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ISDA response to targeted consultations on the review of the Financial Collateral Directive and Settlement Finality Directive

The International Swaps and Derivatives Association (**ISDA**) and its members welcome the opportunity to respond to the European Commission's targeted consultations on the review of the Financial Collateral Directive (**FCD**)[1] and Settlement Finality Directive (**SFD**)[2].

1. FINANCIAL COLLATERAL DIRECTIVE

1.1 Scope

1.1 Should the personal scope of the FCD be amended to include the following entities:

(a) Payment institutions;

(b) e-money institutions;

(c) central securities depositories;

(d) any other entities?

We consider that the personal scope of the FCD should be extended where this is consistent with the Commission's statement that the scope of the FCD should cover systemically important collateral takers and providers. In particular, we consider that the FCD should be extended to include central securities depositories (to the extent that they are not already in scope as settlement agents or otherwise), as these entities are a key part of EU financial market infrastructure.

1.2 Do you agree with maintaining the current rationale that only financial collateral arrangements should be protected where at least one of the parties is a public authority, central bank or financial institution?

1.2.1 Please explain why and how the rationale should be changed in your opinion?

Yes.

[1] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2021-financial-collateral-review-consultation-document_en.pdf

[2] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2021-settlement-finality-review-consultation-document_en.pdf

We agree with the current rationale, subject to the comments on potential extension of the entities that would qualify as a financial institution, as set out in our response to question 1.1 above.

1.3 Does the exclusion in Article 1(3) (allowing Member States to exclude retail / SME from the scope of the FCD) present any problems to the cross-border provision of collateral in your opinion?

1.3.1 If yes, please explain why the exclusion in Article 1(3) presents any problems to the cross-border provision of collateral in your opinion.

Yes.

In our experience the SME opt-out has caused problems in certain jurisdictions (i.e., those that apply the opt-out in whole or in part). The exclusion of SMEs or more specifically "unregulated corporate legal entities" limits the ability of financial institutions to provide certain derivatives, margin financing, prime brokerage and related services to such unregulated clients that may, but for their lack of regulatory authorisation, organically belong in the financial markets sphere. Examples of such entities may include unregulated proprietary trading companies (often affiliated with a regulated group company), trading subsidiaries, special purpose vehicles, family offices and even some sophisticated corporates that routinely enter into financial markets transactions.

By way of example, the partial implementation of the SME opt-out in France means that French financial institutions struggle to provide certain derivatives, margin lending and prime brokerage services to these unregulated corporate legal entities because the netting and security safe harbours in the French favourable netting regime of Article L.211-36 et seq of the Monetary and financial code ("French Collateral Regime") do not apply to these relationships. This is because certain features of these products (e.g. lending, margin lending, custody and ancillary fees) currently fall outside the scope of the French Collateral Regime as applicable to relationships with unregulated companies. Similarly, certain derivative transactions that have a financing element or have terms that resemble a loan may introduce a "bad apple" risk that creates legal uncertainty and undermines the netting and collateral terms in certain industry standard master agreements entered into with unregulated companies.

Whilst we believe that the benefits to the cross-border provision of collateral of removing the SME opt-out in Article 1(3) significantly outweighs the potential costs, we also acknowledge that the issue of the SME opt-out may remain controversial for a limited number of Member States. To limit the worst effects of the Article 1(3) the Commission may wish to consider limiting the opt-out in scope so that it provides a minimum safe-harbour extending to certain financial markets activities entered into by financial institutions with unregulated corporates. We consider that these should include, without limitation, derivatives, transactions in financial instruments, prime brokerage services, repo, securities lending, margin lending, clearing, custody together with any ancillary or related fees, expenses and overdrafts. Insolvency safe-

harbours in the EU and elsewhere often have similar financial markets activity-based safe harbours for example the US Bankruptcy Code affords special treatment to "securities contracts" and certain other "qualified financial contracts". The list of activities presented above are not intended to be exhaustive but merely represent those activities that we understand may routinely be entered into by financial institutions with unregulated corporates and organically belong in the financial markets sphere.

1.4 Should the FCD be exclusively applicable to the wholesale market (i.e., turning the national opt-out for retail / SME granted under Article 1(3) into a binding FCD provision)?

1.4.1 Please provide an explanation / further information if you would like to.

No, the national opt-out for retail / SMEs should not be turned into a binding FCD provision.

For the reasons described in our response to question 1.3 above, we consider that it would be detrimental to the cross border provision of collateral to turn Article 1(3) into a binding provision. In particular, it would needlessly expose financial institutions that face unregulated corporates to the risk of gross exposures and unnecessary legal uncertainty regarding the enforceability of their collateral arrangements. The vast majority of EU Member States did not choose to implement the full opt-out in Article 1(3) of the FCD.

1.2 Provision of cash and financial instruments under the FCD

2.1 Do you see the need to specify the ways in which financial collateral such as dividend or interest ("claims relating to or rights in or in respect of") could be evidenced in writing when it is provided separately from its financial instrument?

2.1.1 Please explain how this could be done.

No.

We consider that there is sufficient clarity on this point, and that amending the FCD to specify this further would risk unintended consequences (e.g., excluding some types of financial collateral that are currently eligible).

2.2 Do you think that the concepts of "possession" and "control" in the FCD require further clarification?

2.2.1 Please explain why you think that the concepts of "possession" and "control" in the FCD require further clarification and for which type of collateral. Please elaborate how this should be done in your opinion.

Yes.

The concepts of "possession" and "control" under the FCD are the subject of further guidance under national implementing legislation and have also been the subject of litigation (including in the European Court of Justice and also in the UK, while the UK was still a part of the EU). In order to protect financial institutions, we consider that further high-level guidance or detail in the FCD could be provided at an EU level on what would constitute possession or control for the purposes of the FCD. For example, the FCD could be amended to give the Commission the power to define these concepts further in level 2 legislation.

In particular, we consider that these concepts should be clarified with regard to:

- Confirming, consistent with market practice, that it is actually possible to have possession or control where there is no delivery, transfer or holding of the collateral by the collateral-taker, but rather the collateral remains in the possession of the collateral-provider but on terms which give a legal right to the collateral taker to ensure that it is dealt with in accordance with its instructions and, in such circumstances, how the collateral taker can demonstrate that it has possession and control;
- Whether it is always necessary to demonstrate control throughout the course of the arrangement when the assets are held, or, as in the U.S. where security collateral is far more prevalent due to reduced concerns around enforceability, whether it may be sufficient that the collateral is clearly in the possession or control of the collateral taker at the point of enforcement.

