CLS response to the Commission's "Targeted consultation on the review of the Directive on settlement finality in payment and securities settlement systems" (submitted on May 6, 2021 electronically)

About you

Language of my contribution
- English

I am giving my contribution as
- Company/business organisation

First name
- N/A

Surname
- N/A

Email (this won't be published)
- N/A

Organisation name
- CLS Bank International, the operator of the CLS system

Organisation size
- Large (250 or more)

Transparency register number
- N/A

Country of origin
- United States

Field of activity or sector (if applicable):
- Market Infrastructure Operation

Are you a system operator under the SFD?
- No

Are you a system operator of a non-SFD designated system based on the law of a Member State of the European Union?
- No

Are you a system operator of a system based on the law of a third-country (non EU country)?
- Yes, of a payment system

Are you a (direct) participant of a system designated and notified under the SFD?
- Yes, of a payment system

Are you a clearing member of an EMIR authorised CCP?
- No

Are you an indirect participant of a system designated and notified under the SFD?
- No

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Are you a client of a clearing member of an EMIR authorised CCP?

- No

Are you a (direct) participant of a system based on the law of a third-country (non EU country)?

- Yes, of a payment system

Are you an indirect participant of a system based on the law of a third-country (non EU country)?

- No

Is there anything else you would like to mention?

CLS Bank International ("CLS") welcomes the opportunity to respond to this consultation on the review of the SFD. CLS was established by the private sector to mitigate settlement risk (loss of principle) associated with the settlement of payments relating to foreign exchange transactions and is the operator of a financial market infrastructure ("FMI") that is the predominant settlement system for foreign exchange transactions (the "CLS System," also referred to as CLSSettlement). The CLS System is the world's largest multicurrency cash settlement system, providing payment-versus-payment ("PvP") settlement in 18 currencies directly to 74 direct participants, including many members in the EU ("members"), some of which provide access to the CLS System for over 25,000 third party institutions. CLS is an Edge Act corporation organized under the laws of the United States and is regulated and supervised by the Federal Reserve. Additionally, in July 2012, CLS was designated a systemically important financial market utility by the United States' Financial Stability Oversight Council. As a systemically important FMI, CLS is also subject to the April 2012 CPSS-IOSCO Principles for financial market infrastructures (the "PFMI"), as applicable to payment systems.

CLS is also subject to collective oversight by 23 central banks, including the European Central Bank, as well as five other Eurosystem central banks (i.e., Belgium, France, Germany, Italy, and the Netherlands) who participate in the CLS Oversight Committee. The CLS Oversight Committee is organized and administered by the Federal Reserve and operates in accordance with the Protocol for the Cooperative Oversight Arrangement of CLS. This protocol was adopted by the CLS Oversight Committee to minimize duplication of effort by the central banks, foster consistent, transparent communications between the central banks and CLS and enhance regulatory transparency regarding applicable regulatory policies in the 25 jurisdictions where CLS's members have their head or home offices or where CLS settles the currency.

Given that CLS's rules are governed by English law, CLS is no longer designated under the SFD (following the end of the Brexit transition period). Instead, CLS relies on domestic finality legislation implemented by various EU countries pursuant to Recital 7 of the SFD. These protections form the basis of the legal framework that supports the participation of CLS's EU members in the CLS System.

The Commission will publish all contributions to this public consultation. You can choose whether you would prefer to have your details published or to remain anonymous when your contribution is published. For the purpose of transparency, the type of respondent (for example, 'business association, 'consumer association', 'EU citizen') country of origin, organisation name and size, and its transparency register number, are always published. Your e-mail address will never be published. Opt in to select the privacy option that best suits you. Privacy options default based on the type of respondent selected.

Contribution publication privacy settings

- Anonymous

Only organisation details are published: The type of respondent that you responded to this consultation as, the name of the organisation on whose behalf you reply as well as its transparency number, its size, its country of origin and your contribution will be published as received. Your name will not be published. Please do not include any personal data in the contribution itself if you want to remain anonymous.

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1. Participation in systems governed by the law of a third-country

The Settlement Finality Directive (SFD, Directive 98/26/EC) covers systems governed by the law of a Member State but not those governed by the law of a third-country. Credit institutions and investment firms may, however, participate in an SFD system even when their head office is in a third-country (third-country participant). The protections of the SFD apply fully and without discrimination in the event of the insolvency of a third-country participant in an SFD system. However, since the SFD does not cover third-country systems regardless of whether such systems are established inside or outside the EU, transactions and collateral posted by EU participants in such systems and related netting are not protected under the SFD.

Recital 7 of the SFD recalls that it is up to Member States to apply the provisions of the SFD to their domestic institutions, which participate directly in third country systems, and to collateral security provided in connection with participation in such systems.

During the legislative process for the BRRD 2 the European Parliament (EP) sought to extend the protections of the SFD to any third-country system where at least one (direct) participant had its head office in the EU. The EP's proposals were not adopted. Article 12a was added to the SFD 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. If appropriate, the Commission shall provide a proposal for revision of the SFD.

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

- Yes

Question 1.1.1 Please explain your answer to Question 1.1:
5000 character(s) maximum

CLS believes that EU institutions which participate in third country systems should be eligible for protection under the SFD, ensuring that such third country systems and their participants may benefit from protections in the event of the insolvency of an EU participant in any such system (the "Designation Option"). The issues described below would be addressed by the Designation Option:

Systemic contagion risks in the EU - given the significant notional amounts that are exchanged in the settlement of FX transactions on a daily basis, settlement risk is a major concern that can have systemic implications for stability within financial markets. If EU-wide statutory protections do not apply to third country systems, all Member States (even those which have implemented domestic finality legislation pursuant to Recital 7 of the SFD) could be subject to systemic contagion risks. A failing participant in one Member State which has not implemented, or has partially implemented, Recital 7, could potentially expose the third country system, including other EU participants, to risk in the event of an adverse court order (e.g., a court order in an EU jurisdiction that has not implemented Recital 7, which results in the unwind of transactions or payments settled through the third country system). The Designation Option will ensure a consistent standard of protection for all EU participants in such systems. While CLS takes steps to ensure that only EU participants located in EU jurisdictions which have implemented Recital 7 in a satisfactory manner may participate directly in CLS, CLS is not aware of the position taken by other third country systems.

Adverse impact on intra-EU transactions - extension of the protections of the SFD to third country systems will enable EU-wide participation by EU institutions in third country systems that must comply with the CPSS-IOSCO Principles for financial market infrastructures (the "PFMI"), including Principle 1 (Legal basis) and Principle 8 (Settlement finality). While CLS cannot speak for other FMIs, in the

absence of a Designation Option for third country systems, FMIs may need to adopt risk mitigation measures that prevent or increase the cost of continued participation by EU participants in cases where the implementation of Recital 7 does not fulfil their requirements for participation. This will result in barriers to cross-border clearing and settlement within the EU as well as increased risks and transaction costs.

Transparency - the SFD provides that the names of all designated systems are reflected on a publicly available list prepared by ESMA. With respect to domestic laws implemented pursuant to Recital 7, there is no consistent requirement for a similar level of transparency and there is no straightforward way for stakeholders to know if a system is protected under Recital 7 in EU jurisdictions.

Efficiency - there are clear efficiency benefits (both for systems and regulators) in ensuring that third country systems do not need to separately register or apply for recognition in each of the multiple EU jurisdictions where they have participants and which have implemented Recital 7, each with its own set of requirements.

Consistency/Highest standard - there is no consistent standard for implementing Recital 7 and some jurisdictions have not implemented Recital 7. As a result, the scope and manner of implementation vary substantially. In addition, there is no consistent interpretative approach to the implementation of those measures as between the local courts of each state. The Designation Option would address this concern and ensure better alignment across the EU with Principle 1 of the PFMI, which provides that a robust legal basis for an FMI's activities in all relevant jurisdictions is critical to an FMI's overall soundness. The explanatory notes to Principle 1 further provide that if the legal basis for an FMI's activities is inadequate or uncertain, its participants and their customers may face unintended or unmanageable credit or liquidity risks, creating or amplifying systemic risks.

