ISDA response to EC SIU consultation

(Targeted consultation on integration of EU Capital markets)

10 June 2025

Part 1

1. **Simplification and burden reduction**

1. **Is there a need for greater proportionality in the EU regulatory framework related to the trade, post- trade, asset management and funds sectors? Please choose from 1 (strongly agree) to 5 (strongly disagree) or 'no opinion'. If yes, please explain and provide suggestion on what form it should take**

Rating: 1

ISDA believes that the lack of equivalence for UK MTFs and OTFs is clearly disproportionate given the high level of commonality of structure and rulebooks that they share with EU MTFs and OTFs. ISDA considers that granting equivalence to UK MTFs and OTFs to enable EU firms to comply with the derivatives trading obligation by trading on those venues would materially benefit EU firms by simplifying their ability to execute.

ISDA believes that reporting of transactions carried out as a result of post-trade risk reduction services under MiFIR Article 26 is disproportionate and should not be required. This has already been recognised for public transparency under MiFIR Articles 10 and 21 and EMIR Article 9. There is no logical basis to retain this requirement under MiFIR Article 26.

ISDA also notes that where trading venues operate a request for quote protocol, and where such venues must report transactions carried out through their systems by third country entities, the requirement to identify the parties on whose behalf the third country entity executed the transaction is disproportionate. This particularly affects MTFs, as OTF participants trade overwhelmingly on their own behalf.

ISDA believes that there is a need for greater proportionality in sustainable finance regulation. We outline several points that could help achieve this in our answer to Q7, but as one example: the Trading Book KPI should be removed from the Taxonomy Delegated Act, as it is meaningless. Trading book activities include positions held by banks on behalf of their clients, and those banks do not have visibility on their clients' investment objectives.

We underline the need for all legislative proposals concerning the trade, post- trade, asset management and funds sectors to have been the subject of thorough, independent cost-benefit assessment. Such legislation should not be pursued unless this impartial and thorough assessment has confirmed that the benefits of such legislation exceed the costs.

5. **Are there areas that would benefit from simplification in the interplay between different EU regulatory frameworks (e.g. between asset management framework and MiFID)? Please choose from 1 (strongly agree) to 5 (strongly disagree) or 'no opinion'. If you agree, please explain and provide suggestions for simplification. Also if possible present estimates of the resulting cost savings?**

Rating: 1

ISDA believes that there are significant opportunities for simplification in the regulatory reporting of OTC derivatives across EMIR and MiFIR. The two regimes have developed side by side in an often-piecemeal fashion, and there is significant and growing duplication between them.

While recognising that this is not possible in the short term, ISDA is of the view that transaction reporting of OTC derivatives under MiFIR Article 26 could ultimately be deprecated, with the limited delta of data reported between MiFIR and EMIR being added to reporting under EMIR Article 9.

This could be the first step in an eventual refactoring of regulatory reporting, where investment firms could report a superset of data once across all EU regimes, to be used many times by various regulators for their respective purposes.

ISDA furthermore believes that simplified, efficient EMIR and MiFIR reporting should be single-sided. Double-sided reporting has not delivered good quality data (it has arguably undermined data quality) and single-sided reporting would reduce costs and enhance data quality.

ISDA also observes that the regulatory obligations imposed on non-EU branches of EU-based firms creates a considerable reporting burden on these branches and it is not clear whether the benefit to EU regulators justifies this burden, particularly when EU reporting is duplicative and applies across a number of pieces of legislation.

As it has consistently advocated, ISDA believes that the ISIN is unsuitable as an identifier for OTC derivatives, and instead the UPI should be used for all scenarios requiring identification of the instrument used in an OTC derivatives transaction across both MiFIR (including both public transparency and transaction reporting) and EMIR.

As stated in our response to Q1, transactions carried out as a result of post-trade risk reduction services should not be required to be reported under MiFIR Article 26, bringing this in line with reporting under EMIR Article 9.

7. **Do you have other recommendations on possible streamlining and simplification of EU law, national law or supervisory practices and going beyond cross-border provision?**

Yes / no / no opinion

If yes, please list your recommendation and suggested solutions. Please rank them as high, medium or low priority.

Please explain

As mentioned in our response to Q5 in this section, ISDA envisages an eventual state for regulatory reporting where EU investment firms and other reporting parties could report a superset of data required under all their reporting obligations once per day to a single repository.

That data superset could be made available to all regulatory and supervisory bodies, to be used for their respective purposes.

In the shorter term, ISDA questions the need for dual-sided reporting under Article 9 of EMIR, noting that other analogous third country regimes such as CFTC reporting do not require this. At the very least, where EMIR reporting is delegated, there seems little point in the delegate reporting what is essentially the same report twice. While clearly the direction of the trade is reversed in each of the two reports, all other data should be common to both.

In respect of reporting under Article 26 of MiFIR, where both parties must report personally identifiable information (PII), consideration could be given to requiring a stripped-down report from smaller firms, whereby they would only report a subset comprising their own reference data including their PII. Careful thought would need to be given to how the two reports could be linked, but this should not be insoluble.

As also stated in our response to Q5, ISDA strongly believes that use of the ISIN as an identifier for OTC derivatives in both MiFIR (for both public transparency and transaction reporting) and EMIR should be deprecated in favour of the UPI. Noting that as of February of this year, over 150 million OTC derivatives ISINs had been created since MiFIR first came into effect, removing the requirement to use an ISIN would clearly simplify operations for reporting firms and reduce their burden.

In respect of sustainable finance, EU authorities should:

- Ensure a proportionate, harmonized and symmetrical approach to the use of derivatives in the EU's SF framework. As per the EU PSF recent derivatives recommendations, ISDA calls for the application of a consistent approach to account for derivatives across the sustainable finance framework at entity and product level (e.g. Taxonomy & SFDR).
- Permanently remove the Trading Book KPI from the Taxonomy DA as trading book activities involve positions held by banks on behalf of their customers. This KPI is thus meaningless as banks do not have visibility on clients' investment objectives.
- Include structured products under the SFDR scope during the upcoming SFDR L1 review to ensure an equal treatment with funds' products given that all types of assets are eligible for consideration under MiFID sustainability preferences.
- Ensure that the guidance required to adopt under Article 18 of the CSDDD ('model contractual clauses') will be purely guidance and that, while companies may take that guidance into account, they will still be permitted to use any contractual wording that they consider appropriate for compliance with their obligations under Articles 10 and 11.
- Encourage the scaling up of high-quality, high-integrity removal credits, certified under the EU CRCF and independent and/or under international crediting programmes.
- Include international VCCs for the purposes of the EU ETS and the EU CBAM if such credits successfully overcome issues around consistency, comparability and clarity.