By way of specific recommendations, the FCD could be amended to make it clear that the fact that the collateral-provider has the following rights set out below, will not prevent the collateral-taker from having “possession” or “control” of the collateral whether the collateral is held in the collateral-taker’s accounts or held via a third party custodian:

1) account name: the collateral may be held in an account in the name of either the collateral-provider or the collateral-taker;

2) income: to the extent that any income (e.g. interest, coupons or dividends) accrues in respect of the financial collateral (at least where the security has not become enforceable), the collateral-provider will be entitled to withdraw such income from the account;

3) notices: if any notices are received in respect of any collateral in the form of securities, the collateral-provider will be entitled to receive a copy of them;

4) voting rights: to the extent that any voting rights attached to any securities forming part of the collateral become exercisable (if the security has not become enforceable), the collateral-provider will be entitled to exercise such voting rights;

5) valuation: to the extent that the value of the collateral or the secured obligations are not readily observable (as, for example, where the secured obligations are derivatives, which may have an uncertain and fluctuating value), the collateral-provider may be responsible for determining the value of the collateral or the secured obligations; and

6) insolvency: if the collateral-taker becomes insolvent, the collateral-provider will generally be entitled to require the custodian to return the collateral to the collateral-provider (although only after certifying that it has discharged the secured obligations); and

7) automated collateral management services: the provision of a standing instruction to a third party custodian or collateral manager to provide automated substitutions, return of excess collateral or transfers or reinvestment of income (e.g. interest, coupons or dividends).

Additionally we would propose the following amendments:

- Include a non-exhaustive definition of "collateral taker";
- Amend the term "excess financial collateral" to make it clear that an "excess" arises where the value (or estimated value) of the collateral exceeds the amount of collateral required to be posted from time to time under the agreement between the collateral-provider and the collateral-taker. For example, the term could be defined as "including the case where the value of the financial collateral to which a financial collateral arrangement relates exceeds an amount agreed between the parties, or determined by reference to a formula or any other criteria agreed between the parties, including, but not limited, to any agreement between the parties that any such determination is made by the collateral-taker, the collateral-provider or a third party, reasonably or in good faith or as otherwise provided by the terms of the relevant agreement(s) between the parties";
- Amend the definition of "security financial collateral arrangement" and "security interest" to include the words "(including upon the default of the collateral-taker)" after the words "withdraw excess financial collateral";

~~The FCD could also incorporate a checklist-style approach to, in effect, codify the existing analysis the market conducts for security financial collateral "control" assessments (e.g., that a collateral taker can prevent the withdrawal of collateral and collateral taker consent (whether upfront or otherwise) to collateral substitution, to voting rights in collateral and in the treatment of collateral proceeds).~~

We also consider that where emission allowances are included within the definition of "financial instrument" the Commission should undertake a review to confirm that the current conditions of "control" and "possession" are suitable or whether something further should be included in order to capture the possibilities of title transfer and security interest of these assets.

2.3 Do you believe that the notion of a good faith acquirer within the EU should be further clarified in the FCD?

2.3.1 Please explain how this might be done for "cash" and "financial instruments".

No, we do not consider that the notion of a good faith acquirer should be further clarified in the FCD.

1.3 "Awareness" of (pre)insolvency proceedings

3.1 Do you see the need to clarify how "awareness" of (pre-)insolvency proceedings under Article 8(2) of the FCD is determined?

Please explain in your opinion clarifying how a collateral taker can "prove that he was not aware" could be done.

Please explain in your opinion clarifying how a collateral taker can "prove that he should not have been aware" could be done.

Yes.

We consider that it could be helpful to clarify this requirement further. In particular, we would recommend reversing the standard of proof (so that it must be demonstrated that the collateral taker was aware in order for the protection to not apply, rather than requiring the collateral taker to demonstrate that they were not aware). We consider this preferable as it creates a greater level of certainty and, in any event, proving a negative can be difficult to achieve in even the most favourable fact patterns.

1.4 Recognition "close-out netting provisions" in the FCD and its impact on SFD systems

4.1 Have you encountered problems with the recognition / application of close-out netting provisions?

4.1.1 What were these problems related to? [use within one Member State? Cross-border use? Both?]

4.1.2 What did these problems concern? [OTC transactions / transactions carried out on an SFD system / both]

4.1.3 Please describe the problems and the outcome.

4.1.4 Please describe a solution that you consider appropriate.

Yes, we have encountered problems with the recognition / application of close-out netting provisions.

European netting legislation would provide legal certainty and would avoid different legal regimes across Europe, enhancing cross border activity among European entities and investment from third country firms.

The Commission may wish to consider converting the FCD into a regulation in order to maximise harmonisation and consistency of approach across the EU. However, we appreciate that this may be difficult given the differences in insolvency legislation across the different EU member states. We would not support conversion of the FCD into a regulation if this would result in a weakening of the existing financial collateral regime under the FCD in order to make

the regime fit within the restrictions of national insolvency or other legislation. In addition, the question of how to deal with existing national discretions and opt-outs in a regulation should be resolved in favour of inclusion of the relevant arrangements and collateral.

The Commission may also wish to consider developing an EU netting directive providing for harmonised EU-wide protection from insolvency for netting provisions in a broader context than the FCD. For example, in some jurisdictions enforceability of netting is too heavily dependent on FCD implementation and that leads to discrepancies in product coverage and a split in the analysis for enforceability of netting with ISDA on its own v ISDA and CSA. For example, the Italian legislation implementing FCD provides a safe harbour for netting agreements that are financial collateral arrangements but an ISDA agreement on its own is not afforded the same protection, so even though local law considerations would still result in netting being enforceable, requirements such as notarisation etc become relevant.

Differences in treatment of different counterparty types between EU jurisdictions:

Effectiveness of netting provisions varies depending on counterparty type between different EU member states – for example, the ISDA netting opinion for Italy does not cover pension funds.

Differences in treatment of different contract types:

Different contract and transaction types are treated differently in different EU member states. For example, credit default swaps (CDS) were not considered qualifying transactions for netting under German legislation until 2019, while being considered qualifying transactions under other local legislations. Similarly, open/on demand repos are not qualifying transactions for netting under German legislation unless a fallback repurchase date is included in the agreement/confirmation, while these are considered a qualifying transaction under the law of other EU member states.

Any agreements that contain master netting arrangements (including many prime brokerage agreements) will allow for the set-off or netting of multiple close-out amounts that are determined under separate netting agreements. These master netting arrangements should also benefit from the close-out netting provisions of the FCD consistently across all Member States. These master netting arrangements may cover different product types and provide an efficient method for financial institutions and their clients to mitigate credit exposures across multiple product agreements.

Link between close-out netting and financial collateral arrangements:

“Close-out netting” is defined in the FCD only in connection with a financial collateral arrangement (see the definition of “close-out netting” and the definition of “financial collateral arrangement”). Therefore the FCD does not currently provide any protection to close-out netting without a collateral arrangement. Also, the definition of “relevant financial obligations” does not include all types of derivatives. A broader definition of "close-out netting" would also support protections available under other legislation (e.g., BRRD, which offers protection to certain netting arrangements). Therefore we propose that the scope of protection provided by

the FCD would be extended to include close-out netting without financial collateral arrangements relating to the relevant transactions. For example, the definition of "close-out netting provision" could be amended to mean "a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or of any other arrangement, or, in the absence of any such provision […]".

While our response focusses on derivatives, because this is ISDA's core area of focus, similar issues arise with respect to other types of financial market transactions.

This relates also to question 4.5 further below.

4.2 In case you have collected legal opinions regarding the enforceability of close-out netting: are they upheld or to be changed in light of the framework for the recovery and resolution of central counterparties (Regulation (EU) 2021/23)?