Alignment with other jurisdictions - if the SFD is not amended, the EU's finality legislation will remain inconsistent with comparable legislation in other jurisdictions. As far as CLS is aware, no other jurisdiction has a similar requirement in respect of a system's governing law, preventing the extension of protections to third country systems. This limitation prevents the SFD from more fully achieving its objective of reducing systemic risk. The CLS System benefits from special statutory protections under applicable law by virtue of designation or recognition in jurisdictions outside the EU (i.e., in Australia, Canada, Hong Kong, Israel, New Zealand, Singapore, South Africa, South Korea and Switzerland). CLS also benefits from statutory and other protections in jurisdictions that do not have a designation or recognition regime (i.e., the US, Japan and Mexico).

Question 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 (most suited)	2	3	4 (least suited)
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 1.2.1 Please specify what is/are the other option(s) you refer to in question 1.2:
5000 character(s) maximum

If the Designation Option is ultimately not adopted, another alternative may also be feasible. Various third country systems (including CLS) rely on the implementation of Recital 7 in EU jurisdictions where their participants are located. Certain of these jurisdictions have implemented Recital 7 over the course of the last few years, in order to ensure that their domestic institutions could maintain access to third country systems after Brexit. In light of the importance of maintaining access to third country systems, it is critical to ensure that if the Designation Option is not possible, Recital 7, in some form, will remain in place. In this event, CLS supports the mandatory implementation of domestic protections pursuant to Recital 7 in all EU jurisdictions (the "Alternative Option"); Recital 7 would become an operative provision of the SFD, requiring the implementation of certain minimum standards (e.g., transparency regarding which systems are protected). In the event the Alternative Option is pursued, or Recital 7 is maintained in its current form, CLS proposes amendments to the term "participant" (or "system operator") to ensure that it includes the operator of relevant third country systems. Please refer to CLS's response to Question 2.1.1.

However, regardless of the approach that is ultimately chosen, it is important to ensure that (i) the current protections provided to third country systems via the implementation of Recital 7 are not weakened, but instead are expanded and enhanced, as appropriate, to ensure that the ability of EU institutions to participate in third country systems (e.g., the CLS System), is not jeopardized and that systems that are currently protected will continue to be protected, notwithstanding any changes to the SFD or Recital 7; and (ii) there is a significant transition period with respect to any new regime to eliminate the risk of any gaps in the application of statutory protections, that could result in systemic instability or contagion risk (e.g., to ensure that transfer orders previously entered into relevant third country systems prior to the implementation of any new regime will be covered by the new regime).

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?

- The SFD should defer to the protections conferred by the applicable third-country law

Question 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?

- There is no need for an assessment

Question 1.4.1 Please explain why there is no need for an assessment:
5000 character(s) maximum

Many jurisdictions with robust finality legislation that clearly ensure finality of settlement (including many of the jurisdictions that have designated the CLS System) do not have "line-by-line" equivalent rules to the SFD and may also have different standards for eligibility with respect to participation. As indicated in CLS's response to Question 1.4 above, CLS does not believe that a comparability assessment is the appropriate assessment for determining whether a third country system is eligible for designation. Instead, as suggested by CLS's responses to Questions 1.5(e) and 1.5(r), CLS suggests that that the assessment should relate to broader policy considerations concerning the safety and efficiency of the particular third country system and the public interest in designating the third country system for the purposes of the SFD. As noted in those responses, this would include having regard to matters such as the rules of the third country system and the system's compliance with the relevant jurisdiction's implementation of the PFMI, as well as whether it is in the interests of the relevant EU jurisdiction(s) for EU institutions to become participants in the third country system.

Question 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.

- Disagree

Do you have comments/explanations on your opinion to proposal 1.5 a)? If so, please provide them here:

CLS is not aware of any other jurisdictions which have adopted this approach with respect to third country payment systems. As noted above, although CLS's rules are governed by English law, CLS benefits from protections under the relevant finality legislation in many jurisdictions outside the EU. Please refer to CLS's response to Question 1.1.1 for additional detail.

As a matter of principle, however, CLS believes that the extension of SFD protections should not be contingent on whether a third country extends finality protections to SFD systems. In light of the significant policy rationale for extending finality protections to third country systems (described above), including providing a legal basis for EU financial institutions to safely participate in such systems, in CLS's view there is no reason to limit the extension of the SFD's protection to third country systems to situations where the third country extends protections toward SFD systems. The benefits of providing SFD protection to third country systems extend not only to such systems but to all participants in the third country system (domestic as well as from other jurisdictions, including the EU), and the financial ecosystem taken as a whole (as opposed to just the third country itself).

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.

- Fully agree

Do you have comments/explanations on your opinion to proposal 1.5 b)? If so, please provide them here:

CLS believes that it is beneficial for operators of systems to provide information about the insolvency of a participant in a third country system to relevant authorities. Many jurisdictions have implemented finality legislation that provides that upon the occurrence of a "true insolvency" of a domestic participant in the jurisdiction (i.e., liquidation or winding-up), shortly thereafter the finality protections conferred by the local legislation will cease. For this reason (in addition to other important reasons), it is anticipated that the system will suspend or terminate the member. In light of the importance of this occurrence, CLS believes that it is very helpful for designating authorities to be aware of this development, so that they can understand and potentially mitigate any impact on participants in their own jurisdiction who have engaged in transactions with the insolvent entity.

As noted above, CLS is subject to collective oversight by 23 central banks, including the European Central Bank, as well as five other Eurosystem central banks (i.e., Belgium, France, Germany, Italy, and the Netherlands) who participate in the CLS Oversight Committee. In the case of the insolvency of one of its participants, CLS would notify the CLS Oversight Committee. If the SFD were amended to allow designation of third country systems (including the CLS System), CLS would be prepared to likewise provide notice of the insolvency of a participant (either within or outside the EU) to the relevant EU designating authority, as appropriate.

c) Information about insolvency of a domestic participant should be provided in a timely manner by the third-country national authorities.

- Fully agree

Do you have comments/explanations on your opinion to proposal 1.5 c)? If so, please provide them here:

In light of the fact that finality protections terminate in many jurisdictions upon or shortly after the commencement of an insolvency proceeding with respect to a domestic participant, CLS strongly supports clear provisions in all relevant finality legislation that require relevant authorities, wherever located, to provide immediate and direct notice to relevant systems regarding the commencement of any such insolvency in their jurisdiction. CLS notes that it has arrangements in place with certain authorities to this effect and believes that this practice should be expanded. In light of the potential adverse consequences of an insolvency, CLS believes that it would be very beneficial for such information to be conveyed and coordinated between multiple jurisdictions where possible (e.g., where collective oversight arrangements exist).

In addition, please refer to CLS's response to Questions 5.1(e) and 5.2 regarding the importance of providing immediate, direct notice of the opening of insolvency as well as the commencement of resolution to system operators.

d) Systemic importance of the third-country system should be prerequisite.

- Neutral

Do you have comments/explanations on your opinion to proposal 1.5 d)? If so, please provide them here:

- N/A

e) Adequacy of the rules of the system should be given.

- Fully agree

Do you have comments/explanations on your opinion to proposal 1.5 e)? If so, please provide them here:
5000 character(s) maximum

CLS believes that an assessment of a third country system (as opposed to a comparability assessment regarding the law of the jurisdiction, for the reasons set forth in CLS's response to Question 1.4.1) is appropriate prior to designation and suggests that it would be reasonable to consider certain factors with respect to such assessment, including: (i) the adequacy of the rules of the third country system and whether the rules are enforceable under applicable law; (ii) the existence of a cooperative oversight arrangement with respect to such system, including at least one central bank in the European system of central banks, and (iii) the system's compliance with the PFMI, as implemented in the relevant jurisdiction.

For additional information, please refer to CLS's response to Question 1.5(r), relating to assessment criteria.

f) Only systems that are as strict as the SFD regarding the provisions about (direct) participation should be eligible for designation.

