption if the SFD mandated a different settlement timing for certain transactions and that any timing issues can be solved by the exchange of collateral. Other respondents argued that the principle of delivery against payment regulate the main risk (counterparty risk due to asymmetric execution) without having to go to a simultaneous finality of each leg.

Certain respondents suggested that sector specific legislation, e.g. CSDR and EMIR, already require systems to make such specifications, and that needs and rules may differ depending on the nature of the system. One of these respondents pointed out that for CSDs operating in Target2Securities, these moments have been specified in the T2S Collective Agreement.

3.5.2. Notification about insolvency proceedings

A majority (33 respondents) agreed that SFD should stipulate that a system operator should be immediately notified about the opening of insolvency proceedings (in addition to an authority chosen by the Member State, the ESRB, ESMA and other Member States); one disagreed; six were neutral and 32 did not reply or express an opinion. Respondents generally pointed out that systems are notified, but considered it helpful for the SFD to include an express requirement to this effect, in particular in the cross-border context, where notifications can be delayed a few days. In addition, two respondents pointed out that settle-to-market payments offered by the CCPs for risk mitigation and its effect in the relationship between the clearing member and its client should be protected from avoidance and not be considered prepayment of a debt in the insolvency scenario of the client.

3.5.3. Third-country systems specifically

Asked whether their **replies would change if SFD would be extended to cover third-country systems**, 24 respondents said that their reply would not change; 48 did not reply or express an opinion. No further explanations were provided, as no respondent replied that its reply would change.

3.6. SFD and other Regulations/Directives

The targeted consultation asked respondents if in their view the proper functioning of SFD requires clarity regarding its interaction with other relevant legislation, especially insolvency legislation.

3.6.1. Insolvency Regulation and Directive on the reorganisation and winding up of credit institutions

Five respondents said that **Insolvency Regulation**[31] is not sufficiently clear in its interaction with the SFD or the other way round. 11 respondents did not see any problems and 56 had no opinion or did not reply. Three respondents pointed to a need amend the Insolvency Regulation and its **definition of 'payment, settlement system or financial market'** to include SFD systems, CCPs, CSDs (both EU and third-country CSDs) and trading venues. Another respondent said that the Insolvency Regulation should be amended to clearly **recognise SFD protections for CCPs default management processes** if a participant defaults. In addition, protection for actions must extend beyond the first day of insolvency of the participant, as many CCPs default management process will take longer than one day.

Two other respondents argued that if the protection under SFD is extended to third-country, the Insolvency Regulation and Directive 2001/24/EC on the reorganisation and winding up of credit institutions[32] ('CIWUD') would need to be amended to clarify that **they will not interfere with the finality protection in SFD systems** (including third-country systems).

3.6.2. Second Chance Directive

Three respondents saw a need to clarify the **Second Chance Directive**[33] as the interaction with the SFD is unclear**;** eight did not see any problem and 61 did not reply or express an opinion.

3.6.3. Bank Recovery and Resolution Directive

Ten respondents saw a need to clarify the Bank Recovery and Resolution Directive[34] (**'BRRD');** 11 did not see any problem and 51 did not reply or express an opinion.

Several respondents thought that BRRD, in particular the **reference to 'systems and operators of systems designated in accordance with SFD**' should be amended to ensure that third-country systems to which the SFD protection has been extended benefit with the same protection against resolution stays, bail-in and partial transfers as EU SFD systems and CCPs (both EU CCPs and recognised third-country CCPs). BRRD and SFD should also be amended to ensure that third-country systems can be **informed promptly** when insolvency or resolution proceedings are started in relation to an EU participant.

Another said that if SFD protection were to be extended to third-country systems, an analysis of Article 44(2)(f) of BRRD would be needed to ensure that the resolution of an EU institution would not be considered an insolvency procedure in the relevant third country.

One respondent also considered the current imprecise reference to '**systems'** in BRRD problematic and proposed a reference to 'participants of a system'.

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31 Regulation (EU) 2015/848 (OJ L 141, 5.6.2015, p. 19).
32 Directive 2001/24/EC (OJ L 125, 5.5.2001, p. 15).
33 Directive (EU) 2019/1023 (OJ L 172, 26.6.2019, p. 18).
34 Directive 2014/59/EU (OJ L 173, 12.6.2014, p. 190).