Please see ISDA's position paper on the Omnibus sustainability package for further detail:

In general, we propose for any new regulation:

- Regulatory requirements that require technical standards only enter into force when the technical standard enters into force. Ideally of course we'd also receive FAQ/guidance.
- This could be implemented very simply and cheaply by:
    1. ensuring that every draft regulation prepared by the EC includes this concept in the level 1 text; and
    2. for current regulatory implementations, make a forbearance statement.
- If there is a dependency in a regulation (e.g. requirement z can only be fulfilled once action x has completed and regulatory guidance y is in place), do not set absolute deadlines for the dependent requirement, but make the deadline dependent on completion of the actions this requirement is dependent on (e.g., requirement z comes into force 3 months after x and y have been completed).
- Allow for sufficient implementation periods to avoid industry having to implement changes several times using tactical solutions.
- As experienced with EMIR3 AAR, industry is having to implement based on (hurried) draft rules, only to then have to repair and replace to conform to the actual rules. At this point, firms have to rely on regulatory forbearance and waste considerable time, with multiple market participants asking multiple local regulators about a centralised EU text.

2. Trading

2.1. Nature of barriers to integration, modernisation of liquidity pool

2.2. Regulatory barriers to cross-border operations in the trading space

3. On a scale from 1 to 5 (1 being "insufficient" and 5 being "fully harmonised"), what is your assessment of the current level of harmonisation of EU rules applicable to trading venues other than regulated markets and their operators:

   Rating: 2

   If you replied 4 or less to any of the items in the previous question, on a scale from 1 to 5 (1 being "not needed" and 5 being "highly needed"), how necessary would you deem, for the purpose of fostering cross border operations, an increase in the level of EU harmonisation of rules applying to trading venues and their operators:

   Rating: 5

4. **For which areas do you believe that further harmonisation would be beneficial (multiple choice possible)?**

- **Rules of trading venues (i.e. exchange rulebook);**
- **Approval of rules of trading venues and oversight over their implementation/changes;**
- **Governance of the market operator;**

- **Open/fair access provisions;**
- **Other areas (please specify**

ISDA believes that further harmonisation of the following would be beneficial: approval of rules of trading venues and oversight over their implementation/changes; and open/fair access provisions.

ISDA considers that transparency of execution costs on OTFs varies widely, and more harmonisation of the rules regarding this would be beneficial.

ISDA notes that rules on reverse solicitation and cross-border operation as they apply to trading venues other than regulated markets and their operators are fragmented across EU Member States, leading to a patchwork of investment service provision for clients across the Union depending on their geographical location. Greater harmonisation of these rules would be greatly beneficial.

ISDA also notes that in the past, there has been a lack of harmonisation across the EU of application of the trading venue perimeter. We expect that the inclusion of the definition of a multilateral system in MiFIR will improve this situation.

5. **Please explain and provide concrete examples of areas where a lack of harmonisation might hamper the full harnessing of the benefits of the single market and, where relevant, differentiate between regulated markets and other trading venues (notably, multilateral trading facilities (MTFs), small and medium enterprises (SME) growth markets and organised trading facilities (OTFs)). Please provide an estimate of costs and benefits of greater harmonisation in each specific case, where possible.**

ISDA cautions against a reductive view of OTC derivatives market structure, and against any assumption that differentiation is automatically undesirable.

OTC markets are vital to liquidity, and the different types of trading venue present in the OTC derivatives ecosystem serve different purposes. All are necessary to cater for the heterogeneity of OTC markets.

2.5. Enhanced quality of execution through deeper markets

28. **When the same financial instrument is traded on multiple execution venues, the best execution rule plays a key role. The rule seeks to protect investors, ensuring the best possible result for them, while also enhancing the efficiency of markets by channelling liquidity towards the most efficient venues.**

    On a scale from 1 (insufficient) to 5 (completely efficient), what is your assessment of the effectiveness of the best execution rules in the EU?

    Please explain.

ISDA cautions against applying concepts developed for equities markets to OTC derivatives, particularly the notion of assessing best execution on the basis of which execution venues are most efficient.

In OTC derivatives markets, where buy side market participants typically access sell side liquidity on MTFs, the RFQ trading protocol is still the predominant protocol used, with liquidity providers trading in a principal capacity. Buy side investment managers meet their best execution obligations to their fund clients by requesting prices from multiple liquidity providers on their venue of choice. As sell side liquidity providers typically stream the same prices to all MTFs on which they provide liquidity, there is rarely a difference in quality of pricing between these MTFs.

Similarly, voice (ie bilateral, off-venue) trading is still significant in OTC derivatives markets, particularly for larger and/or more complex trades. A buy side entity will request quotes from multiple dealers, but bilaterally rather than through a trading venue. The successful dealer trades in a principal capacity, and does not owe best execution to the buy side entity. The buy side entity generally meets its best execution obligations to its end clients by trading on the best quote it obtains from the multiple dealers from which it has requested a quote.

Even in cases where a buy side entity places an order with a dealer (most notably in FX derivatives markets), whether bilaterally or through a trading venue, the dealer will typically be acting in a principal capacity, and will fill the order from its own liquidity. The dealer will owe best execution to the buy side entity in this scenario, as will the buy side entity to its end clients. The dealer will typically provide the same set of functionalities (e.g. trading algorithms) to the buy side entity regardless of whether a trading venue was used, or if the order was placed bilaterally.

As can be seen from the above explanations of the various means of execution, a focus on relative efficiency of trading venues is of limited use in the context of OTC derivatives.

2.6. Building quality liquidity for EU market participants: impact of recent trends

24-hour trading

47. **On a scale from 1 to 5 (1 being "not significantly positive", 5 being "extremely positive"), how positive do you deem extended trading hours / 24-hour trading for the development and competitiveness of EU markets? Please explain your reasoning.**

48. **On a scale from 1 to 5 (1 being "very advantageous", 5 being "highly risky"), how advantageous or risky do you deem extended trading hours/24-hour trading for the orderly functioning of EU capital markets? If you attribute a score pointing at a risk, please explain these risks and, where relevant, differentiate between different categories of investors (e.g. professional investors and retail investors). If you provide a score pointing at advantages, please explain those advantages.**

49. **In your view, do the advantages of extended / 24h trading outweigh the potential risks?**

Several issues require careful consideration in this context, including liquidity, collateral access, operational resiliency, and default management outside normal business hours. Below we distinguish between 24/7 trading and 24/7 clearing.

<u>24/7 Trading</u>

Supporting 24/7 trading is a decision for trading platforms, but that decision cannot occur in a vacuum. Critical market infrastructure is needed 24/7 to support 24/7 trading, including middleware and other third-party service providers essential in all aspects of the trading lifecycle. Service providers also need to maintain full-time technical and trading support, increasing the cost of trading. Market participants and infrastructure providers need to further evaluate whether additional costs are justified and ensure that they are not passed to end-users that do not want to trade 24/7.