- Disagree

Do you have comments/explanations on your opinion to proposal 1.5 f)? If so, please provide them here:
5000 character(s) maximum

CLS does not believe that only systems that are as strict as the SFD regarding the provisions concerning direct participation should be eligible for designation. As reflected in CLS's response to Question 1.4.1. above, different jurisdictions have implemented robust finality and netting protections in a manner that differs materially from the SFD, including with respect to the types of entities that may benefit from that jurisdiction's statutory protections (e.g., please refer to the relevant legislation in the United States, the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") and Regulation EE, which expands the FDICIA definition of "financial institution" and therefore expands FDICIA's protections in the United States, reflected in the following link: https://www.federalregister.gov/documents/2021/02/26/2021-03596/netting-eligibility-for-financial-institutions, as recently amended]. With respect to payment systems, CLS is not aware of any jurisdictions that have taken the position that finality protections for such systems (whether domestic or third country) will only be granted in the event that the legislation of the third country, as reflected in the rules of the system, provides for identical participation requirements.

g) Only systems that are as strict as the SFD regarding the provisions about indirect participation should be eligible for designation.

- Disagree

Do you have comments/explanations on your opinion to proposal 1.5 g)? If so, please provide them here:

CLS has two comments in response to this question, as follows:

CLS believes that, with respect to indirect participation, the question to be considered by the designating authority relates to the overall assessment of the third country system and the policy determination with respect to the rationale for designation. Please refer to CLS's responses to Questions 1.5(e) and 1.5(r).

In addition, CLS observes that the definition of "participant" in Article 2(f) of the SFD appears to have been incorrectly amended by Directive (EU) 2019/879, so as to remove the original power of a member state to treat indirect participants as participants where this is justified on grounds of systemic risk. In

CLS's view, it is likely that Article 2(1)(b) of Directive (EU) 2019/879 was only intended to replace the first subparagraph of Article 2(f) but, due to a drafting error, instead deleted (f) in its entirety.

h) No discrimination between EU institutions and other institutions should be made by the third-country system.

- Neutral

Do you have comments/explanations on your opinion to proposal 1.5 h)? If so, please provide them here:

5000 character(s) maximum

In response to the question, CLS proposes the adoption of Principle 18: of the PFMI: Access and participant requirements, as an appropriate standard. Principle 18 provides that "An FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access."

i) All participants have to be known to the system operator.

Neutral

Do you have comments/explanations on your opinion to proposal 1.5 i)? If so, please provide them here:
5000 character(s) maximum
- N/A

j) The country of establishment of the system operator should be considered.
- Neutral

Do you have comments/explanations on your opinion to proposal 1.5 j)? If so, please provide them here:
5000 character(s) maximum
- N/A

k) The country where the infrastructure is located, maintained and/or operated should be considered.
- Neutral

Do you have comments/explanations on your opinion to proposal 1.5 k)? If so, please provide them here:
5000 character(s) maximum
- N/A

l) The third-country law governing the system should fulfill the assessment criteria as indicated in my response under question 1.4.
- Neutral

Do you have comments/explanations on your opinion to proposal 1.5 l)? If so, please provide them here:
5000 character(s) maximum
- Please refer to CLS's responses to Questions 1.4.1, 1.5(e) and 1.5(r) regarding assessment criteria.

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.
- Neutral

Do you have comments/explanations on your opinion to proposal 1.5 m)? If so, please provide them here:
5000 character(s) maximum
- N/A

n) Cooperative oversight arrangements with the third country concerned should be prerequisite.
- Neutral

Do you have comments/explanations on your opinion to proposal 1.5 n)? If so, please provide them here:
5000 character(s) maximum
- Please refer to CLS's response to Question 1.5(e).

o) In the case of CCPs the recognition of the CCP concerned under Article 25 of EMIR should be prerequisite.
- Don't know / no opinion / not relevant

Do you have comments/explanations on your opinion to proposal 1.5 o)? If so, please provide them here:
5000 character(s) maximum

- N/A

p) In the case of CSDs the recognition of the CSD concerned under Article 25 of CSDR should be prerequisite.

- Don't know / no opinion / not relevant

Do you have comments/explanations on your opinion to proposal 1.5 p)? If so, please provide them here:
5000 character(s) maximum

- N/A

q) The criteria should be the same for all third-country systems regardless by which third-country law they are governed.

- Neutral

Do you have comments/explanations on your opinion to proposal 1.5 q)? If so, please provide them here:
5000 character(s) maximum

- N/A

r) Other: please indicate other assessment criteria that you consider useful:
5000 character(s) maximum

In addition to the criteria referenced in CLS's response to Question 1.5(e) concerning the particular features of the third country system of relevance to its assessment, CLS suggests that another consideration relevant to the assessment is whether it is in the interests of the relevant EU member state(s) for EU institutions to become participants in the third country system (and therefore whether designation would be desirable from an overarching policy perspective). One aspect of such a public interest test might be to consider whether (i) in the event of resolution, it would be considered important for an EU participant in resolution to maintain access to the specific third country system and (ii) designation of the third country system would maximize the likelihood of continued access to the system by an EU participant in resolution (for additional detail, please refer to CLS's response to Question 6.1.3 below, relating to the BRRD).

Question 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?

- To both, payment and security settlement systems

Question 1.6.1 Please explain your answer to question 1.6:

As a systemically important payment system, CLS believes that designation should be possible for third country payment systems for the reasons set forth in its response to Question 1.1.1. CLS does not see any reason why other systems should be excluded, particularly in cases where such systems must also comply with the PFMI, including Principles 1 and 8.

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

- Don't know / no opinion / not relevant

Question 1.7.1 Please explain your answer to question 1.7:
5000 character(s) maximum

While CLS does not take a position generally regarding whether or not the SFD should be extended to all EU-institutions participating in third country systems (and CLS is not aware of which institutions are in fact participating in third country systems, other than CLS's own EU-based participants), CLS believes that at a minimum, institutions that fall within the current definition of "participant" should be eligible for participation in third country systems designated under the SFD, subject to satisfying each system's requirements for participation.

In addition, please refer to CLS's response to Question 2.1.1.

Question 1.7.2 If the scope of the SFD should only be extended to certain EU institutions: On which basis should a selection take place?

	1 (disagree)	2 (rather not agree)	3 (neutral)	4 (rather agree)	5 (fully agree)	Don't know - No opinion - Not applicable
Size of the institution			x			
Systemic relevance for the financial market of the Member State in which the institution is located			x			
Amount that the institution is participating with in the system			x			
Type of participant (e.g. only banks, investment firms, ...)			x			
Other risk based criteria			x			
Other					x	

Please specify what are the other risk based criteria you refer to in your response to question 1.7.2:
5000 character(s) maximum

- Please refer to CLS's response to Question 1.7.1.

Please specify what is/are the other basis you refer to in your response to question 1.7.2:
5000 character(s) maximum

- N/A

Designation of a third-country system if the scope was to be extended

Question 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).

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

- No

Question 1.9.1 Please explain your answer to question 1.9:

In CLS's opinion, a regular evaluation should not be required; CLS is not aware of any other jurisdiction that requires a regular reevaluation with respect to payment systems that are protected under comparable finality legislation. CLS notes, however, that various jurisdictions do have certain ongoing requirements that must be fulfilled as a condition of designation (e.g., providing the designating authority with notice of changes to the system's rules or changes to its participants) and have implemented notification requirements as a condition of designation under the applicable finality legislation in those jurisdictions (e.g., Australia, the United Kingdom and Singapore). In addition, as a result of designation, certain other jurisdictions also have the ability to request information from the operator of the system in specific circumstances. Accordingly, CLS believes that it would be reasonable to amend the SFD to include similar types of provisions. As noted above, CLS also believes that it is important to consider whether or not the system is subject to collective oversight and whether one or more Eurosystem central banks participate in such collective oversight arrangement (e.g., with respect to CLS, via participation in the CLS Oversight Committee). In the event that one or more Eurosystem central banks participate in the third country system's collective oversight, such central banks could expect to have detailed knowledge regarding material aspects of the system, as well as any proposed material changes. As part of the application process, the EU designating authority could also require the third country system to provide relevant information in the event that the EU designating authority has specific concerns.

Question 1.9.1 If your answer to question 1.9 is yes: In which frequency should an evaluation be required?

- Don't know / no opinion / not relevant

2. Participants 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 the SFD. (Direct) participants are, among others, credit institutions, investment firms, public authorities, CCPs, system operators and clearing members of an EMIR authorized CCP.