4.2.1 Please specify why and how the legal opinions you have collected were changed.

4.3 In case you have collected legal opinions regarding the enforceability of close-out netting: were they upheld or changed in light of the revision of the BRRD (Directive 2014/59/EU)?

4.3.1 Please specify why and how the legal opinions you collected were changed.

The ISDA Master Agreement has established international contractual standards governing privately negotiated derivatives transactions that reduce legal uncertainty and allow for reduction of credit risk through netting of contractual obligations. Ensuring the enforceability of the netting provisions of the ISDA Master Agreement remains a key initiative for ISDA. The ISDA netting opinions address the enforceability of the termination, bilateral close-out netting and multibranch netting provisions of the 1992 and 2002 Master Agreements. ISDA has published netting opinions covering 75 jurisdictions, which are updated on a regular basis.

These opinions have not been updated or changed in light of the framework for the recovery and resolution of central counterparties (2021/23), as the ISDA netting opinions relate to bilateral uncleared transactions.

Where ISDA has updated its netting opinions following transposition of BRRD2 (revising BRRD) into the national law of relevant EU member states, these netting opinions have been amended to reference BRRD2 and in particular the possibility for resolution authorities to suspend, for a limited period, certain contractual obligations before an institution is placed into resolution and the requirement for parties to include a contractual clause recognising the effect of stays in resolution. However, this has not resulted in any additional qualifications to these opinions or in these opinions no longer being upheld.

4.4.1 Do you see legal uncertainties related to close-out netting provisions due to the FCD's silence regarding the application of national avoidance actions to such provisions?

4.4.1.1 Please explain the legal uncertainties you have identified and how these might be solved.

Yes.

When the FCD was first enacted, there was no regulatory requirement to post and collect variation margin or initial margin. Now that this requirement applies pursuant to EMIR, the issues arising from national avoidance provisions have been put into the spotlight. The common avoidance cases of collateralisation of pre-existing debt and transfer of additional collateral are of particular concern when it comes to regulatory margining.

The Commission should conduct a study as to the national avoidance laws which apply irrespective of the bad faith of the collateral taker and cases where the burden of proof is with the collateral taker, and should identify cases where it should exclude the application of national avoidance actions (including where banks are subject to an obligation to collect and post collateral).

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

4.4.2.1 Please explain the legal uncertainties you have identified and how these might be solved.

No.

The introduction of Article 1(6) of the FCD has not affected the conclusions of the opinions obtained by ISDA on effectiveness and enforceability of the close-out netting provisions of the ISDA Master Agreement in connection with parties established in EU member states.

4.5 Do you consider that there is a need for further harmonisation of the treatment of contractual netting in general and close-out netting in particular?

4.5.1 Please explain your reasons as well as possible solutions taking into account possible interactions with other national or EU law and the importance of close-out netting for risk management and the calculation of own funds requirements for credit institutions and investment firms under the CRR.

Yes.

It may be useful for EU legislation to provide for further harmonisation of the treatment of contractual netting in general and close-out netting in particular. We are aware of differences in the extent and clarity of netting legislation in different EU member states and we consider that it would be appropriate for the Commission to carry out a detailed comparison of netting

legislation in each EU member state in order to assess where any discrepancies or gaps exist and how these could best be addressed at an EU level (e.g., by further guidance from the Commission, by amendments to the FCD or by introduction of separate EU legislation on netting).

In particular, we would note that due to the uncertainties regarding possession and control (discussed above), it can be challenging to obtain a clean legal opinion on security financial collateral in some jurisdictions (for example, where the national legislation implementing the FCD presents some uncertainties regarding effectiveness of close-out netting).

It is critical that these uncertainties are addressed.

1.5 Financial collateral

5.1 Do you think other collateral than cash, financial instruments and credit claims should be made eligible under the FCD?

5.1.1 If so, please elaborate which type of collateral and why.

No, subject to our comments below regarding emission allowances and crypto-assets that qualify as financial instruments.

5.2 Do you see the need to update the definitions of currently eligible collateral? [cash / financial instruments / credit claims]

Please explain why and how updating the definition of cash should be done.

Please explain why and how updating the definition of financial instruments should be done.

Please explain why and how updating the definition of credit claims should be done.

Yes, we do see a need to update these definitions.

Definition of cash:

Financial markets participants including prime brokers, agent lenders and others routinely take security over certain contractual rights such as close-out amounts determined under a close-out netting arrangement. These are important components of various credit protection packages used when the financial collateral arrangement is intended to benefit more than one secured party and the lack of mutuality of obligations does not permit such lenders to rely on close-out netting or set-off rights alone. This has caused challenges in jurisdictions such as Ireland and the Netherlands where these types of claims, that we believe naturally belong in many financial collateral arrangements, do not benefit from the protections under domestic Member State implementation of the FCD. Security arrangements that include a mixture of financial and non-financial collateral may cause a degree of unnecessary legal uncertainty as to whether the FCD protections apply to the arrangements (in whole or in part).

One way of addressing these concerns would be to define cash as "money in any currency, credited to an account, or a similar claim for repayment of money and includes money market deposits and sums due or payable to, or received between the parties in connection with the operation of a financial collateral arrangement or a close-out netting provision".

We believe that a similar extension of the definition of cash in the FCD would benefit the cross-border provision of financial collateral in the EU.

In addition we believe more generally that it may be beneficial to clarify that an arrangement that covers mixed financial collateral and non-financial collateral (including, for example, related rights under the transaction documentation assigned by the collateral provider to the collateral taker) shall still qualify for the protections of the FCD where the majority of the collateral constitutes financial collateral. This would reduce the bad apple risk that a broadly drafted credit protection package may fall outside the scope of the protections due to some residual claims or interests that do not technically qualify as financial collateral.

Definition of financial instruments:

We consider that the definition of financial instruments should be updated to align more closely with the definition under MiFID.

In addition to including the types of financial instruments listed in MIFID, Section C (Financial instruments), which includes “units in collective investment undertakings” we consider it would be helpful to include other types of “fund units” that may be redeemed for cash at a future point in time. To the extent that “fund units” are included as “financial instruments” we believe it would be helpful to expressly enable the collateral provider to have the accompanying right to redeem their interest in the “fund units” in exchange for cash at any time, without the collateral taker losing “possession” and “control” over the “fund units”. The right to redeem “fund units” for cash would be in line with the current substitution rights which permit substitution or exchange or financial collateral for “substantially the same value” which would be the case with fund units redeemed for cash.

In particular, the definition of financial instruments should be updated to include emission allowances. This is needed because emission allowances are often a form of collateral of choice to be held against exposures under futures and options contracts and other derivatives where the underlying deliverable asset is itself an emissions allowance. As the Commission will be aware, there is an active exchange-traded and cleared marketplace in emissions allowance derivatives where such collateral is commonly used or desired (and where use of this asset class as collateral, and certainly as security collateral, may be inhibited by a lack of designation of this asset class under the Financial Collateral Directive).

5.3 Should emission allowances be added to the definition of financial instruments in the FCD?

Yes, they are a commonly used financial collateral and should therefore be eligible as collateral under the FCD.