Trading venues will need to restructure staffing models, trading protocols, and surveillance and compliance mechanisms to ensure adequate compliance 24/7. They also need to consider how their market data obligations need to evolve for 24/7 trading.

Furthermore, in a 24/7 trading environment, there would be a lack of downtime for platform maintenance and upgrades, with heightened risk of outages, complicated patch management, and requirement for live change deployments and rollback mechanisms. Venues would need to take additional steps to safeguard their systems' reliability and integrity.

Continuous trading may result in thinly traded periods, especially at weekends. The current concentration of derivatives trading within specified hours has supported efficient price discovery and market liquidity. Extending trading hours to times when fewer market participants are likely available may diminish liquidity, widen spreads, increase volatility, and reduced price transparency. Extension of trading hours should therefore be considered on a product-by-product and measured basis, in consideration of pricing and liquidity.

Robust discussion is required to fully understand the implications of 24/7 trading on derivatives markets.

<u>24/7 Clearing</u>

If the market determines that 24/7 trading is desirable, infrastructure for 24/7 clearing is necessary, enabling e.g. market participants to transfer cash and collateral continuously throughout the clearing period, and clearinghouses' management of real-time margining and collateral. However, current banking and payment infrastructures do not operate 24/7, limiting prompt collateral movement during non-business hours. Market participants need to be able to convert non-cash collateral to cash during extended trading hours and over the weekend. Thus, for 24/7 clearing to work for derivatives, repo and other markets may need to be accessible.

Further, CCPs operate on fixed schedules, with clearly defined margining cycles. A continuous clearing model requires significant reengineering of these systems. CCPs will need to determine how to extend intraday variation margin ("VM") schedules to encompass the entire period during which they are operational. In doing so, CCPs should ensure that clearing participants can feed into re-designed CPMI-IOSCO-aligned intraday VM arrangements.

24/7 clearing may pose risk management concerns. Markets can be volatile during periods of low volume. This, combined with limited asset mobility could result in increased defaults where clearing members or their clients lack sufficient margin to cover positions. Where default occurs during periods of thin market liquidity, either the clearing member (in case of client default) or CCP (in case of clearing member default) may have limited ability to close out positions or hedge associated risks. Default management processes require either a market that is liquid and accessible to trade and close out of positions, or rely on coordination across various stakeholders, such as auction participants. Neither may be available over a weekend.

While auto-liquidation may be useful in certain cases, it is not appropriate for swaps. In clearing member default, auto-liquidation could lead to a rushed auction, generating losses tapping into mutualized resources. End users value the dependability that clearing provides and do not want to lose carefully assembled positions due to an operational issue or inability to make margin calls at weekends. A default without a true cure period could expedite a close-out that may override limited recourse and other lock-up provisions and potentially trigger cross-defaults to other trading agreements. Auto-liquidation in 24/7 clearing would therefore not improve financial stability outcomes, nor mitigate any of these risk management considerations.

24/7 derivatives market access requires careful consideration and holistic evaluation with an understanding of the interdependencies between trading venues, middleware and software providers, clearing systems, margining frameworks, payments systems, default mechanisms, and adjacent markets.

The role of multilateral vis-à-vis bilateral trading

50. Based on the current legal framework, and considering developments in technology and market practices (including the development of smart order routing systems), is the dividing line between multilateral trading facilities and bilateral trading sufficiently clear?

Yes, No, Don't know.

Please explain and provide concrete examples.

ISDA believes that in general, the perimeter between multilateral trading facilities and bilateral trading is sufficiently clear in OTC derivatives markets. Unlike equities (and indeed other securities), market structure does not revolve around placing orders onto multiple execution venues on an agency basis. Rather, OTC derivatives markets function on a principal to principal basis. This is either intermediated through trading venues offering multiple sources of liquidity, or involves bilateral trading directly between counterparties without intermediation.

ISDA notes that in recent years, a small number of technology providers have emerged that provide direct structured communication channels between buy side and sell side entities. In the UK (which at the time was still using onshored EU MiFID in respect of defining multilateral trading), one such technology provider was obliged to seek authorisation as a MTF as it developed its offering, which supports the view that the perimeter is adequately defined. As mentioned in our answer to Q5, in the past the application of this definition has been inconsistent across Member States, but this should be resolved by the inclusion of the definition of a multilateral system now being contained in MiFIR.

ISDA also notes that as a result of the MiFID Review, the construct of systematic internaliser (SI) will no longer apply to trading in OTC derivatives (unless the provider of liquidity has opted in to be a SI, which ISDA understands from its members there is little appetite to do). ISDA has long held the position that the concept of SI as an execution venue was not meaningful in the context of OTC derivatives markets. Under revised MiFIR this has been recognised, and there is no longer even the technical existence of defined bilateral execution venues for OTC derivatives. Bilateral trading will simply be direct negotiation between two counterparties, as was the case before the application of the SI construct to OTC derivatives.

51. **In your view, what are the benefits stemming from competition between bilateral and multilateral execution venues? Please explain your reasoning and differentiate between different categories of clients (professional investors vs retail investors)?**

52. **In your view, what are the main drawbacks stemming from competition between bilateral and multilateral execution venues? Please explain your reasoning and differentiate between different categories of clients (professional investors vs retail investors)?**

53. **In your view, do benefits stemming from competition between bilateral and multilateral execution venues outweigh the associated drawbacks?**

Yes/No/No opinion.

Please explain your reasoning and differentiate between different categories of clients (professional investors vs retail investors)?

If you responded "no" to the previous question, would you see merit in requiring that retail orders be executed on multilateral and lit venues?

Yes/No/don't know.

Please explain your reasoning, in particular please specify any impact that such a measure would have on the quality of execution of retail orders.

If you responded "yes" to the previous question, do you believe that any measures would be necessary to avoid an increase in execution costs for retail orders? Yes, No, Don't know. Please explain your reasoning.

ISDA refers to its answer to Q50, and underlines that the concept of competition between multilateral and bilateral execution venues in the OTC derivatives context is fundamentally flawed. ISDA further notes that OTC derivatives markets are comprised of sophisticated market participants: retail participation is not a feature.

54. **Does the emergence of DLT-based/tokenised asset markets bring in a new element or dynamic, compared to bilateral versus multilateral venues? If so, how? Should our regulatory framework be adapted to reflect this change? If so, how?**

No.