Furthermore, the SFD gives Member States the option to decide that, for the purposes of the SFD, an 'indirect participant' may be considered a 'participant', if that is justified on the grounds of systemic risk. Only 'indirect participants' that fall under the categories eligible for direct participation, may be considered as (direct) 'participants' under this derogation.

Largely, the SFD does not mandate the legal form of eligible participants. Both natural and legal persons that come under the definitions are eligible to participate, except for CCPs which must be legal persons. Investment firms must be legal persons under MiFID 2 although Member States are allowed to authorise natural persons as investment firms subject to conditions.

E-money institutions under the E-Money Directive (EMD 2) and payment institutions under the Payment Services Directive (PSD 2) are not currently eligible participants under the SFD. In its Retail Payment Strategy, the Commission announced that it would consider, in its SFD review, extending the scope of the SFD to include e-money and payment institutions, subject to appropriate supervision and risk mitigation. In the absence of a harmonised SFD solution at EU level, some Member States have introduced national solutions that allow e-money and payment institutions either direct or indirect participation in payment systems, provided they fulfil certain criteria. This situation has led to level playing field issues between Member States, fragmentation of the European retail payment market and legal uncertainty regarding the cross-border recognition of settlement finality on SFD payment systems with wider national participation. It might be worth considering to add them to the list of eligible participants when they fulfil certain criteria to ensure a level playing field and provide legal certainty in a cross-border context. In the public consultation on the EU's retail payments strategy, nearly 43% of respondents thought that direct participation in SFD qualifying systems should be allowed, whilst nearly 32% thought that indirect participation through banks was sufficient1.

Currently, the operator of a payment system that is not designated under the SFD is not an eligible type of SFD participant. Stakeholders raised the issue that this prevents these payment system operators from participating in TARGET2 (TARGET2 is the real-time gross settlement (RTGS) system owned and operated by the Eurosystem), where payment orders in euro are processed and settled in central bank money. They argue that (direct) participation of these payment system operators in TARGET2 (being SFD designated systems) would reduce the use of commercial bank money for settlement and the related credit and liquidity risk. Principle 9 of the principles for financial market infrastructures (PFMI) asks relevant (i.e. systemically important) financial market infrastructures to reduce credit and liquidity risks by conducting "its money settlements in central bank money where practical and available. If central bank money is not used, an FMI should minimise and strictly control the credit and liquidity risk arising from the use of commercial bank money." Adding them to the list of (direct) SFD participants would open up the possibility to allow their participation in TARGET2. While this could reduce credit and liquidity risk arising from settlement in commercial bank money, it has to be ensured at the same time that any risks arising for SFD systems are adequately mitigated.

Since the adoption of EMIR, CCPs have been added to the list of eligible (direct) SFD participants. However, CSDs as defined in Article 2(1)(1) of the CSDR are not explicitly included although their participation is implicitly covered in their function as 'settlement agents' and 'system operators'. Yet, Article 39(1) of the CSDR, requires Member States to designate and notify securities settlement systems operated by CSDs in accordance with the SFD. Adding them to the list of (direct) participants would further clarify that they benefit from the SFD protection also in those cases, where they do participate in a system but not in the function of 'settlement agent' or 'system operator'.

See consultation for retail payments. A sizeable majority of respondents thought that direct participation should be allowed because non-banks are too dependent on banks. Some respondents thought that fees charged by banks were too high or that banks restricted access to bank accounts to non-banks. Others thought that indirect participation through banks was sufficient because non-banks offered indirect access at reasonable conditions or because the cost of direct participation would be too high.

Question 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

Question 2.1.1 Please specify how it should be extended:
5000 character(s) maximum

CLS proposes the following amendments to the SFD, which would expand the list of currently eligible SFD participants:

CLS believes that the SFD's definition of "institution" should be expanded (for EU systems as well as third country systems) to explicitly include certain additional low risk institutions. In particular, CLS notes that Article 1(2)(b) of the Financial Collateral Directive (the "FCD") expressly provides that supranational institutions such as the European Investment Bank and the Bank for International Settlements, among others, are categories of collateral-taker/collateral-provider that fall within the scope of the FCD and that the FCD is expressly linked, in policy terms, to the SFD (as evidenced by Recitals (1), (2) and (7) of the FCD) (and that both directives are under review at this time as part of the European Commission's targeted review of these legislative instruments in the wider interest of ensuring the continued safety and efficiency of the EU's financial markets). In CLS's view, in the interests of progressing the financial stability and financial market efficiency policy considerations that underlie both the SFD and the FCD, there should be an appropriate degree of consistency between (i) the categories of person who are "participants" for the purposes of the SFD and (ii) the categories of person whose financial collateral arrangements benefit from the protections afforded to qualifying financial collateral arrangements under the FCD. CLS is not aware of any reason to exclude these institutions from the scope of the SFD. In the absence of such changes, it is possible that certain of the institutions specifically referenced in the FCD may not be able to participate in systemically important systems (subject to a fact specific analysis with respect to the specific entity and each system's applicable requirements), which would be inconsistent the with SFD's objective of reducing systemic risk.

In addition, in CLS's view, entities other than those that are specifically within the definition of "participant" in the SFD should also fall within the definition of "participant" where warranted on the grounds of systemic risk. Amendments to the final paragraph of Section I, Article 2(b) of the SFD are necessary to accomplish this goal with respect to payment systems. The current text provides that in certain circumstances, a Member State may decide that undertakings which participate in such a system and which have responsibility for discharging the financial obligations arising from transfer orders within this system, can be considered institutions, if warranted, on grounds of systemic risk (e.g., in particular, low risk supranational institutions). However, this discretion is limited to systems that execute transfer orders relating to securities. CLS believes that the SFD should be amended to extend this discretion to other systems as well (i.e., payment systems (including third country payment systems) that do not execute transfer orders relating to securities). CLS is not aware of any reason to exclude payment systems.

Lastly, in the event that third country systems will not have the ability to be designated under the SFD (which in CLS's view, should not be the outcome), CLS believes that it will be important to amend the definition of "participant" to include the operators of systems protected under the implementation of Recital 7 and/or operators of systems that are protected under the Alternative Option.

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

- Don't know / no opinion / not relevant

Question 2.2.1 Please explain your answer to question 2.2:

5000 character(s) maximum

- N/A

Question 2.3.1 What is your opinion about payment institutions being (potential) participants?

- Don't know / no opinion / not relevant

Question 2.3.2 What is your opinion about e-money institutions being (potential) participants?

- Don't know / no opinion / not relevant

Question 2.4 Please state your opinion on the following:

a) If payment institutions and e-money institutions are added to the list of participants, they should be subject to a specific risk assessment.

- Neutral

Please provide some comments/explanations on your opinion to proposal 2.4 a):

5000 character(s) maximum

- N/A

b) Payment institutions and e-money institutions should only be made eligible SFD participants if 'warranted on grounds of systemic risk'.

- Neutral

Please provide some comments/explanations on your opinion to proposal 2.4 b):

5000 character(s) maximum

- N/A

c) If payment institutions and e-money institutions are added to the list of participants, no particular risk assessment is needed.

- Neutral

Please provide some comments/explanations on your opinion to proposal 2.4 c):

- N/A

Question 2.5 Which risks should be considered in a specific risk assessment (mentioned in question 2.5.) for payment and e-money institutions?

How could such a risk assessment look like?

Please state your opinion on the following:

a) IT risks should be considered.

- Neutral

Please provide some comments/explanations on your opinion to proposal 2.5 a):

5000 character(s) maximum

- N/A

b) Operational risks (other than IT risks) should be considered.

- Neutral

Please provide some comments/explanations on your opinion to proposal 2.5 b):
5000 character(s) maximum

- N/A

c) Credit risk should be considered.

- Neutral

Please provide some comments/explanations on your opinion to proposal 2.5 c):
5000 character(s) maximum

- N/A

d) Liquidity risk should be considered.

- Neutral

Please provide some comments/explanations on your opinion to proposal 2.5 d):
5000 character(s) maximum

- N/A

e) Other, please specify:
5000 character(s) maximum

- N/A

Question 2.6 In case a risk assessment is deemed useful: How often should risks be assessed?