5.4 For crypto-assets qualifying as financial instrument, would you see a need to specify the ownership, provision, possession and control requirements of the FCD further for a DLT context in order to provide legal certainty as to the question whether they are covered within the FCD?

5.4.1 Please elaborate on how this might be done in a manner that is compatible with national laws regarding securities, companies, contracts, property and book-entry.

No.

Where crypto-assets qualify as a financial instrument, we consider that the provisions of the FCD that relate to ownership, provision, possession and control of other financial instruments should be sufficient to address these issues as they apply to crypto-assets. It should not be necessary to specify these issues further in the context of distributed ledger transactions. DLT is ultimately a mechanism for transferring (and recording the transfer of) assets – it does not confer additional or different rights regarding ownership, possession or control that would need to be reflected in the FCD.

5.5.1 Should the notions of "account" be retained, replaced or further clarified / specified for the purposes of evidencing the provision of cash or securities collateral provided through DLT?

Please explain why you think so and how this matter might be solved.

Retained.

The FCD defines "relevant account" in relation to book entry securities collateral which is subject to a financial collateral arrangement, as the register or account – which may be maintained by the collateral taker – in which the entries are made by which that book entry securities collateral is provided to the collateral taker.

This definition is sufficiently broad to cover a register or account that may be maintained using DLT.

5.5.2 Should the notions of "book-entry" be retained, replaced or further clarified / specified for the purposes of evidencing the provision of cash or securities collateral provided through DLT?

Please explain why you think so and how this matter might be solved.

Retained.

The FCD defines "book entry securities collateral" as financial collateral provided under a financial collateral arrangement which consists of financial instruments, title to which is evidenced by entries in a register or account maintained by or on behalf of an intermediary.

This definition is sufficiently broad to cover a register or account that may be maintained using DLT.

5.6 Are there any other issues you would like to address regarding FCD financial collateral in a DLT environment?

5.6.1 Please elaborate on how this might be done in a manner that is compatible with national laws regarding securities, companies, contracts, property and book-entry.

No.

5.7 In your opinion, do existing provisions on set-off create a problem for the provision of credit claims as collateral?

5.7.1 What is the context of this problem? [national context, cross-border context, both of the above]

No.

5.7.2 Do you see the need to remove a debtor's set-off rights? Please consider the set-off risks against the risks to households and SMEs in the event of the insolvency of a credit institution?

5.7.2.1 Why do you see the need to remove a debtor's set-off rights?

5.7.2.2 Under which conditions should such a removal take place?

No, it is for the collateral taker to decide what kind of collateral they accept and ensure appropriate risk mitigation where applicable.

1.6 The FCD and other Regulations / Directives

6.1 Is there any legislation where provisions are not sufficiently clear in terms of their interaction with the FCD or the other way around?

6.1.1 Insolvency Regulation (Regulation (EU) 2015/848) – please explain why you think the provisions of the Insolvency Regulation are not sufficiently clear in terms of their interaction with the FCD or the other way around. Please also explain how this matter might be solved.

6.1.2 Second Chance Directive (Directive (EU) 2019/1023)

6.1.3 BRRD (Directive (EU) 2014/59/EU)

6.1.4 Framework for the recovery and resolution of central counterparties (Regulation (EU) 2021/23)

6.1.5 If there is any other legislation where provisions are not sufficiently clear in terms of their interaction with the FCD or the other way around, please specify which ones, explain why, and explain how this matter might be solved.

We consider that changes may be required to MiFID.

MiFID:

Article 16(10) of Directive 2014/65/EU (MiFID II) prohibits an investment firm from concluding title transfer financial collateral arrangements with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients. This has resulted in investment firms being required to conclude security financial collateral arrangements in the context of significant enforceability issues. If the definitions of possession and control are not resolved favourably as discussed in section 2.2.1, then article 16(10) of MiFID II should be repealed.

1.7 Other issues

7.1 To what extent have inconsistencies in the transposition of the FCD caused cross-border issues which would merit further harmonisation? Please provide examples of such instances.

7.2 How could we further enhance cross-border flows of financial collateral across the EU?

N/A

7.3 Is there anything else you would like to mention?

Application of the FCD to DLT or cryptoassets:

Before proposing any amendments to the FCD (or any similar or related legislation) that are intended to promote the use of DLT or cryptoassets within the EU, we would encourage the Commission to conduct a thorough review and impact assessment on the potential impact of any modifications on non-DLT based financial transactions.

In particular, we note that there is a broad spectrum of DLT platforms and many different types of cryptoasset. As mentioned in our comments above, some of these may qualify as financial instruments (and may be capable of being treated in the same way as any other financial instrument under MiFID), and some may not. The proposed Markets in Crypto Assets Regulation will introduce new requirements in relation to the latter category, and it may be worth reviewing the treatment of these assets again once that Regulation has come into effect.

Creating a precise definition or taxonomy of different types of DLT system and/or cryptoasset or digital asset is challenging, given the rapid development of the technology, the range of platforms used and the kind of assets that are digitally represented on these platforms. We note that there is currently no such taxonomy at an EU or international level. This lack of taxonomy presents challenges in determining the extent to which DLT-based collateral systems might fall within or outside of the scope of the FCD. For example:

- Does the DLT system's operational set-up provide for the creation of an "account" or "relevant account"?
- Do cryptoassets constitute "cash" or "financial instruments"?
- How is collateral in the form of cryptoassets provided and how does the collateral taker demonstrate that it has sufficient "control" of the collateral?

Where assets do not fall within the existing framework (e.g., because they do not qualify as financial instruments under MiFID, or because the relevant system does not involve registers or accounts that fall within the definitions of "account" or "relevant account" under the FCD), the answer is not necessarily going to be to amend or broaden the scope of the FCD to include these assets and systems – as we mention above, this may give rise to unintended consequences, and it may be wholly inappropriate to include them within the scope of the FCD. Rather, we consider that the Commission should undertake a detailed review of these assets and systems to understand the issues associated with trading these assets or trading through these systems and assess whether they should be included within the scope of the FCD, whether it may be appropriate to legislate separately to manage any identified risks or whether further legislation is not necessary at this stage.

Requirement for evidence in writing or in a durable medium:

The FCD applies to financial collateral once it has been provided and if that provision can be evidenced in writing. References to “in writing” include, in addition to paper, recording by electronic means and any other durable medium; however our suggestion would be to delete the term "in writing" and substitute this term directly by “durable medium”. In the current context of new technologies the number of means/mediums which fulfil the same functions as paper form and meet the requirements of investor protection, has increased. The tendency of the market is moving towards the reduction of the use of paper form; the majority of EU jurisdictions have e-contracts legislation or have recognized them as equivalent to paper form. Additionally, there has been an increase in the technical methods available for guaranteeing unchanged reproduction. Given that the FCD currently further clarifies that “in writing” includes “electronic means and any other durable medium”, we consider that it should directly include references to “durable medium” and include the requirements a mean/medium should comply with in order to be considered a “durable medium".

Clarification on scope of netting sets:

Due to the great advance in the clearing volumes of derivatives in Central Counterparties (“CCP”) since EMIR and its clearing obligation came into effect, another field for adding legal

certainty would be the clarification, at FCD level, that client clearing agreements (e.g. those developed by ISDA to cater for principal-to-principal client clearing) benefit from Close-out Netting Provisions and that a single netting set can include various sub-netting sets (e.g. a single ISDA master agreement including annexes for client clearing trades and pure OTC trades).