2.6.2 Single market maker venues

55. **In your view, what are the main benefits and drawbacks associated with so-called "single market maker venues" (i.e. where the venue operator limits market making to one participant)? Please explain your reasoning, in particular when it comes to quality of execution.**
56. **Are you aware of any existing practices that may restrict the presence of multiple market makers/liquidity providers on these venues? Yes, No, don't know. Please explain and provide concrete examples and specific restrictions or costs obstacles. If you responded "yes" to the previous question, please clarify whether, in your view, these practices are justified and flag any potential risks in terms of efficiency of trading?**

Single market maker venues, where the venue operator limits market making to one participant, are not a feature of the OTC derivatives market structure.

2.7 Other issues on trading

58. **Please provide any further suggestions to improve the integration, competitiveness, simplification, and efficiency of trading in the EU. Please provide supporting evidence for any suggestions.**

Mutual equivalence between EU and UK trading venues for the purposes of meeting the derivatives trading obligation would simplify trading in the EU and make it more efficient. At present a significant amount of trading between EU and UK counterparties takes place on US based Swap Execution Facilities (SEFs) which have more onerous execution requirements (such as RFQ to three unrelated dealers) than either EU or UK trading venues.

ISDA believes that the integration, competitiveness, simplification and efficiency of trading in the EU would benefit from ESMA being provided with a mandate to pursue competitiveness as a secondary objective in its rulemaking. This would naturally curb the level of complexity and fragmentation (intra-EU and globally) faced by EU market participants under the current framework.

Support for the competitiveness and growth of the EU economy is a secondary objective of the UK FCA.

6. **Post-Trading**

3.1.5 Barriers and other aspects under the SFD

51. What are the main barriers to the smooth operation of the settlement finality framework in the EU?

The key barriers to the smooth operation of the settlement finality framework are:

- Lack of consistent application to EU institutions participating in third country systems;
- Lack of availability of protection in Article 9(1) of the SFD to clients of participants, in the event of the insolvency of that participant;
- Inconsistent application of opt-outs.

We discuss each of these further in our response below.

52. Are there any aspects of the SFD that have created barriers for the market or market participants, in particular in a cross-border environment?

See our response to question 52 above.

54. Do the definitions, in particular the definition of a "system" and "transfer orders", result in barriers related to the change in market practice in the set-up of systems as well as the use of DLT?

No.

The definitions do not result in barriers related to the change in market practice in the set-up of systems or the use of DLT.

55. Is SFD protection important for settlement systems, such as those based on DLT, that settle trades instantly and atomically, and not on a deferred net basis or in settlement batches?

Yes.

Payment systems such as TARGET2 already settle transactions on a near-instantaneous basis, but still benefit from settlement finality designation.

No system, even those offering instant settlement, is entirely free of settlement risk. Settlement finality designation provides legal certainty regarding settlement finality and underpins confidence in the system.

In addition, where systems interact or offer interoperability, settlement finality designation provides a key protection for the interactions between the two systems regardless of the speed of settlement. For EU systems that benefit from settlement finality designation, they may not be able to interact or interoperate with other systems unless those other systems also benefit either from settlement finality designation under SFD or under a similar regime.

56. Should settlement systems that achieve probabilistic (operational) settlement finality be designated and benefit from SFD protections?

If yes, please explain how settlement finality could be achieved in such a case and why this would be desirable.

Yes.

As discussed in our response to question 55 above, legal protection for settlement finality should be available in addition to any operational protections that seek to ensure settlement. No system is entirely free of settlement risk.

57. Are the criteria that need to be met for a system to be designated under the SFD creating unjustified barriers to entrance?

Aside from the limits on the ability of third-country systems to obtain designation under the SFD, we do not consider that the criteria for designation create unjustified barriers to entrance.

58. Do diverging national practices for notifying systems create an uneven level playing field or legal uncertainty?

We are not aware of diverging national practices for notifying systems that create an uneven level playing field or legal uncertainty.

59. For the purposes of designating a system under the SFD, are the current list of participants, the designation process and the focus on entities rather than on the service provided creating barriers for new entities to provide settlement services in a system designated under that Directive?

No.

We are not aware of any barriers created by the current list of participants or by the designation process.

61. Is there legal certainty on the scope of the settlement finality protection under SFD?

Yes.

Other than the points already raised in this response, we are not aware of any points of legal uncertainty regarding the scope of settlement finality protection under the SFD.

62. Is the lack of harmonised settlement finality moments in SFD (i.e. leaving it to the rules of the system or national law) creating legal uncertainty and preventing the development of a single capital market?

No.

We do not consider that there is legal uncertainty resulting from the lack of harmonised settlement finality moments under the SFD. Article 3(3) provides that "the moment of entry of a transfer order into a system shall be defined by the rules of that system. If there are conditions laid down in the national law governing the system as to the moment of entry, the rules of that system must be in accordance with such conditions" and Article 5 provides that "a transfer order may not be revoked by a participant in a system from the moment defined by the rules of that system".

If the intention is for the SFD to specify the moment of entry into the system and the point of irrevocability, we strongly disagree with this approach and consider that this should remain a matter for the rules of the relevant system.

63. The SFD does not apply to third-country systems, however, Member States can extend the protections in the SFD to domestic institutions participating directly in third-country systems and to any relevant collateral security ('extension for third-country systems'). Is the lack of transparency related to Member States extending for third-country systems creating barriers to the provision of services in the single market or creating a non-level playing field for EU entities?

Yes.

The lack of a requirement for Member States to extend the protections in the SFD to institutions participating in third-country systems creates barriers to the provision of services in the single market and creates a non-level playing field for EU entities. Any lack of transparency in relation to this issue adds to the barriers but the key concern is the lack of a harmonised approach to extension for third-country systems.

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

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

It is to mitigate the risks for settlement and clearing systems as a whole (and not to protect EU participants) that third-country CCPs have sought third-country "designated system" status in individual EU member states and EU member states have been keen to grant such designations, especially with the exit of the United Kingdom from the EU. Without these designations, third country systems might not feel able to admit EU entities as members or provide access to EU entities for membership or usership of their systems, since the legal opinions and legal comfort required by third country CCPs under applicable regulations would be insufficient. CCPs, in particular, are required to have legal opinions supporting the enforceability of their rules under EMIR. The availability of SFD designation to third country systems must therefore be first and foremost: (i) about protecting the systems themselves (and other non-defaulting participants) from insolvency law challenges in EU insolvency proceedings and (ii) about ensuring that EU participants are not cut off from accessing international settlement and clearing systems due to insolvency-related uncertainties.

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

65. **Has the fact that SFD designation is not mandatory for all systemically important systems (except when mandated under Art. 2(1) and 2(10) CSDR and Art. 17(4)(b) EMIR), including payment systems, created barriers to the single market?**

No.

We are not aware of any barriers to the single market created by the fact that SFD designation is not mandatory for all systemically important systems.

66. **Are there any national barriers in relation to legal certainty arising from how the SFD is transposed in the Member States?**

No.