- Don't know / no opinion / not relevant

Question 2.6.1 Please elaborate on your answer to question 2.6:
5000 character(s) maximum

- N/A

Question 2.7 Do you agree with adding CSDs to the list of participants covered by the SFD?

- Don't know / no opinion / not relevant

Question 2.7.1 Please explain your answer to question 2.7:
5000 character(s) maximum

- N/A

Question 2.8 What do you think of adding operators of EU payment systems that are not designated under the SFD to the list of participants covered by the SFD?

- Don't know / no opinion / not relevant

Question 2.9 What do you think of limiting the number of eligible SFD participants by replacing or complementing the current list of eligible participants by an approach that is based on a risk assessment for participants?

- Other

Please specify what you mean by 'other' in your answer to question 2.9:
5000 character(s) maximum

CLS suggests extending the current list of eligible SFD participants and also believes that it should be possible to recognize additional participants based on a risk assessment. Please refer to CLS's responses to Questions 1.7.1 and 2.1.1.

Question 2.9.1 Please explain your answer and specify how such a risk assessment could look like, whether it should replace or complement the current list of eligible participants and how often it should take place:
5000 character(s) maximum

- N/A

3. SFD and technological innovation

The SFD is meant to be technologically neutral. Tech neutrality is primarily achieved by referring key requirements (e.g. the moments of entry into the system and irrevocability) to the rules of the SFD system, rather than mandating them in the SFD, itself. This approach, has largely allowed SFD systems to develop as needed, without major legislative change, so far.

The Commission has received input from various stakeholders who argue that some of the SFD's requirements create obstacles to the use of distributed ledger technology (DLT) and crypto-assets1. Their main concerns refer to the application of the SFD in a decentralised permission-less DLT and in a context where multilateral as opposed to mainly bilateral relationships prevail. The most important issues for permission-less DLT are that there is no centralised operator, unidentified participants can enrol without restriction and functions can be attributed simultaneously to several participants. As the existence of a system operator defining the rules of a system and clear legal responsibility are important for the functioning of the SFD, this poses considerable challenges whether the SFD provisions can actually apply and if so under which conditions.

As there is not enough experience yet of the benefits and risks associated with the use of DLT, the Commission has adopted a proposal for a pilot regime on DLT market infrastructures (the pilot; COM/2020/594 final) using a sandbox approach to allow experimentation by derogating from certain EU financial markets provisions.

The pilot enables CSDs to operate 'DLT securities settlement systems' outside the scope of the SFD, but does not preclude CSDs from operating 'DLT securities settlement systems' within the SFD as stakeholder feedback suggests that this may well be possible for permissioned DLT under certain circumstances, where the system operator could design the system and its rules to be SFD compliant, possibly subject to some specification or clarification of the SFD to enhance legal certainty. Furthermore, the pilot does not apply to DLT payment systems. Hence, it could be useful to specify and clarify, in the current review, certain definitions and concepts in the SFD (e.g. system, transfer order, book-entry, settlement account and agent, conflict of laws, links with other financial market infrastructures). This could ensure they are tech neutral when applied to permissioned DLT based payment systems as well as DLT securities settlement systems that are not covered by the pilot. Feedback received so far by the Commission in this respect provided very mixed results and has not allowed for the full specification of those obstacles and potential solutions or proposals.

Stakeholders indicate further, that not only Member States transpose the existing SFD requirements differently but also national competent authorities (NCAs) interpret them differently, which might lead to legal uncertainty. Clarifying certain concepts and definitions in the SFD could hence help avoiding diverging national interpretations and transpositions and resulting legal uncertainty.

On 19 December 2019, Commission services launched a consultation on markets in crypto-assets. 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 clearly stated. See also 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 market integration' by the 'Advisory Group on Market Infrastructures for Securities and Collateral' (AMI-Seco), September 2017.

Question 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 (please explain under question 3.5.).

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

- 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 enroll without restriction and functions can be attributed simultaneously to several participants.

Question 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?

- Yes

Question 3.3.1 Please explain your answer to question 3.3:
5000 character(s) maximum

While CLS expresses no view on the necessity of regulating permissionless DLT environments, it seems logical that in order for any system to be regulated in accordance with the requirements of the SFD, 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.

Question 3.4 Do you think that first experience with the pilot regime for market infrastructures based on DLT (COM/2020/594 final) should be gained before considering possible issues in the SFD?

- Don't know / no opinion / not relevant

Question 3.4.1 Please elaborate on your answer to question 3.4, if necessary:
5000 character(s) maximum

- N/A

Question 3.5 Should any of the definitions or concepts in the SFD be clarified or amended to apply explicitly in a permissioned DLT context?

3.5.1 Definition of a system

a) Should the definition of a system be clarified or amended to apply explicitly in a permissioned DLT context?

- Yes

b) How should this ideally be done?
5000 character(s) maximum

In general, CLS believes that policymakers should adhere to the principles of technology neutrality and proportionality and aim to regulate activities and not the technology itself (i.e., "same risk, same regulatory outcome"). However, as the technology facilitates the development of new activities, services and business models, policymakers may need to issue clarifying guidance and/or amend existing standards in the interests of promoting legal and regulatory certainty. In the SFD, there are several definitions that would benefit from additional clarification in the context of the transfer of digital assets across distributed systems. These include, the definition of a "system" itself, which raises potential uncertainties, including by way of example:

The current definition refers to a "system operator". As discussed above at Question 3.3.1, this concept may require further consideration or adjustment to the extent that the decision is made to try and capture permissionless systems.

A system must have a governing law chosen by the participants. Again, this requirement is likely to work most effectively in the context of a permissioned system where express choices are made by the system operator. It is less clear, however, how these choices would be made where you have permissionless system without a centralized rulebook.

A system must have "common rules and standardized arrangements", the "adequacy" of which must then be determined by Member States. In the context of distributed systems, it would be helpful to clarify what level of "adequacy" is required, in order to better understand whether distributed / digital systems are able to rise to this standard. Do these rules, for example, have to be in written form, or is it sufficient to build some or all of them into the business logic or chain code of the distributed system? Consideration should be given to whether there anything specifically required in the rules of a DLT system, in addition to the rules that you might commonly expect to find where applicable to non-DLT systems (for example, rules around endorsement and validation of transaction data etc.).

A system must also be a "formal arrangement" relating to the "execution of transfer orders". However, it is unclear what is required in order to be a "formal arrangement" and whether the transfer of digital assets may constitute "transfer orders" pursuant to existing definitions. There are, for example, potential uncertainties relating to such definitions (which you recognize elsewhere in this Consultation but which we have not commented on in detail), due to the referencing of more traditional concepts such as "money", "book entry", and "accounts", that wouldn't have been originally drafted with DLT and cryptoassets in mind.

c) Is an amendment to the SFD required?

- Yes

d) Please explain you answer to 3.5.1 c):

5000 character(s) maximum

- N/A

e) Could this be dealt with by the system operator in the rules of the system?

- Don't know / no opinion / not relevant

f) Please explain you answer to 3.5.1 e):

5000 character(s) maximum

- N/A

3.5.2 Definition of transfer order

a) Should the definition of transfer order be clarified or amended to apply explicitly in a permissioned DLT context?

- Don't know / no opinion / not relevant

3.5.3 Concept of book-entry

a) Should the concept of book-entry be clarified or amended to apply explicitly in a permissioned DLT context?

- Don't know / no opinion / not relevant

3.5.4 Definition of settlement account

a) Should the definition of settlement account be clarified or amended to apply explicitly in a permissioned DLT context?

- Don't know / no opinion / not relevant

3.5.5 Definition of settlement agent

a) Should the definition of settlement agent be clarified or amended to apply explicitly in a permissioned DLT context?

- Don't know / no opinion / not relevant

3.5.6 Links with other financial market infrastructures and trading venues (traditional or DLT based)

a) Should the links with other financial market infrastructures and trading venues (traditional or DLT based) be clarified or amended to apply explicitly in a permissioned DLT context?

- Don't know / no opinion / not relevant

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?

- Don't know / no opinion / not relevant

3.5.8 Other

a) Is there any other definition or concept that should be clarified or amended to apply explicitly in a permissioned DLT context?