Several respondents argued that to ensure **greater certainty for CCPs** and enhance financial stability, BRRD **protection should be extended to all kinds of liabilities, irrespective of maturity.** Moreover, **a CCP's default rules and default management procedures under EMIR** should be protected in all circumstances, and even in the event of a resolution scenario where a clearing member has defaulted (other than as a result of its own resolution process). Two argued that the **finality of holdings of securities and cash** at CSDs and CCPs, and whether these should properly be the target of write-down or conversion powers, should also be considered further. Others said that **protection for any actions** must extend **beyond the first day of insolvency** of a member as CCPs default management processes will take longer than one day.

Other respondents argued that the **current terms seem appropriate** and no change is needed, with **the exception a clarification as to the effects moratoria or other intervention rights** have in comparison with the insolvency of a system participant.

3.6.4. CCP Recovery and Resolution Regulation

Six respondents **said that the CCP Recovery and Resolution Regulation[35] needs to be clarified; seven** did not see any problem and 59 did not reply or express an opinion.

Two respondents noted that if the protection of the SFD is extended to third-country systems, the framework for the recovery and resolution of central counterparties should be amended or checked to ensure that **such third-country systems, and their operators, benefit with the protection against resolution stays, bail-in and partial transfers.**

One respondent also considered the current imprecise reference to '**systems**' in the framework for the recovery and resolution of central counterparties[36] problematic.

Three others argued that the **current terms are appropriate** and no change is needed, except a clarification as to the **effects moratoria or other intervention rights** have in comparison with the insolvency of a system participant.

3.6.5. Payment Services Directive 2

Seven respondents indicated there is a need to clarify Payment Services Directive 2 ('**PSD2**')[37]; nine did not see any problem and 56 did not reply or express an opinion. Five respondents argued that the exclusion of SFD payment systems from the so-called **fair and non-discriminatory access regime** in Article 35 should be revised, if the list of eligible participants in the SFD is extended. Three respondents thought that the term '**institution**' needs to be expanded to cover electronic money institutions within the meaning of the E-Money Directive, and authorised payment institutions as defined in PSD2 to allow direct participation for payment institutions and e-money institutions.

3.6.6. Other legislation

The targeted consultation asked for views on other legislation where provisions are not sufficiently clear in terms of their interaction with the SFD or the other way round. 65 respondents did not reply or express an opinion.

Two respondents argued that the insolvency protection in **Articles 39 and 48 of EMIR** applicable to EU CCPs for porting of client positions and client assets in the event of a default of a clearing member, should be extended to third-country CCPs to give them legal certainty about porting or leapfrog payments to clients clearing via EU clearing

35 Regulation (EU) 2021/23 (OJ L 22, 22.1.2021, p. 1).
36 Art. 55(3), 56(2) and 57(2)
37 Directive (EU) 2015/2366 (OJ L 337, 23.12.2015, p. 35).

members. Currently, the level of protection depends on the national law of the Member State of a clearing member.

An association of CCPs also argued that CCPs' default rules and procedures should be protected and the protection should extend beyond the first day of insolvency of the member, as default management processes often will take longer than that. Moreover, it pointed to an issue with Article 8 of SFD, which refers to the insolvency law governing the system, also in the event of an insolvency of a foreign participant. In particular, the reference to 'the relevant rights and obligations arising from, or in connection with, the participation of the participant in the system' should be broadened and a clear reference to CCPs' default management procedures under Article 48 of EMIR should be added to ensure that SFD protection for designated systems and collateral apply in all systems (also non-designated) operated by one and the same CCP. Finally, it stressed that a single European insolvency framework would provide CCPs with the sound, robust and enforceable legal framework needed to manage the insolvency and default of their participants. Under Article 48(4) of EMIR CCPs must verify that their default procedures are enforceable. That is an issue in some jurisdictions, who do not recognise that EMIR achieves that and where, in practice, CCPs rely on specific national legislation and/or the national transposition of FCD and SFD. This situation results in additional costs for insolvency legal opinions.

A CSD said that it has not encountered any problems due to incompatibility or inconsistency between other pieces of (insolvency) legislation and SFD. However, another respondent said that the point on coordination of the authorisation and reporting flows between CSDR and SFD could be clarified (Article 19 CSDR for new securities settlement systems and Article 10 of SFD and the related reporting flow to the national competent authority under CSDR and to the oversight supervisor under SFD). It questioned if dual authorisations for new securities settlement systems is needed (one under SFD and another under CSDR) or if a single authorisation could be sufficient. Regarding regulatory reporting, a single reporting flow should be set up with the national competent authority sharing the data with the SFD oversight supervisor to avoid duplication under CSDR and SFD.