Similarly, any agreements that contain master netting arrangements (including many prime brokerage agreements) will allow for the set-off or netting of multiple close-out amounts that are determined under separate netting agreements. These master netting arrangements should also benefit from the close-out netting provisions of the FCD consistently across all Member States. These master netting arrangements may cover different product types and provide an efficient method for financial institutions and their clients to mitigate credit exposures across multiple product agreements.

Expansion of the title transfer financial collateral arrangements covered by the FCD:

The title transfer financial collateral arrangements encompassed by the FCD protections are limited to those that secure or otherwise cover the performance of "relevant financial obligations" (see the definition of "title transfer financial collateral arrangement" at Article 2(1)(b)). Whereas the definition of "security financial collateral arrangement" is not limited in the same way, the protections afforded to those arrangements are structured by reference to "relevant financial obligations" (see Article 4(1) and (6), Article 5(2) and Article 8(2) and (3)) and limited accordingly. Relevant financial obligations are restricted to obligations that give a right to cash settlement and/or delivery of financial instruments (as defined in the FCD), as further clarified at Article 2(f). Many derivatives encompass obligations other than the payment of cash and the delivery of financial instruments as defined in the FCD, such as physically settled bullion and commodity derivatives, physically settled credit default swaps referencing loans and physically settled emissions allowance transactions (but see our response to question 5.3 regarding emission allowances). The transaction of such derivatives under the same collateralised master agreement as derivatives the obligations under which comprise only relevant financial obligations are transacted – which may be advisable for collateral optimisation or other reasons - may deprive that entire collateral arrangement, and any related close-out netting provision, of FCD protections. We agree with the statement of the European Commission set out in its June 2020 document "Working Document on Collateral from the Commission to relevant bodies for consultation" that "There seems to be no reason to limit the types of exposure that should be covered. Collateral is currently used to reduce the credit exposures arising from all kinds of financial transactions. To attempt to distinguish different transactions would be difficult to achieve and burdensome to operate and would appear to serve no useful purpose.". In our view this has proved to be the case as, in order to obtain any FCD protections, industry participants are required to segregate into FCD eligible and non-FCD eligible arrangements portfolios of transactions that, from the perspectives of business, risk management and collateral optimisation, should comprise a single arrangement. We would recommend that the restriction on the definition of "relevant financial obligations" be removed and consideration be given to replacing it with:

"'relevant financial obligations' means the obligations which are secured **or otherwise covered** by a financial collateral arrangement ~~and which give a right to cash settlement and/or delivery of financial instruments~~. Relevant financial obligations may consist of or include:

(i) present or future, actual or contingent or prospective obligations (including such obligations arising under a master agreement or similar arrangement);

(ii) obligations owed to the collateral taker by a person other than the collateral provider; or

(iii) obligations of a specified class or kind arising from time to time;"

The reference to "or otherwise covered" is proposed to reflect the use of that terminology in the definition of "title transfer financial collateral arrangement".

We would be happy to discuss these and other relevant issues further with the Commission.

2. SETTLEMENT FINALITY DIRECTIVE

2.1 Participation in systems governed by the law of a third country

1.1 Should EU institutions that participate in third-country systems be protected by the SFD?

1.1.1 Please explain your answer to question 1.1.

Yes.

We strongly agree that EU institutions that participate in third-country systems should be protected by the SFD. However, this must be achieved through extending SFD designation to third-country systems, not by restricting the measures to protections for participants. SFD designation is already extended to third-country systems under the national law of a number of EU member states, and it would be helpful for the SFD to be amended to provide for a harmonised EU-wide approach to designation for third-country systems, allowing participants from all EU member states to benefit from the protections of the SFD where they participate in third-country systems.

The key issue and lacuna that needs addressing under the SFD is that a third country system operator (and other non-defaulting participants) must be able to have confidence to deal with EU participants through an EU-wide designation for third country systems (not their EU participants). With SFD designation for third country system operators, an insolvency official of an EU participant will not be able to interfere with the third country system's operation. Without SFD protections in the context of third country CCPs, in particular, EMIR (Regulation 648/2012) provides no insolvency law protections. If an EU clearing member defaulted, the CCP would risk becoming mired in insolvency proceedings and litigation in respect of whether EU laws would respect the holdings stated in its records, or as to the finality of transfer orders or collateral security, which would risk being voided by the insolvency official. This could cause financial losses to system operators, and other participants and related systemic events. This would affect the third-country CCP's ability to prevent that default spreading throughout the EU and globally. The defaulting EU participant would not be affected by these losses or systemic events, since it would already be in an insolvency process, although the relevant insolvency process might be simpler and less expensive if the rules on settlement finality were clear. It may promote certainty for clients of the defaulting participant to have greater settlement finality protections.

It is to mitigate the risks for settlement and clearing systems as a whole (and not to protect EU participants) that third-country CCPs have sought third-country "designated system" status in individual EU member states and EU member states have been keen to grant such designations, especially with the exit of the United Kingdom from the EU. Without these designations, third country systems might not feel able to admit EU entities as members or provide access to EU entities for membership or usership of their systems, since the legal opinions and legal comfort required by third country CCPs under applicable regulations would be insufficient. CCPs, in particular, are required to have legal opinions supporting the enforceability of their rules under

EMIR. The availability of SFD designation to third country systems must therefore be first and foremost: (i) about protecting the systems themselves (and other non-defaulting participants) from insolvency law challenges in EU insolvency proceedings and (ii) about ensuring that EU participants are not cut off from accessing international settlement and clearing systems due to insolvency-related uncertainties.

Extending SFD protections to EU institutions (only) participating in third-country systems would not achieve any of these objectives, since this would leave it open to the insolvency official appointed in respect of an EU participant to take legal actions against system operators or other participants to unwind orders that had become final, declare void collateral arrangements or declare non-binding the holdings in the system. CCPs and other settlement systems will simply not admit EU participants to membership on those terms, potentially reducing access to financial markets, and choice and pricing for EU persons and businesses.

1.2 Please bring the following options in an order, attributing 1 to the option that you consider most suited and 4 to the option that you consider least suited:				
	1	2	3	4
Criteria for protection should be set at EU level. Also, decisions to extend the protection should be taken at EU level. This ensures a level playing field in the EU and predictability for market participants.	X			
Criteria for protection should be set at EU level. However, decisions to extend the protection should be taken at national level. This ensures greater harmonization within the EU but gives the possibility to consider national market characteristics and laws.		X		
Criteria for protection should be set by each Member State. Also, decisions to extend the protection should be taken by each Member State. They know best their national market and possible implications and interactions with national laws.			X	
Other				X

Question 1.3 In case the scope of the SFD was to be extended to EU institutions participating in third-country systems, how should this be done? **Please explain your answer to Question 1.3.**

The provisions of the SFD should apply directly to the third-country system in their entirety.

If the scope of the SFD is extended so that SFD designation may be extended to third country systems with EU participants, then we consider that the protections available as a result of SFD designation should be available to EU participants (rather than deferring to the protections available under the applicable third-country law).