- Don't know / no opinion / not relevant

b) Please specify what other definition or concept should be clarified or amended to apply explicitly in a permissioned DLT context?
5000 character(s) maximum

- N/A

Question 3.6 Are there any other amendments to the SFD that should be considered to deal with opportunities and/or risks that are specific to a permissioned DLT based SFD system?

- Don't know / no opinion / not relevant

4. Protections granted under the SFD vis-à-vis collateral security

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

Article 9(1) of the SFD insulates collateral security given in connection with participation in an SFD system or in connection with monetary operations involving the national central banks of the Member States (NCBs) or the ECB from the effects of the insolvency of the collateral giver where the latter is a:

- *participant in a system or in an interoperable system*
- *system operator of an interoperable system that is not a participant*
- *counterparty to the NCBs or ECB*
- *third party that provided the collateral security*

However, Article 9(1) of the SFD does not protect collateral security provided by the client of a participant in an SFD system (e.g. a counterparty clearing its derivatives) from the effects of the opening of insolvency proceedings against the participant (e.g. a clearing member) or the system operator (e.g. a CCP) beyond any protection afforded by sectoral legislation (e.g. EMIR or CSDR).

Question 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?

- Don't know / no opinion / not relevant

Question 4.1.1 Please explain your answer to question 4.1:
5000 character(s) maximum

- N/A

Question 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.

- Don't know / no opinion / not relevant

Please explain why you provided that response to question 4.2 a):
5000 character(s) maximum

- N/A

b) The client should have to fulfill criteria that are predefined by the system operator, e.g. regarding the client's credit/risk assessment.

- Don't know / no opinion / not relevant

Please explain why you provided that response to question 4.2 b):
5000 character(s) maximum

- N/A

c) The client should have its own segregated account.

- Don't know / no opinion / not relevant

Please explain why you provided that response to question 4.2 c):
5000 character(s) maximum

- N/A

d) The client should provide collateral security to secure transactions exceeding the threshold under EMIR (whereupon they are obliged to centrally clear their transactions).

- Don't know / no opinion / not relevant

Please explain why you provided that response to question 4.2 d):
5000 character(s) maximum

- N/A

e) Other, please specify and explain why:
5000 character(s) maximum

- N/A

5. Settlement finality under the SFD

The SFD bestows settlement finality on SFD systems. To determine what is covered and how it is covered, the SFD refers to two specific moments that must be defined in the rules of the system: entry into the system and irrevocability.

In this regard, stakeholders indicated what they consider shortcomings in the SFD. They state that 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, is not clearly stipulated in the SFD (see also EPTF Report, 15 May 2017). Furthermore, in their opinion, the settlement finality provisions of the SFD do not accommodate the specificities of clearing systems both under business-as-usual and market stress conditions (e.g. where commodities derivative contracts reached maturity or when a CCP's default management procedures kicked-in). Additionally, they raised the point that there was no 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 based on 'delivery-versus-payment'. Especially in the event of the insolvency of a participant in an SFD system, different finality timestamps in interoperable systems could cause problems. A transaction could be final, protected and executable in one system, while being neither final nor executable in another system (e.g. relevant in case of a CCP and a CSD of which one settles the cash leg and the other settles the securities leg of the transaction).

Question 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.

- Neutral

Please explain your answer to question 5.1 a):
5000 character(s) maximum

- N/A

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.

- Neutral

Please explain your answer to question 5.1 b):
5000 character(s) maximum

- N/A

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.

- Neutral

Please explain your answer to question 5.1 c):
5000 character(s) maximum

- N/A

d) The SFD needs to be amended to ensure that different times of finality do not cause problems in interoperable systems.

- Neutral

Please explain your answer to question 5.1 d):
5000 character(s) maximum

- N/A

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).

- Fully agree

Please explain your answer to question 5.1 e):
5000 character(s) maximum

Since the SFD's protections terminate shortly after the commencement of an insolvency proceeding, CLS believes that it is critical to ensure that third country systems with EU participants, who may be in different time zones, will have immediate and direct notice of such insolvency so that they can take any necessary steps (e.g., suspension) to protect the system and to protect other participants in the system, including but not limited to other EU participants. In light of the end of protections, these steps are necessary to avoid systemic contagion. Accordingly, CLS suggests amendments to the SFD to ensure that such immediate, direct notice of insolvency will be conveyed to the operator of a designated system, upon or even prior to the insolvency (where possible). The means of notification as well as the contact details should be agreed with each system operator. In addition, CLS believes that it is likewise important to ensure that systems will receive immediate, direct notice regarding the resolution of a participant (See, e.g., the "FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions", dated 15 October 2014, Section 5.1 of Appendix II, Annex 1 (Resolution of FMI Participants), which provides that "Resolution authorities should inform FMIs as soon as possible of the resolution of a participant, and if possible in advance of the firm's entry into resolution.").

Please refer to CLS's response to Question 1.5(b) and 1.5(c).

f) Other, please specify and explain your answer:
5000 character(s) maximum

- N/A

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

- No

6. The SFD and other Regulations/Directives

The proper functioning of the SFD also requires clarity regarding its interaction with other relevant legislation, especially insolvency legislation. When the SFD was adopted, (pre-) insolvency and insolvency-like proceedings (e.g. regulatory moratoria) were governed by national law. Since then, the EU has adopted the BRRD, the Insolvency Regulation as well as the Second Chance Directive and the Framework for the recovery and resolution of central counterparties.

The Commission's services are interested in possible other legislation where provisions may not be sufficiently clear in their interaction with the SFD or vice versa.

Question 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 round?

6.1.1 Insolvency Regulation (Regulation (EU) 2015/848)

- Yes

Please explain why you think the provisions of the Insolvency Regulation (Regulation (EU) 2015/848) are not sufficiently clear in terms of their interaction with the SFD or the other way round.

Please also explain how this matter might be solved:
5000 character(s) maximum

CLS proposes amendments to the EU Insolvency Regulation (Regulation (EU) 2015/848, "EUIR") and the EU Credit Institutions Winding Up Directive (Directive 2001/24/EC,"CIWUD") to ensure that neither legislative framework cuts across the protections that are intended to be afforded to systems and the financial markets they support by the SFD. EUIR and CIWUD broadly set out which law should apply in the event of the insolvency of an EU undertaking, being the law of the location of its centre of main interests (COMI) or the law of its member state of authorization, respectively (depending on which regime is applicable). Recital (71) and Article 12(1) of EUIR include an exception from this general rule, providing that the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system shall be governed solely by the law of the member state applicable to that system. Recital (71) also confirms that the provisions of the SFD should take precedence over the general rules laid down in the EUIR. Recital (26) to CIWUD similarly clarifies that CIWUD should not interfere with the protections afforded by the SFD.

However, there are certain issues concerning the current interaction between EUIR and CIWUD and the SFD, including in the context of the SFD being extended to include a designation regime for third country systems:

Article 12(1) of EUIR refers to the "law of the Member State applicable to that system", suggesting that the provision (providing an exception to the general rule that the law of COMI should govern the insolvent entity's rights and obligations) only applies in respect of EU designated systems.

CIWUD does not currently contain any operative provision confirming that the SFD takes precedence over the provisions of CIWUD (i.e. there is no equivalent in CIWUD to Article 12(1) of the EUIR), and that the rights and obligations of parties to a payment or settlement system remain governed by the law of the system. Recital (26) to CIWUD currently stands on its own without any supportive substantive provision in the main body.

In order to address any potential legal uncertainty (particularly in the context of the extension of the SFD to include a designation regime for third country systems), CLS proposes that EUIR and CIWUD

are amended to make clear that the provisions of EUIR and CIWUD are not intended to interfere with or otherwise disapply the settlement finality protections for systems designated under the SFD (including third country systems). This will involve, for example, amending Article 12(1) of EUIR to extend its application to third country systems (so that it specifies that the effects of the insolvency proceedings on the rights and obligations of participants shall be governed solely by the law of the country or territory applicable to the system) and ensuring that there is a similar operative provision of equivalent scope in CIWUD.