Aside from the barriers mentioned elsewhere in this response (e.g., in relation to designation of third-country systems and the application of the SME opt-out), we are not aware of any national barriers in relation to legal certainty.

67. **Some stakeholders suggested a centralised overview over the insolvency of participants of all SFD designated systems is needed, ie. published on a common centralised website. Is a lack of transparency related to the insolvency of participants of designated systems creating barriers to the single market?**

No.

We are not aware of any barriers to the single market created by lack of transparency related to the insolvency of participants in designated systems.

68. **Are there any other barriers created by the SFD which are not mentioned above?**

While these are not barriers created by SFD, changes may be required to the following legislation in order to support EU settlement finality.

Insolvency Regulation

Article 12(1) of this Regulation provides that, "without prejudice to Article 8, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market shall be governed solely by the law of the Member State applicable to that system or market." Whilst we understand that "payment or settlement system or financial market" intends to include a "system" under article 2(a) of the SFD, the parameters of these terms are unclear. We would propose including a new definition in the Insolvency Regulation for "payment, settlement system or financial market" to clarify this (we can provide drafting for consideration if helpful).

BRRD

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

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

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

Article 80(1) provides that Member States shall ensure that the application of a resolution tool does not affect the operation of systems and rules of systems covered by Directive 98/26/EC where the resolution authority: (a) transfers some but not all of the assets, rights or liabilities of an institution under resolution to another entity; or (b) uses powers under Article 64 to cancel or amend the terms of a contract to which the institution under resolution is a party or to substitute a recipient as a party. In our view, cleared derivatives at CCPs may have an expiry date year into the future and may not constitute "transfer orders" when delivery obligations are not due; any partial transfer may cause systemic events. We would therefore recommend that such protections should be extended to CCPs authorised under article 14 of EMIR or recognised under article 25 of EMIR.

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

Framework for the recovery and resolution of central counterparties

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

EMIR

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

3.3. Barriers and other aspects under the FCD

84. What are the main barriers to the integration of EU markets and/or consolidation of financial market infrastructures related to the FCD?

Please see our response to question 87.

85. Is there sufficient clarity regarding the use of tokenised assets as financial collateral in the context of financial collateral arrangements under the FCD?

No. While the FCD provides a clear framework for traditional collateral, there is insufficient clarity regarding the specific application of its provisions to certain types of tokenised assets used as financial collateral. This lack of clarity creates uncertainty for market participants and may affect adoption of DLT-based collateral solutions.

Key areas of uncertainty include:

- **Lack of definitional clarity**. The legal characterisation of a tokenised asset under national law, and its subsequent mapping to FCD definitions, will determine whether it is "financial collateral" for the purposes of the FCD. However, depending on the structure, it is not always clear how tokenised assets fit within the FCD's existing definitions. For example, uncertainty remains around:
    - where the boundaries of "financial instruments" lie when considering tokenised assets linked to 'Digital Objects of Property'[1] (we refer to this arrangement as

[1] We use the term 'Digital Object of Property' to refer to tokens that are themselves recognised as objects of property rights independent of any legal rights they might otherwise represent. In certain jurisdictions this may refer to tokens exclusively issued and transferred via public, permissionless DLT-based systems under certain structures. Such tokens can be distinguished from a broader class of digital tokens which merely evidence or represent rights in a novel digital form, on a DLT record, without themselves attracting property rights.

the "Bearer Structure" in ISDA's Guidance Note on Tokenized Collateral published in May 2024);

- o to what extent the terms "money" and "pecuniary claims" capture novel forms of payment instrument (including e-money tokens under the Markets in Crypto-assets Regulation (MiCAR) or other stablecoins) and claims denominated or settled in such forms of tokenised cash, respectively; and
- o how the term "account" should be construed in the context of various DLT arrangements, particularly those that do not rely on traditional account-based structures (such as some Bearer Structures).

- **Application of core FCD concepts.** Key FCD concepts such as "possession," "control," "accounts," (as noted above) and "book-entry" (which are critical for the perfection and enforceability of financial collateral arrangements) do not neatly translate to all forms of tokenised assets.

  These assets can be structured in various ways, and each structure has different operational and legal characteristics that can impact how FCD provisions apply, particularly concerning the creation, perfection, and enforcement of security interests. For example:

  - o Existing legal precedent and guidance in relation to the boundaries of the concept of "possession or control" by the collateral taker will not necessarily provide the market with the same degree of certainty in relation to tokenized assets as it does for traditional assets. While the use of tokenization and smart contract techniques may in some cases make it easier to demonstrate practical control, further complexity can arise in relation to certain arrangements, for example where the operational movement of assets is controlled through an automated smart contract, which cannot be interfered with by the collateral taker.

  - o In some jurisdictions there may be uncertainty around the legal mechanisms for the effective transfer of tokenised assets that comprise a 'Digital Object of Property', including for the purposes of effecting or enforcing collateral in accordance with the FCD.

  - o DLT systems may not utilise "accounts" in the traditional sense, especially in Bearer Structures.[2] Even in Registered or Claims Structures where a DLT-based ledger records entitlements, the way these records function may differ from traditional "accounts." Similarly, the recording of interests on a distributed ledger may not necessarily align with established interpretations of "book-entry" securities systems, which often presuppose a specific type of intermediated holding structure and set of operational rules.

- **Jurisdictional divergence**. As a general matter, the legal status and proprietary nature of tokenised assets can vary across EU Member States. This, combined with national

[2] Digital Objects of Property are generally recorded to an address that is typically a hash of a public key which corresponds cryptographically to a unique private key. That private key is required to sign/authenticate any transfer of Digital Objects of Property recorded to the corresponding public key address. There may or may not be any account overlay to this.

implementations of the FCD, can lead to differing levels of clarity and certainty regarding the use of tokenised assets as collateral.

Legal clarity at the FCD level would benefit the market by providing a harmonised and predictable environment for the use of tokenised assets as financial collateral. We believe further analysis and potentially targeted clarifications or guidance at an EU level are needed to address these points.

86) In the last FCD consultation, the addition re-insurers, alternative investment funds (AIF), institutions for occupational retirement provision (IORPs), crypto-asset service providers, all non-natural persons, non-financial market participants which regularly enter into physically or financially settled forward contracts for commodities or EU allowances (EUAs) was suggested by stakeholders. It was also asked if payment institutions, e-money institutions and CSDs should be added to the scope. Please provide any views you may have of one or several of the suggested potential additional participants.

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

87. Are there barriers related to the scope of the FCD (i.e. parties eligible as collateral taker and collateral provider, definition of financial collateral, definition of cash)?

Yes.