1.4 Do you see the need to carry out an assessment whether the applicable third-country law provisions are comparable to the SFD's? **1.4.1 Please explain why there is no need for an assessment.**

There is no need for an assessment.

The effect of designation under the SFD is that the settlement finality rules of the relevant third-country system would prevail over relevant insolvency provisions in the event of the insolvency of a participant. It is not necessary to assess whether or not the relevant third country has comparable provisions in order to achieve this result under the SFD. All that is needed is for the SFD to prescribe the types of settlement finality rules which are protected (as currently), and then to the extent the third country system has such rules, they will fall within the insolvency law carve-out.

1.5 In case the SFD should provide criteria for the assessment for designation of a third country system, what is your opinion regarding the following statements?	
(a) SFD protection should only be extended to third country systems if the third country extends protections towards SFD systems.	1 – Disagree It is not necessary for there to be reciprocal protection offered by the third country to SFD systems in order for SFD protection to be extended to third country systems. EU participants benefit where SFD protection is extended to third country systems, and if this protection is only available where reciprocal protection is available, this would potentially remove an important protection for EU participants without achieving any proportional benefit. Additionally, some jurisdictions, such as the U.S., do not have bespoke settlement finality

	regimes in place but still offer key insolvency law protections in other ways which are satisfactory, including to EU systems such as EU derivatives clearing houses. Given that settlement finality is a particularly EU concept, it would be inadvisable to constrain the European Commission's discretion in this way.
(b) information about insolvency of a participant in the third country system should be provided in a timely manner by the third country system operator.	1 – Disagree If the SFD is extended to apply to third country systems to the extent that they admit EU participants, its provisions should operate in the same way in relation to those third country systems as they currently do to EU systems. Under the SFD, where insolvency proceedings are commenced against an EU institution, the relevant judicial or administrative authority shall immediately notify that decision to the appropriate authority in its Member State, who would immediately notify other Member State. This approach should not need to be amended in relation to EU participants in a third country system (and it is unlikely that a third country system operator would have more information on the insolvency of EU participants, or more timely information, than the relevant EU authority).
(c) information about insolvency of a domestic participant should be provided in a timely manner by the third country national authorities.	1 – Disagree We understand that the proposal is to extend the SFD so that its protections are available where EU institutions participate in a third-country system. As a result, the insolvency of a domestic participant would not be relevant for these purposes.
(d) systemic importance of the third country system should be prerequisite.	1 - Disagree

	It should be possible for any third country system that meets the relevant criteria to qualify for designation under the SFD. It is unlikely that any third country system that is not designated under the SFD would become systemically important in the EU, so requiring systemic importance as a prerequisite for designation is likely to limit the availability for these protections for EU participants, reduce choice of using emerging economy systems for EU participants and stifle start-up or new systems from gaining recognition. This is because systems themselves may be reluctant to admit EU members unless they have legal certainty in relation to settlement finality issues.
(e) Adequacy of the rules of the system should be given.	5 – Fully agree. We fully agree that there should be some level of assessment regarding the adequacy of the rules of a designated system (rather than an equivalence assessment based on the local legislative regime).
(f) Only systems that are as strict as the SFD regarding the provisions about (direct) participation should be eligible for designation.	1 – Disagree We understand that the intention is to extend the SFD so that its protections are available to EU institutions that participate in designated third country systems. If the protections under the SFD are limited in this way, it should not also be necessary to restrict third country systems from admitting other types of direct participants – to the extent that they do admit other types of direct participants, the protections would simply not be available to those participants. It is particularly important that the SFD does not restrict third country systems regarding the types of non-EU participants that they can admit, as these non-EU participants are not relevant for the purposes of applying

	SFD protections to EU participants in third country systems. In addition, there are frequently challenges in applying EU legislative definitions to entities regulated in other jurisdictions, meaning that it is unclear whether a local entity would or would not be an "institution" if it was established in the EU. Imposing restrictions of this type is likely to result in third country systems being reluctant to admit EU participants.
(g) Only systems that are as strict as the SFD regarding the provisions about indirect participation should be eligible for designation.	1 – Disagree
(h) No discrimination between EU institutions and other institutions should be made by the third-country system.	3 – Neutral
(i) All participants have to be known to the system operator	1 – Disagree We understand that "participant" here means both direct and indirect participants. A system operator would often not know the identify of all indirect participants (e.g., a CCP would not know the identity of all clients of clearing members).
(j) the country of establishment of the system operator should be considered.	1 – Disagree The country of establishment of the system operator in and of itself should not be a relevant factor.
(k) The country where the infrastructure is located, maintained and/or operated should be considered	1 – Disagree Again, so long as the system operator has sufficient controls in place, this shouldn't be relevant
(l) The third-country law governing the system should fulfil the assessment criteria as indicated in my response under question 1.4	1 – Disagree We indicated that there was no need for such an assessment under question 1.4.

(m) 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.	1 – Disagree
(n) Cooperative oversight arrangements with the third country concerned should be prerequisite	4 – Rather agree
(o) In the case of CCPs, the recognition of the CCP concerned under Article 25 of EMIR should be prerequisite	1 - Disagree An EU participant would only be able to access a third country CCP if that CCP has obtained recognition under Article 25 EMIR. As a result, we do not consider that it is necessary to make obtaining Article 25 EMIR recognition a prerequisite for SFD designation, as Article 25 EMIR will have this effect in any event. If the European Commission decided to make Article 25 recognition a prerequisite for obtaining SFD designation, it will be important to ensure that this does not create unintended consequences or circular conditions (e.g., a situation where a non-EU CCP needs SFD designation in order to obtain Article 25 EMIR recognition, but can only obtain Article 25 EMIR recognition where it has SFD designation). Third country CCPs should be able to apply in tandem for both EMIR recognition and SFD designation to avoid the risk of having to operate without key insolvency law protections.
(p) In the case of CSDs the recognition of the CSD concerned under Article 25 of CSDR should be prerequisite	1 – Disagree
(q) The criteria should be the same for all third-country systems regardless by which third-country law they are governed	5 – Fully agree
(r) Other: please indicate other assessment criteria that you consider useful	Designated third country systems should have clear contractual or rulebook provisions

	on settlement finality, specifying: (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. The existence and legal effectiveness of such rules under the governing law of the system rules should be the key point assessed in any recognition process. We regard the various other criteria developed in this consultation as all being of secondary importance.

1.6 In case the scope of the SFD was to be extended to EU institutions participating in third country systems, should the scope be extended to EU institutions participating in third-country payment and security settlement systems?

Please explain your answer to question 1.6

To both, payment and security settlement systems.

1.7 Should the scope of the SFD be extended to all EU institutions participating in third country systems without discrimination?

Please explain your answer to question 1.7

Yes.

As mentioned above, we strongly support extension of the scope of the SFD so that third country systems may obtain SFD designation with the result that their EU participants benefit from protection under the SFD, in the same way that they do when participating in designated EU systems. It is unclear to us what the basis for any discrimination might be, but we consider that the same protections should be available to EU institutions participating in designated third country systems as are currently available to EU institutions participating in designated EU systems.