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

- Don't know / no opinion / not relevant

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

- Yes

Please explain why you think the provisions of the BRRD2 (Directive (EU) 2019/879) are not sufficiently clear in terms of their interaction with the SFD or the other way round.

Please also explain how this matter might be solved:
5000 character(s) maximum

Regulators and authorities have universally acknowledged the need for an FMI participant in resolution to have the ability to continue to access critical FMI services. This understanding is broadly reflected in the FSB's July 2017 Guidance on Continuity of Access to FMIs for a Firm in Resolution (the "Guidance"), which provides that "maintaining access to critical FMI services is essential to ensuring that a firm's critical functions can be maintained throughout resolution without disruption and for restoring stability and market confidence after resolution (Introduction to the Guidance), and is likewise embedded in resolution and contingency planning requirements for firms (e.g., the Single Resolution Board's March 2020 Expectations for Banks, including Section 2.4. ("Principles – access to FMI services)). Despite this shared understanding and the common goals of the authorities and FMIs to maintain continuity of access, various deficiencies in the BRRD2 have resulted in a lack of certainty regarding whether or not EU participants in resolution in certain jurisdictions will be able to continue to participate in the CLS System, notwithstanding CLS's best efforts to accommodate the member in resolution as a participant. With respect to payment systems, the BRRD2 currently only extends its exemptions and protections with respect to certain resolution tools (e.g., exemptions from Articles 44, 68, 69, 70, 71 and 80, collectively the "Safeguards") to SFD-designated payment systems. Systemically important payment systems that rely on the implementation of Recital 7 in numerous EU jurisdictions (e.g., the CLS System) do not fall within the definition of SFD-designated system in the BRRD2 and therefore do not benefit from the Safeguards under the terms of the BRRD2. CLS believes that all the policy reasons for protecting SFD-designated systems in the BRRD2 (i.e., to maximize the likelihood of continued access to the FMI in the event of resolution and to avoid a potential significant adverse impact on financial stability, including by preventing contagion to the FMI) are equally applicable to systemically important third country payment systems with EU participants and that there is no reason to treat these systems differently.

For the reasons set forth below, CLS believes that this issue should be clearly addressed on an EU-wide basis through amendments to the SFD/BRRD:

Failure to extend the protections may result in significant adverse ramifications including: (i) the introduction of systemic risk to the system and its other participants in the EU and elsewhere in a worst-case scenario (e.g., the application of a resolution tool to the system may result in contagion to the system and its participants world-wide, including other EU participants); (ii) creating a risk of exclusion from the third country system of the EU participant in resolution, contrary to the regulatory goal of maintaining continuity of access; and (iii) a lack of EU-wide consistency and transparency, resulting in

continued uncertainty for third country systems, their participants in the EU and in other jurisdictions, and relevant authorities world-wide.

Lack of alignment with international guidance, including the FSB's Guidance, which specifically provides that providers of critical FMI services should apply the same arrangements to a foreign FMI service user (i.e., a third country FMI should apply the same arrangements to an EU participant in resolution) "based on the presumption that the resolution framework in the jurisdiction in which the foreign participant is located provides adequate safeguards to the provider of critical FMI services." (Section 1.2 of the Guidance).

Lack of alignment with other jurisdictions. As noted above, third country payment systems (e.g., the CLS System) are designated or otherwise protected under applicable finality legislation in numerous jurisdictions. CLS is not aware of comparable resolution-related restrictions or risks to third country payment systems pursuant to the legislation of these other jurisdictions.

Please note CLS's additional thoughts on Question 6.1.3 in the "Additional Information" section.

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

- No

6.1.5 PSD2 (Directive (EU) 2015/2366)

- Don't know / no opinion / not relevant

6.1.6 If there is any (insolvency or other) other legislation where provisions are not sufficiently clear in terms of their interaction with the SFD or the other way round, please specify which ones, explain why, and explain how this matter might be solved:
5000 character(s) maximum

CLS believes that Regulation (EU) No 655/2014 (establishing a European Account Preservation Order procedure to facilitate cross-border debt recovery in civil and commercial matters ("EAPO")) likewise merits specific consideration. Article 2(3) of EAPO currently provides that the regulation does not apply to accounts maintained in connection with the operation of any system as defined in point (a) of Article 2 of the SFD. In the interests of systemic stability (e.g., with respect to the CLS System, the funds paid by its participants into its accounts with certain EU central banks are used for purposes of settlement across the books of CLS), it is equally important to extend such protections to systemically important third country payment systems with accounts at such central banks. All the policy reasons that necessitated an exemption with respect to SFD designated systems likewise apply to third country systems that maintain EU central bank accounts through which payments relating to, and necessary for, settlement are made.
This issue could be resolved by amendments to the SFD to allow the designation of third country payment systems such as the CLS System. (Please refer to CLS's response to Question 1.2.1.).

However, if designation is not possible and third country systems either continue to rely on Recital 7 or Recital 7 becomes mandatory (e.g., the Alternative Option described in CLS's response to Question 1.2.1 is adopted), another drafting solution will need to be found. For example, the exemption to SFD designated systems in EAPO (cited above) could be extended to third country payment systems that are subject to a cooperative oversight arrangement involving at least one central bank in the European System of Central Banks.

7. Other issues

The Commission's services are interested in possible other matters that stakeholders may have encountered in the context of the SFD that might be important for the review.

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

Please provide examples of such instances:
5000 character(s) maximum

CLS would like to highlight the following inconsistencies that have come to its attention:

With respect to the implementation of Recital 7 in the EU, various EU jurisdictions have taken different approaches, including with respect to whether they have extended the BRRD's Safeguards to third country systems protected under their specific jurisdiction's implementation of Recital 7. For example, CLS understands that certain jurisdictions, such as France and the Netherlands, explicitly extended the BRRD's protections and exemptions to third country systems that are protected under Recital 7.

For the reasons set forth in CLS's response to Question 6.1.3, CLS believes that this inconsistency should be resolved and that a consistent approach should be adopted on an EU-wide basis.

Question 7.2 Is there anything else you would like to mention?
5000 character(s) maximum

Please see the following suggested amendments to the SFD:

The knowledge proviso set forth in Section II, Article 3 is ambiguous and may result in significant uncertainty. The SFD provides that where transfer orders are entered into a system after the moment of opening of insolvency proceedings, such instructions are only protected for a limited period (i.e., within the business day), provided the system operator can prove that, at the time that such transfer orders became irrevocable, it was neither aware, nor should have been aware, of the opening of such proceedings. While this standard may be appropriate in other contexts, CLS believes that is does not provide a sufficient degree of legal certainty. As a practical matter, it will be a question of fact as to whether or not a system operator (which may not be in the same time zone or jurisdiction as the participant) had knowledge of the insolvency proceedings. In light of the importance of this issue, CLS believes that a clear and consistent standard should be adopted, that will provide sufficient time for systems to react in an appropriate manner in accordance with their rules, and will also provide sufficient time for systems to consult with relevant regulatory and other authorities (e.g., with respect to transfer orders entered into a system after insolvency, 24 hours after actual receipt of notice by the system operator that insolvency proceedings have commenced). Please refer to CLS's responses to Questions 5.1(e) and 5.1(f).

Amend the SFD to explicitly extend protections in all circumstances, including circumstances outside insolvency. The SFD focuses on the impact of insolvency on a designated system's finality and netting protections. However, there are actions and claims that could have an equally damaging effect on a system which occur outside of an insolvency proceeding (e.g., actio pauliana). In light of the potential adverse systemic impact of these claims and actions on systems and their participants (and other stakeholders), the SFD should be amended to clarify that all actions and claims which could potentially lead to a revocation of a transfer order or an unwind of netting are protected (including resolution proceedings).

Amend the SFD to allow relevant authorities to explicitly authorize the potential continuation and/or reinstatement of protections after insolvency proceedings, subject to certain conditions. It is possible that in certain circumstances, there will be a desire by various authorities for a participant to continue to participate in a system after insolvency (e.g., in the event of certain types of reorganizations, as opposed to a liquidation), as long as the requirements for participation in the system are met. The SFD, in its current form, does not provide a path to either continue or reinstate its protections post-insolvency.