We have observed the following barriers or challenges related to the scope of the FCD:

- Limits on the types of entities eligible as collateral taker and collateral provider;
- Lack of clarity regarding the concept of "possession and control";
- Definitions of "cash" and "financial instrument" are no longer aligned with the definitions used in other EU financial services legislation;
- Inconsistent application of opt-outs;
- Concept of "awareness" of insolvency proceedings under Article 8(2);
- Recognition of close-out netting
- Interaction with other EU financial services legislation.

89. Do the definitions and concepts in the FCD, including the notion of ‘possession and control’, ‘accounts’ and ‘book-entry’ result in barriers or legal uncertainty, e.g. due to the change in market practices, the use of DLT?

Yes.

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

We will provide detailed suggestions in due course as to ways in which these concepts could be clarified – we have not included these herein because of the character limit.

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

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

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

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

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

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

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

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

8) if the collateral is held via a third-party custodian: if the custodian has prior ranking security interests, liens or contractual set-off rights for their customary fees and expenses.

Additionally we would propose the following amendments:

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

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

90. Is the list of collateral providers and collateral takers limiting the applicability of the FCD in a detrimental manner for DLT-based financial collateral arrangements?

The limitations regarding the list of eligible collateral providers and collateral takers under the FCD affect both traditional and DLT-based financial collateral arrangements. Our comments on the personal scope of the FCD, as outlined in our response to question 86 (regarding the potential inclusion of entities like CSDs) and question 87 (identifying limits on eligible parties as a barrier), are therefore equally relevant here.

The key consideration for the FCD's scope should be the nature of the activities undertaken and the systemic importance of the entities involved, rather than the specific technology (such as DLT) used to record or transfer collateral.

However, it is worth noting that technological neutrality could be adversely affected if new types of entities which are central to DLT-based collateral ecosystems (eg. certain operators of DLT platforms facilitating collateral transactions, or crypto-asset service providers acting in a capacity analogous to traditional financial intermediaries in collateral chains), do not fall within the FCD's current or reasonably expanded scope. If such entities are not eligible as collateral takers or providers, it could limit the FCD's applicability to innovative DLT-based collateral structures.

Therefore, while the primary issue is the general scope of the FCD, any review should ensure that the categories of eligible entities are defined in a manner that is forward-looking and can accommodate new types of market participants that may play important roles in DLT-based financial collateral arrangements.

91. Do you think that collateral other than cash, financial instruments and credit claims should be made eligible under the FCD, in particular in light of DLT based financial collateral arrangements?

If yes, please list what other forms of collateral should be considered as eligible and explain why.

No, subject to our comments above regarding expansion of the definitions of "cash" and "financial instruments".

We discuss in our response to question 98 some of the considerations that should be taken into account before expanding the FCD to cover collateral other than cash, financial instruments and credit claims (in particular, before expanding it to cover cryptoassets). However, this is subject to our comments regarding the crucial need to clarify the definitions of "cash" and "financial instruments" to ensure they are technologically neutral and can adequately encompass tokenized equivalents of these assets. In particular:

- The definition of "cash" should be reviewed to clarify its application to various forms of tokenised money, including stablecoins that function as cash equivalents.
- The definition of "financial instruments" should be clarified to ensure it includes tokenised securities and other DLT-based instruments that have the characteristics and regulatory treatment of traditional financial instruments negotiable on capital markets, even if they use a Bearer Structure.

If the definitions of "cash" and "financial instruments" are appropriately clarified to be technology-neutral, many DLT-based assets intended for use as collateral should fall within these existing categories.

Introducing entirely new categories of eligible collateral beyond these three could introduce unintended complexities and risks, particularly if these new asset types lack the legal certainty, stability of value, or liquidity typically associated with financial collateral. As we note in our response to question 98, before considering any expansion to include novel crypto-assets that do not clearly fit within updated definitions of cash or financial instruments, a thorough review and impact assessment is necessary. This includes developing a clear taxonomy of such assets and understanding their risk profiles and the legal frameworks governing their creation, holding, and transfer.

92. Do you see the need to change the current approach that only financial collateral arrangements should be protected where at least one of the parties is a public authority, central bank or financial institution?

Please explain

No, subject to our comments above (in response to question 86) regarding the personal scope of the FCD and expansion of the entities that would qualify as a "financial institution".

94. Are the opt-out provisions for Member States creating any barriers to the single market?

Yes.

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

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

Whilst we believe that the benefits to the cross-border provision of collateral of removing the SME opt-out in Article 1(3) significantly outweighs the potential costs, we also acknowledge that the issue of the SME opt-out may remain controversial for a limited number of Member States. To limit the worst effects of Article 1(3) the Commission may wish to consider limiting the opt-out in scope so that it provides a minimum safe-harbour extending to certain financial markets activities entered into by financial institutions with unregulated corporates. We consider that these should include, without limitation, derivatives, transactions in financial instruments, prime brokerage services, repo, securities lending, margin lending, clearing, custody together with any ancillary or related fees, expenses and overdrafts. Insolvency safe-harbours in the EU and elsewhere often have similar financial markets activity-based safe harbours for example the US Bankruptcy Code affords special treatment to "securities contracts" and certain other "qualified financial contracts". The list of activities presented above are not intended to be exhaustive but merely represent those activities that we understand may routinely be entered into by financial institutions with unregulated corporates and organically belong in the financial markets sphere.

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

95. Have you encountered problems with the recognition/application of close-out netting provisions under the FCD (both national and cross-border)?

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

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

The Commission may wish to consider converting the FCD into a regulation in order to maximise harmonisation and consistency of approach across the EU. However, we appreciate that this may be difficult given the differences in insolvency legislation across the different EU member states. We would not support conversion of the FCD into a regulation if this would result in a weakening of the existing financial collateral regime under the FCD in order to make the regime fit within the restrictions of national insolvency or other legislation. In addition, the question of how to deal with existing national discretions and opt-outs in a regulation should be resolved in favour of inclusion of the relevant arrangements and collateral.

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

Differences in treatment of different counterparty types between EU jurisdictions:

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

Differences in treatment of different contract types:

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

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

Link between close-out netting and financial collateral arrangements:

"Close-out netting" is defined in the FCD only in connection with a financial collateral arrangement (see the definition of "close-out netting" and the definition of "financial collateral arrangement"). Therefore the FCD does not currently provide any protection to close-out netting without a collateral arrangement. Also, the definition of "relevant financial obligations" does not include all types of derivatives. A broader definition of "close-out netting" would also support protections available under other legislation (e.g., BRRD, which offers protection to certain netting arrangements). Therefore we propose that the scope of protection provided by the FCD would be extended to include close-out netting without financial collateral arrangements relating to the relevant transactions. For example, the definition of "close-out netting provision" could be amended to mean "a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or of any other arrangement, or, in the absence of any such provision […]".