1.8 Should the assessment for designation of a third-country system be done on a case-by-case basis?

Yes. This is most appropriate as criteria which are specific to a certain system should be considered (see my answers to question 1.5 above).

1.9 Should a regular evaluation be required whether the requirements for a designation are still met?

1.9.1 Please explain your answer to question 1.9

No.

We consider that it should be the responsibility of non-EU systems that are designated under SFD to keep their EU competent authority updated regarding any changes in law, regulation or to their system that would be relevant to their designated status.

[Question 1.10 intentionally left blank, as this is a question for non-EU national supervisory authorities]

2.2 Participants in systems governed by the law of a Member State

2.1 Should the list of currently eligible SFD participants be either limited or extended or otherwise modified? Please explain your reasons for each type of participant where relevant.

Should be extended.

We consider that the scope of eligible SFD participants should be extended to include CSDs (to the extent that they are not already in scope as "settlement agents" or "system operators"), e-money and payment institutions, subject to appropriate supervision and risk mitigation.

2.2 Should participation in an SFD system be limited to legal persons?

Please explain your answer to question 2.2

No.

Non-legal persons should be permitted to participate in an SFD system where they otherwise meet the criteria as eligible SFD participants (e.g., if they are authorised under MiFID).

[Questions 2.3 – 2.9 deliberately left blank]

2.3 SFD and technological innovation

3.1 Do you consider the SFD to be technologically neutral?

No, I do not know how to apply certain concepts or definitions of the SFD for specific technologies which creates legal uncertainty.

3.2 Do you agree that the concepts of the SFD do not work in a permissionless DLT environment?

3.2.1 Please provide detailed information on your answer.

Yes, important concepts of the SFD do not work in a permissionless DLT environment, especially as legal responsibilities might be unclear. It is indeed problematic that there is no centralised operator, unidentified participants can enrol without restriction and functions can be attributed simultaneously to several participants.

3.3 Do you agree that the scope of the current review of the SFD should be limited to considering the tech neutrality of the SFD in the context of permissioned DLTs where the system operator could design the system and its rules so as to be SFD compliant?

3.3.1 Please explain your answer to question 3.3

No

We consider that where possible the current review of the SFD should not be limited to the context of permissioned DLTs where the system operator could design the system and its rules so as to be SFD compliant, but rather that the review should take into account any issues that have been identified either by market participants or as a result of the Commission's pilot regime for market infrastructures based on DLT, including the difficulties already identified with regard to the application of the SFD to permissionless DLT systems.

3.4 Do you think that first experience with the pilot regime for market infrastructures based on DLT should be gained before considering possible issues in the SFD?

3.4.1 Please elaborate on your answer to question 3.4, if necessary

No, there are already issues which have to be addressed for the use in a DLT environment as they currently create legal uncertainty.

While it would be useful for any review of the SFD to take into account the outcomes of the pilot regime, we consider that there are already known difficulties in applying the SFD to certain types of structure, including permissionless DLT structures. If the timeline for completing the pilot regime will not allow the results to be reflected in the current review of the SFD, we consider that the Commission should consult with a view to clarifying the application of the SFD in the context of these known difficulties.

[Questions 3.5 – 3.6 deliberately left blank]

3.5.7 Concept of conflict of laws	
(a) Should the concept of conflict of laws be clarified or amended to apply explicitly in a permissioned DLT context?	Yes
(b) How should this ideally be done?	
(c) Is an amendment to the SFD required?	No
(d) please explain your answer to 3.5.7(c)	As discussed further in our response to question 3.5.7(f) below, it would be useful to have clarification of conflict of law issues under SFD. However, this may be an issue that is more appropriately dealt with at an international level rather than dealing with it in the SFD in the absence of international agreement regarding treatment of the conflict of law issues.
(e) Could this be dealt with by the system operator in the rules of the system?	No
(f) Please explain your answer to 3.5.7(e)	The application of conflict of law rules within a DLT-based system would seem to depend on the technological and cryptographic characteristics of the platform. Where the parties exchange or transfer cryptoassets on a DLT platform to effect exchanges of collateral, conflict of law issues could arise from the challenges in identifying the situs of the asset – although these issues could be substantially mitigated to the extent that reliance may be placed upon the existence of book entry securities collateral within the meaning of the FCD. In addition, where an entirely disintermediated form of securities holding system or trading platform is established through the development of a public and permissionless DLT system, such that it is not possible to identify individual platform

	participants, it may not be possible to establish precisely where participants or assets are located. This would seem to be an area of uncertainty with implications beyond the SFD and may require attention at an international level. We have previously suggested that some form of elective situs or "law of the platform" could be considered. See https://www.isda.org/a/4RJTE/Private-International-Law-Aspects-of-Smart-Derivatives-Contracts-Utilizing-DLT.pdf

2.4 Protections granted under the SFD vis-à-vis collateral security

4.1 Should the protection in Article 9(1) of the SFD be extended to clients of participants in an SFD securities settlement system in the event of the insolvency of that participant? **4.1.1 Please explain your answer to 4.1**

Yes.

Article 9(1) of the SFD provides that "the rights of a system operator or of a participant to collateral security provided to them in connection with a system…shall not be affected by insolvency proceedings against: (a) the participant…" If the proposal is to extend these rights to clients of participants, further clarification would need to be provided on what "in connection with a system" means given how broad the effect of this phrase would need to become – note that many collateral arrangements between participants and clients take effect across multiple arrangements, including their arrangements facing designated systems but also often non-designated system transactions such as OTC trading or third country business.

4.2 In case the protection in Article 9(1) of the SFD was extended to clients of participants in an SFD securities settlement system, how useful do you consider the following conditions?	
(a) the client should be known to the system operator	1 – Disagree
(b) The client should have to fulfil criteria that are predefined by the system operator e.g., regarding the client's credit / risk assessment	1 – Disagree

(c) The client should have its own segregated account	1 - Disagree
(d) The client should provide collateral security to secure transactions exceeding the threshold under EMIR (whereupon they are obliged to centrally clear their transactions)	1 - Disagree
(e) Other, please specify and explain why	Provisions in the SFD on collateral security should be extended so that they also include collateral provided on a title transfer financial collateral basis. It should also be clarified that system operators which take the same collateral in relation to both their SFD system and their broader system some of which may not be part of their SFD system (e.g. a clearing house) may benefit from the provisions in the SFD on security collateral.

[Questions 4.3.1 – 4.3.2 deliberately left blank]

2.5 Settlement finality under the SFD

5.1 Do you agree with the concerns raised regarding the settlement finality and notification about insolvency proceedings under the SFD?	
(a) the legal duty for an SFD system to specify the moments of entry into the system and irrevocability as well as where settlement is both enforceable and irrevocable should be clearly stipulated in the SFD	1 – Disagree Article 3(3) already provides that "the moment of entry of a transfer order into a system shall be defined by the rules of that system. If there are conditions laid down in the national law governing the system as to the moment of entry, the rules of that system must be in accordance with such conditions" and Article 5 provides that "a transfer order may not be revoked by a participant in a system from the moment defined by the rules of that system".