One respondent said that SFD lacks requirements regarding the operation of the underlying infrastructures of the **retail payment infrastructures** that are important for the digital operational resilience in the digital economies.

One respondent raised issues with Regulation (EU) No 655/2014 establishing a European Account Preservation Order procedure to facilitate cross-border debt recovery in civil and commercial matters ('**EAPO**'). In particular, it pointed out that Article 2(3) of EAPO currently exempts accounts maintained in SFD designated systems and argued that such protections should be extended to systemically important third-country payment systems with accounts at central banks. In its view, all the policy reasons for the exemption of SFD designated systems apply to such third-country systems. This issue would be resolved if third-country payment systems could be designated under SFD, but would require special attention if such SFD designation is not possible and third-country systems either continue to rely on Member States extending protection to domestic institutions participating in third-country systems.

3.6.7. Other cross-border issues

The targeted consultation asked if inconsistencies in the transposition of the SFD have caused **cross-border issues**, which would merit further harmonisation.

Eight respondents raised issues. Two said that they did not see any further issues that needed to be addressed and 64 did not reply or express an opinion.

Two respondents, representing banks, pointed to a need of **harmonisation** across Member States. One argued for a harmonisation of when the **declaration of insolvency** happens in SFD systems. The other said that SFD can help to harmonise operational procedures by ensuring that the SFD rules, approach and logic are applied in the same way across all Member States and throughout the custody and intermediary chains, albeit recognising that it would be a complex endeavour for various reasons, and that some processes and factors are outside the scope of SFD.

One respondent pointed to the issue with ensuring the **enforceability of settlement finality** for non-EU participants in **Czech systems** and recommended that it be addressed at the EU level by an equivalence system.

3.7. Other comments

Asked whether they would like to indicate **anything else** that should be considered for the review of the SFD, 52 replied 'no' and 20 provided input, some of which some repeated input given already on specific questions, and has not been repeated here.

One respondent felt that the review should take a **holistic look at SFD**, and confirm that its primary **purpose is to reduce systemic risk**, before moving to detailed questions, some of which may no longer be applicable. Another said that to reduce the risks associated with participation in designated systems, the **scope of application in relation to insolvency proceedings against the system operator itself should be clarified** (notwithstanding that a system operator falls within the definition of 'participant'). Another respondent argued that **conflicts between UK and EU law** should be avoided in respect of the enforceability and validity of collateral posted in UK CCPs should be ensured vis-à-vis counterparties based in EU27.

One respondent argued that if the SFD is amended to include protections for **third-country systems,** it would be appropriate to **amend Article 9(2)** so that it applies in respect of securities recorded on a register, account or centralised deposit system in any country or territory (i.e., including a third country) to avoid potential uncertainties as to the law that applies for the purposes of determining the rights of collateral-takers in relation to securities recorded in a third country.

A CSD noted that the current **definition of interoperability** (Article 2) only envisages interoperability through the several system operators, however, some system operators operate several SFD designated systems, and the definition of should reflect this.

Some respondents also expressed **support for a recast of SFD as a regulation**, whereas others argued that directives usually provide a good balance between harmonisation and Member States' flexibility, which is particularly important against the diverse legal environments in Member States' insolvency, corporate or securities laws, for which there is no full harmonization.

One respondent argued that the need for reform of the SFD is well established, specifically to cater for new actors and technologies, and suggested that SFD should take the form of a Regulation to achieve its aims and ensure primacy of the settlement finality rules over national insolvency regimes. Moreover, as to the participation and enforcement of collateral, it suggested to review the ways EU markets deal with the insolvency of indirect participants. Currently, in some markets (e.g. T2S), a transfer order cannot be withdrawn once it has been matched with the opposite transfer order, unless each participant agrees. Accordingly, a custodian (a participant) may have to pay for securities received for the account of its client even though client has become insolvent. That can also be an issue on a trading venue, where the venue would transmit transfer orders without going through the custodian to ensure speed. To remedy this, the

custodian participant should be allowed to cancel transfer orders where there is notice of the insolvency of the indirect participant. In addition, the participant should be allowed to realise - straight away - as collateral any unpaid securities within its possession or control, which are held for the account of the client/indirect participant. The participant acting as a settlement agent should also be able to suspend transfer orders or cancel them, depending on the system, so that transactions are not carried out for the account of indirect participants which are not capable of seeing them through directly.