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

96. As noted in the Commission report on the review of SFD and FCD (COM(2023)345 final), given the FCD deals primarily with financial collateral and only peripherally with netting (only as one of the methods that can be used to enforce collateral arrangements), do you consider that there is a need for further

harmonisation of the treatment of contractual netting in general and close-out netting in particular?

Yes.

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

We note that the legislative proposal for an Insolvency Directive[1] proposes harmonising national avoidance provisions, and that this may include protection for close-out netting. We would urge the Commission to review that legislative proposal in the context of this consultation and ensure that appropriate protection for contractual netting in general and close-out netting in particular is included (and that application of this protection is mandatory in each Member State).

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

We are aware of differences in the extent and clarity of netting legislation in different EU member states. If this is not addressed in the Insolvency Directive then it may be appropriate to introduce separate EU legislation on netting. The Commission may wish to carry out a detailed comparison of netting legislation in each EU member state in order to assess where any discrepancies or gaps exist and how these could best be addressed at an EU level.

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

It is critical that these uncertainties are addressed.

97. Are there any other barriers created by the FCD which are not mentioned above?

N/A

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

Application of the FCD to DLT or cryptoassets:

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

There is a broad spectrum of DLT platforms and many different types of cryptoasset. As mentioned in our comments above, some of these may qualify as financial instruments and some may not. The treatment of these assets should also be reviewed in light of MiCAR.

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

The Commission should undertake a detailed review of these assets and systems to understand the key issues and assess whether they should be included within the scope of the FCD, whether it may be appropriate to legislate separately to manage any identified risks or whether further legislation is not necessary at this stage.

Requirement for evidence in writing or in a durable medium:

The FCD requires provision of financial collateral to be evidenced in writing. References to "in writing" include paper, recording by electronic means and any other durable medium; We would suggest deleting the term "in writing" and substitute "durable medium". The majority of EU jurisdictions have e-contracts legislation or have recognized them as equivalent to paper form and there has been an increase in the technical methods available for guaranteeing unchanged reproduction.

Clarification on scope of netting sets:

Due to the advance in the clearing volumes of derivatives in Central Counterparties ("CCP") since EMIR and its clearing obligation came into effect, FCD should be amended to clarify that client clearing agreements benefit from Close-out Netting Provisions and that a single netting set can include various sub-netting sets (e.g. a single ISDA master agreement including annexes for client clearing trades and pure OTC trades).

Similarly, any agreements that contain master netting arrangements (including many prime brokerage agreements) will allow for the set-off or netting of multiple close-out amounts that are determined under separate netting agreements. These master netting arrangements should also benefit from the close-out netting provisions of the FCD consistently across all Member States.

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

The title transfer financial collateral arrangements encompassed by the FCD protections are limited to those that secure or otherwise cover the performance of "relevant financial obligations" (see the definition of "title transfer financial collateral arrangement" at Article

2(1)(b)). While the definition of "security financial collateral arrangement" is not limited in the same way, the protections afforded to those arrangements are structured by reference to "relevant financial obligations" and limited accordingly. Relevant financial obligations are restricted to obligations that give a right to cash settlement and/or delivery of financial instruments (as defined in the FCD). Many derivatives encompass obligations other than the payment of cash and the delivery of financial instruments as defined in the FCD, such as physically settled bullion and commodity derivatives. Transacting of such derivatives under the same collateralised master agreement as derivatives which relate only to relevant financial obligations may deprive that entire collateral arrangement, and any related close-out netting provision, of FCD protections.

We agree with the statement of the European Commission set out in its June 2020 document "Working Document on Collateral from the Commission to relevant bodies for consultation" that "There seems to be no reason to limit the types of exposure that should be covered. […]To attempt to distinguish different transactions would be difficult to achieve and burdensome to operate and would appear to serve no useful purpose.". This has proved to be the case as, in order to obtain any FCD protections, industry participants are required to segregate into FCD eligible and non-FCD eligible arrangements portfolios of transactions that would otherwise comprise a single arrangement. We would recommend that the restriction on the definition of "relevant financial obligations" be removed. We would be happy to propose wording

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52022PC0702

3.6. Other issues on post-trading

114. Other matters that could potentially contribute to removing barriers to the consolidation of post-trading infrastructure, to improving the EU's capital markets attractiveness while reducing fragmentation and to improving integration in post-trade services might also be important.

Please provide any further suggestions to improve the integration, competitiveness, and efficiency of post-trade services (including clearing and settlement) in the EU. Please provide supporting evidence for any suggestions.

EMIR 3.0 mandates active accounts, forcing firms to split portfolios. This results in higher margin across CCPs, more risk, more complicated processes and more cost for European firms. EMIR 2.2 already grants substantial direct supervisory powers for ESMA on Tier 2 CCPs. As a result of this, measures that aim at reducing reliance on Tier 2 CCPs appear unnecessary, given that ESMA direct supervisory powers should address any financial stability concerns. If necessary, ESMA could consider more cooperation with third country resolution authorities, to address any remaining concerns as to what may happen in a crisis situation affecting a third country CCP. As it stands, EMIR 3.0 has not made clearing or business in the EU more attractive, but worsened the competitive position of EU firms in relation to their global competitors. EU might be forced to become local distributors for their erstwhile competitors, and the role of global banks for financing of the EU roadmap will become more important.

Instead of imposing coercive measures, positive measures to make clearing in the EU more attractive should be explored, such as those outlined in the ISDA roadmap[3]. For example,

[3] A-Roadmap-to-Make-European-Clearing-More-Attractive.pdf

expansion of the operating hours of the ECB's TARGET II would give EU CCPs a competitive edge, by reducing EU clearing members and CCPs' reliance on USD payments for late-in-the-day margin calls.

Part 2.

6. Supervision

6.1 Effectiveness of the current framework

2. What prevents the ESAs from reaching the objectives or performing the tasks listed in Question 1?

Please explain your answer.

Under the current supervisory framework, ESMA has direct supervisory responsibilities vis a vis third country Tier 2 CCP. This direct supervisory role should provide comfort to ESMA, and other EU authorities, that clearing at such Tier 2 CCPs does not carry extra financial stability risk. In light of this, the EMIR 3 AAR appears as an unnecessary burden on EU market participants, as it does not address any demonstrable financial stability risk.

3. Please assess ESMA's governance model currently in place for the direct supervisory mandates. Currently, the Board of Supervisors adopts supervisory decisions prepared either by ESMA staff (for example for credit rating agencies (CRAs)) or the CCP supervisory committee (for tier 2 third country CCPs).

6.4 Questions on the Supervision of EU CCPs

6.4.1 Identifying the costs of the current supervisory framework and benefits of more integrated EU supervision

18. How would you rate the convergence of supervisory practices across Member States in the area of the supervision of CCPs?

Please rate from 1 to 5 (1 very convergent, 5 very divergent)

Please provide examples of divergent outcomes of supervisory practices for CCPs in different Member States.