Amend the SFD to explicitly provide protections for default arrangements, for the avoidance of doubt. CLS notes, for example, that Regulation 9 of the Irish Settlement Finality Regulations (implementing the SFD) protect the default arrangements of a designated system, and actions taken under those arrangements, from interference by Irish insolvency law or the exercise of the powers of an insolvency practitioner. Similar protections are likewise included in the finality legislation of other jurisdictions.

Amend the SFD to explicitly protect against the possibility of cross-border contagion in an insolvency scenario. CLS notes that various jurisdictions explicitly protect against risks relating to insolvency proceedings in other jurisdictions. In particular, Section 14 of the Singapore Payment and Settlement Systems (Finality and Netting Act) provides that: "Notwithstanding any written law or rule of law, a court shall not recognize or give effect to – (a) an order of a court exercising jurisdiction under the law of insolvency in a place outside Singapore; or (b) an act of a person appointed in a place outside Singapore to perform a function under the law of insolvency there, in so far as the making of the order or doing of the act would be prohibited under this Act for a court in Singapore or a relevant office holder". Similar language likewise exists in Regulation 25(2) of the UK's Settlement Finality Regulations and Section 26 of the Hong Kong Payment Systems and Stored Value Facilities Ordinance.

CLS has additional thoughts on Question 1.3, Question 5.2 and Question 6.1.3, which have been uploaded to the "Additional Information" section.

8. Additional information

Please see below, CLS's additional thoughts on Question 1.3, Question 5.2 and Question 6.1.3.

A) 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?

The SFD should defer to the protections conferred by the applicable third- country law.

Question 1.3 Please explain your answer to Question 1.3:

Upon designation, the SFD should defer to the protections conferred by the applicable third country law. The primary reasons for this are as follows:

Legal certainty - the operator of the third country system would reasonably expect the SFD provisions to recognize that upon the insolvency of an EU-incorporated participant, the rights and obligations of such participant (arising from, or in connection with, its participation) will be determined by the governing law of the system, including its settlement finality rules. From a policy perspective, this is in the interests of the safe and efficient operation of the system. In particular, it increases legal certainty, since a third country system would only need to look to a single law to determine these issues, thereby reducing any conflict of laws risk.

Consistency with the SFD itself - Article 8 of the SFD makes it clear that in the event of insolvency proceedings being opened against a participant in a system, the rights and obligations arising from, or in connection with the participation of that participant shall be determined by the law governing that system. Such an approach would therefore mirror the original policy intention behind the SFD and ensure a coherent, consistent and non-discriminatory approach under the SFD as between EU and third country systems.

Consistency with Recital 7 of the SFD - the jurisdictions that have implemented Recital 7 have likewise implemented a similar approach and designation under the SFD is therefore unlikely to have any adverse or conflicting impact on the current legal framework in effect in numerous EU jurisdictions.

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

- No

Question 5.2 Please explain why and how your answer would change if the SFD would be extended to cover third-country systems:

While CLS's answer would not change, CLS notes that this requirement (i.e., direct and immediate notice) is very important with respect to third country systems, where the risks may be greater as a result of time zone differences. In light of the importance of this issue, CLS believes that notice to the operator of the third country system is critical in all circumstances where such systems have EU participants (i.e., even in circumstances where the system is relying upon the implementation of Recital 7 in specific EU jurisdictions) and should not be limited to circumstances where the third country system is designated under the SFD (if that is the ultimate outcome of this consultation).

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

- Yes

Please explain why you think the provisions of the BRRD2 (Directive (EU) 2019/879) are not sufficiently clear in terms of their interaction with the SFD or the other way round.

The first half of CLS's response to Question 6.1.3 has been duplicated to holistically respond to the question.

Regulators and authorities have universally acknowledged the need for an FMI participant in resolution to have the ability to continue to access critical FMI services. This understanding is broadly reflected in the FSB's July 2017 Guidance on Continuity of Access to FMIs for a Firm in Resolution (the "Guidance"), which provides that "maintaining access to critical FMI services is essential to ensuring that a firm's critical functions can be maintained throughout resolution without disruption and for restoring stability and market confidence after resolution (Introduction to the Guidance), and is likewise embedded in resolution and contingency planning requirements for firms (e.g., the Single Resolution Board's March 2020 Expectations for Banks, including Section 2.4. ("Principles – access to FMI services)). Despite this shared understanding and the common goals of the authorities and FMIs to maintain continuity of access, various deficiencies in the BRRD2 have resulted in a lack of certainty regarding whether or not EU participants in resolution in certain jurisdictions will be able to continue to participate in the CLS System, notwithstanding CLS's best efforts to accommodate the member in resolution as a participant. With respect to payment systems, the BRRD2 currently only extends its exemptions and protections with respect to certain resolution tools (e.g., exemptions from Articles 44, 68, 69, 70, 71 and 80, collectively the "Safeguards") to SFD-designated payment systems. Systemically important payment systems that rely on the implementation of Recital 7 in numerous EU jurisdictions (e.g., the CLS System) do not fall within the definition of SFD-designated system in the BRRD2 and therefore do not benefit from the Safeguards under the terms of the BRRD2. CLS believes that all the policy reasons for protecting SFD-designated systems in the BRRD2 (i.e., to maximize the likelihood of continued access to the FMI in the event of resolution and to avoid a potential significant adverse impact on financial stability, including by preventing contagion to the FMI) are equally applicable to systemically important third country payment systems with EU participants and that there is no reason to treat these systems differently.

For the reasons set forth below, CLS believes that this issue should be clearly addressed on an EU-wide basis through amendments to the SFD/BRRD:

Failure to extend the protections may result in significant adverse ramifications including: (i) the introduction of systemic risk to the system and its other participants in the EU and elsewhere in a worst-case scenario (e.g., the application of a resolution tool to the system may result in contagion to the system and its participants world-wide, including other EU participants); (ii) creating a risk of exclusion from the third country system of the EU participant in resolution, contrary to the regulatory goal of maintaining continuity of access; and (iii) a lack of EU-wide consistency and transparency, resulting in continued uncertainty for third country systems, their participants in the EU and in other jurisdictions, and relevant authorities world-wide.

Lack of alignment with international guidance, including the FSB's Guidance, which specifically provides that providers of critical FMI services should apply the same arrangements to a foreign FMI service user (i.e., a third country FMI should apply the same arrangements to an EU participant in resolution) "based on

the presumption that the resolution framework in the jurisdiction in which the foreign participant is located provides adequate safeguards to the provider of critical FMI services." (Section 1.2 of the Guidance).

Lack of alignment with other jurisdictions. As noted above, third country payment systems (e.g., the CLS System) are designated or otherwise protected under applicable finality legislation in numerous jurisdictions. CLS is not aware of comparable resolution-related restrictions or risks to third country payment systems pursuant to the legislation of these other jurisdictions.

Please also explain how this matter might be solved:

This issue could be solved by amendments to the SFD to allow the designation of third country payment systems such as the CLS System. (Please refer to CLS's response to Question 1.1.1.). Accordingly, third country payment systems that are designated would then fall within the scope of the Safeguards. However, if designation is not possible, and third country payment systems either continue to rely on Recital 7 or Recital 7 becomes mandatory (e.g., please refer to CLS's response to Question 1.2.1 above, including the proposed Alternative Option described therein), another drafting solution would need to be found. For example, the BRRD2 could be amended to extend all of its Safeguards to third country payment systems that are protected by Recital 7. The BRRD's Safeguards could likewise be extended to third-country payment systems that are subject to a cooperative oversight arrangement involving at least one central bank in the European System of Central Banks. In recognition of the importance of this issue, this solution was proposed by the European Central Bank in its opinion dated November 8, 2017 (the "ECB Opinion"), although it was never implemented. The ECB Opinion noted that a suspension prohibiting a participant (credit institution) from making any payment to an FMI would de facto cause that participant to no longer be able to meet its obligation as they fell due. The ECB Opinion further provided that with respect to payment obligations to FMIs, suspension would place the participant in default and without an exemption for this type of payment, the moratorium would actually have the potential to create and spread systemic risk before the FMI's safeguards kick in (referencing the common understanding at a Union and international level of the need to protect financial obligations linked to FMIs from a moratorium).