	If the intention is for the SFD to specify the moment of entry into the system and the point of irrevocability, we strongly disagree with this approach and consider that this should remain a matter for the rules of the relevant system.
(b) the settlement finality provisions of the SFD should accommodate the specificities of clearing systems both under business-as-usual and market stress conditions more clearly.	1 – Disagree Again, we consider that this is a matter that is best dealt with by the rules of the relevant system.
(c) a provision in the SFD for ensuring that the moment of settlement finality is identical in relation to both the cash and securities legs of a transaction settled on the basis of "delivery-versus-payment" is needed	4 – Rather agree Where both the cash and securities legs of a transaction settle within a single system or within interoperable systems, we consider that this should be a question for the rules of the relevant system. However, where the cash and securities legs of a DVP transaction may settle in different systems, it may be helpful to address this point through a provision in the SFD.
(d) The SFD needs to be amended to ensure that different times of finality do not cause problems in interoperable systems	4 – Rather agree
(e) The SFD should clearly stipulate that a system operator should also 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).	4 – Rather agree We would expect the rules of an SFD system to require participants to notify the system operator about the opening of insolvency proceedings. It may be helpful for the SFD to include an express requirement to this effect.
(f) Other, please specify and explain your answer	There is also a concern regarding the settle-to-market payments offered by the CCPs for risk mitigation and its effect in the relationship between the clearing member and its respective client. Such payments should be protected from avoidance and should not be considered prepayment of a debt in the insolvency scenario of the client.

5.2 Would your answer change if the SFD would be extended to cover third-country systems?

5.2.1 Please explain why and how your answer would change if the SFD would be extended to cover third-country systems.

No.

2.6 The SFD and other Regulations / Directives

6.1 Is there any (insolvency or other) legislation where provisions are not sufficiently clear in terms of their interaction with the SFD or the other way around?

6.1.1 Insolvency Regulation (Regulation (EU) 2015/848) – please explain why you think the provisions of the Insolvency Regulation are not sufficiently clear in terms of their interaction with the FCD or the other way around. Please also explain how this matter might be solved.

6.1.2 Second Chance Directive (Directive (EU) 2019/1023)

6.1.3 BRRD (Directive (EU) 2014/59/EU)

6.1.4 Framework for the recovery and resolution of central counterparties (Regulation (EU) 2021/23)

6.1.5 PSD2 (Directive (EU) 2015/2366)

6.1.5 If there is any other legislation where provisions are not sufficiently clear in terms of their interaction with the SFD or the other way around, please specify which ones, explain why, and explain how this matter might be solved.

We consider that changes may be required to the following legislation:

Insolvency Regulation:

Article 12(1) of the Insolvency Regulation provides that, "*without prejudice to Article 8, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market shall be governed solely by the law of the Member State applicable to that system or market*." Whilst it is understood that "*payment or settlement system or financial market*" is intended to include a "system" under article 2(a) of the SFD, the parameters of these terms are unclear. We propose including at article 2 (Definitions) of the Insolvency Regulation a new definition for "*payment, settlement system or financial market*": "'*payment, settlement system or financial market' shall include a 'system' as defined in Directive 98/26/EC, a 'central counterparty' as defined in Regulation (EU) No 648/2012, a 'central security depository' as defined in Regulation (EU) No 909/2014, a 'third-country*

central security depository' as defined in Regulation (EU) No 909/2014, and a 'trading venue' as defined in Directive 2014/65/EU."

BRRD:

The BRRD should be amended to ensure that Member States provide third-country systems[3] with the same protection against resolution stays, bail-in and partial transfers in resolution as systems designated under the SFD and EU and recognised third-country CCPs. In particular, references to "*systems and operators of systems designated in accordance with Directive 98/26/EC*" should be checked to ensure that third-country systems and operators of third-country systems to whom the SFD protections have been extended are included within the scope of the exclusion.

The SFD and BRRD should be amended to ensure that operators of third-country systems can, where possible,[4] be informed promptly (in a similar way to operators of EU systems) when insolvency or resolution proceedings are started in relation to an EU institution that is a participant so that the system operator can take appropriate action.

Article 44(2)(f) excludes from write-down or conversion powers certain liabilities whether governed by the law of a Member State or a third country, including "*liabilities with a remaining maturity of less than seven days owed to systems or operators of systems designated in accordance with Directive 98/26/EC or to their participants and arising from the participation in such a system, or to CCPs authorised in the Union pursuant to Article 14 of Regulation (EU) No 648/2012 and third-country CCPs recognised by ESMA pursuant to Article 25 of that Regulation*." Notably, cleared derivatives at CCPs may have an expiry date years into the future and may not constitute "transfer orders" when delivery obligations are not due; any write down of contracts in clearing systems would cause systemic events. This exclusion should therefore be expanded to include all liabilities, irrespective of maturity owed to systems or operators of systems designated under the SFD or to authorised or recognised CCPs.

Article 80(1) provides that Member States shall ensure that the application of a resolution tool does not affect the operation of systems and rules of systems covered by Directive 98/26/EC where the resolution authority: (a) transfers some but not all of the assets, rights or liabilities of an institution under resolution to another entity; or (b) uses powers under Article 64 to cancel or amend the terms of a contract to which the institution under resolution is a party or to

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[3] These amendments should also extend similar protection to third-country CCPs awaiting recognition under EMIR in accordance with the transitional provisions in Article 89 EMIR where those CCPs have EU clearing members.

[4] At least one existing Member State regime protects third-country systems that are similar to EU systems without a formal designation process, meaning that it would not be possible for the Member State to ensure notice to the system operator.

substitute a recipient as a party. In our view, cleared derivatives at CCPs may have an expiry date years into the future and may not constitute "transfer orders" when delivery obligations are not due; any partial transfer may cause systemic events. We would therefore recommend that such protections should be extended to CCPs authorised under article 14 of EMIR or recognised under article 25 of EMIR.

The situation of the finality of holdings of securities and cash assets at CSDs and CCPs to which settlement finality has been afforded, and whether these should properly be the target of write-down or conversion powers, should also be considered further in this legislation.

Framework for the recovery and resolution of central counterparties

The Framework for the Recovery and Resolution of Central Counterparties references a number of times, "*systems or operators of systems designated in accordance with Directive 98/26/EC*." On the assumption that the protections of the SFD are extended to third-country systems, this language should be checked to ensure that third-country systems and operators of third-country systems to whom the SFD protections have been extended are included within the scope of the exclusion.

Other legislation – EMIR

Articles 39 and 48 of EMIR only provide insolvency protections to EU CCPs, in respect of issues such as the porting of client positions and client assets on a default of a clearing member. The present proposals relating to SFD do not address the gaping lacuna in EMIR as regards insolvency law protections for third country CCPs, which as the law stands would be forced to liquidate the positions and assets of clients of EU clearing members without any confidence that they may offer porting or leapfrog payments to clients clearing via EU clearing members. Reform of these provisions of EMIR as they apply to third country CCPs (including those which are also SFD systems) is urgent alongside SFD reforms.

2.7 Other issues

7.1 To what extent have inconsistencies in the transposition of the SFD caused cross-border issues which would merit further harmonisation?

7.2 Is there anything else you would like to mention?

N/A