3, given that ESMA has a role in keeping supervisory practices convergent and there is a common rulebook (EMIR)..

20. To which extent do you agree with the following statements about possible benefits of moreintegrated EU supervision (please rate from 1 to 5)

It could reduce EU CCPs' regulatory costs;

b. It could enhance the quality of supervision over EU CCPs;

c. It could simplify and accelerate the procedure to apply for authorisation to provide clearing

services in the EU;

d. It could simplify and accelerate the procedure for additional authorisations (e.g. to extend the

scope of services or activities offered in the EU);

e. It could simplify and accelerate validation procedures for risk models and parameters;

f. It could simplify and accelerate the procedures for obtaining supervisory approvals, e.g. with

regard to outsourcing;

g. It could lead to more efficient use of supervisory resources;

h. It would decrease uncertainties that currently arise from different implementation or

interpretations of EU Regulations in different Member States or by Member States and ESMA;

i. It would remove the need for market actors to deal with duplicative instructions from more than one supervisory authority;

j. It would create a level playing field between EU CCPs;

k. It would create a level playing field between EU CCPs on the one hand and third-country CCPs on the other hand;

l. It would improve EU capacity to deal with the cross-border risks arising from greater amounts of clearing in the EU;

m. It could ensure a harmonised understanding of decentralised technologies and the novel risks they may bring to the CCP to supervise;

n. It could improve the resilience of EU CCPs;

o. It would reduce the need for detailed regulations and extensive rulebooks to achieve harmonised supervision;

p. Other (please specify in reply to the next question).

For each point, options to choose from:

1 (strongly agree), 2 (rather agree), 3 (neutral), 4 (rather disagree), 5 (strongly disagree), 6 (no opinion

Please explain your answer providing, where possible, quantitative evidence and examples. If you indicated 'Other', please specify what was intended.

With the introduction of EMIR 3, ESMA will co-chair the supervisory colleges of all EU CCPs, and ensure supervisory convergence. Given that EMIR 3 has recently entered into force, we should monitor the implementation of the supervisory colleges and joint monitoring mechanism before considering any further centralization.

21. Do you consider that centralised EU supervision could also produce negative side-effects?

See answer to previous question (Question 20).

6.5.3. How could the potential scope of a possible EU-level supervision be defined?

7. Horizontal Questions on the supervisory framework

7.1. New direct supervisory mandates and governance models

5. **Which governance do you consider most suitable for a given model of direct supervision?**

a. **A Supervisory Committee. It would be composed of a limited number of independent members (employed by ESMA) and representatives of those NCAs in whose jurisdiction directly supervised entities are operating. This committee will guide the supervisory tasks given to the EU level and carried out by ESMA staff and/or joint supervisory teams. The committee could have different formations/configurations for each of the sectors supervised. In terms of decision making, three alternatives could be envisaged:**
    1. **Final decision making by the Supervisory Committee**
    2. **Supervisory Committee in charge but Board of Supervisors (BoS) would have a veto right on certain decisions when a set of pre-defined criteria would be met (e.g. particular political sensitivity/importance)**
    3. **As per the current CCP Supervisory Committee, the new Supervisory Committee would prepare the decisions, but the BoS would be the final decision-making body**

b. **Establishing an Executive Board composed of the Chair of ESMA and a small number of full-time independent members. It will take all decisions towards individual supervised entities. The BoS would ensure some NCAs involvement, and it would still be able to provide its opinion on any decision about directly supervised entities. This model would be similar to the one designed for the Anti-Money Laundering Authority (AMLA).**

c. **A governance model based on the current setting of direct supervision as for example for CRAs. In this model, ESMA would become the sole direct supervisor without any direct participation of NCAs' staff in the authorisation and ongoing supervision. All EU NCAs would remain involved in all supervisory decisions through the BoS approval process, regardless of whether they are home NCA or not. When it comes to day-to-day supervision, this should be performed**

by ESMA staff. ESMA would be able to decide to delegate certain tasks to NCAs, but would continue to remain responsible for any supervisory decision. In your view, which governance model is the most suitable and for which reasons (e.g. speed of decision making, inclusiveness of process)? You may differentiate your reply per sector. Please explain your reply.

6. **Would you envisage a different governance model apart from one of those outlined above? Please explain your reply**

In our experience so far, the ESMA CCP Supervisory Committee does a good job and has good governance. Its structure could be used as a blueprint for other areas.

7.2 Supervisory Convergence

(Answered for ESMA)

7. Please rate the effectiveness of supervisory convergence tools from 1 to 5 (1 least effective, 5 most effective)

- **Breach of Union law**
- **Binding mediation**
- **Peer reviews**
- **Emergency powers**
- **Opinions**
- **Recommendations**
- **Product intervention powers**
- **Inquiries**
- **No action letters**
- **Guidelines**
- **Colleges of supervisors**
- **Coordination groups**
- **Collaboration platforms**
- **Warnings**
- **Questions and Answers**
- **Supervisory handbooks**
- **Stress tests**
- **Union strategic supervisory priorities**
- **other, please specify**

If you would like to differentiate per areas, please comment.

Following the most recent ESAs review, ESMA and the EBA have power to publish 'no-action' letters in relation to the application of requirements under EU regulation. No-action letter powers enable authorities to react to unforeseen events, such as the outbreak of a global pandemic, or streamline implementation of EU regulations, such as sustainability-related disclosures for benchmarks or the EMIR Margin RTS. However, Article 9a of the ESMA Regulation and Article 9c of the EBA Regulation maintain obstacles to the deployment of 'no-action' letters. As such, use of these 'no-action' statements has been limited. ESMA has typically continued to issue 'deprioritisation of enforcement' statements instead.

The existing 'no-action' letter power does not allow the ESAs to disapply the application of EU law, meaning that full legal clarity is not achieved. Furthermore, requirements associated with issuance of 'no-action' letters hamper the ESAs' ability to react swiftly where necessary. ESMA must send a detailed account in writing to the competent authorities and the EC, issue a formal opinion, and provide recommendations for an EU legislative proposal, addressing the issue in question. We believe that the EC should address this weakness in the governance of EU capital markets. Noting the Draghi report's call for a 'European SEC', we see this as a competitiveness issue: ESMA and other ESAs should be empowered to react more nimbly to 'events' which undermine order and efficiency in capital markets, as ESMA's peers (e.g. the SEC and CFTC) can.

7.3 Increasing the effective use of supervisory convergence tools

Please select the ESA(s) for which you are replying, this selection will apply to all questions included this section.

ESMA / EIOPA / EBA

8. **Do you think that the current supervisory convergence tools are used effectively and to the extent that is possible**?

Y/N. If the answer is no, please explain and give example.

See answer to previous question**.**