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Targeted consultation on the review of the Directive on financial collateral arrangements

Fields marked with * are mandatory.

Introduction

Background to this consultation

The Financial Collateral Directive (FCD) was adopted on 6 June 2002 and introduced a harmonised framework for the use of financial collateral to secure transactions: By doing so, it contributed to enhancing cross-border use of financial collateral. Prior to the FCD, only collateral security provided to a central bank or in connection with participation in a payment or securities settlement system covered by the SFD (SFD system) was protected by EU law in the event of the insolvency of the collateral giver. A more comprehensive approach covering also OTC transactions was deemed necessary because divergent national rules applicable to financial collateral were frequently impractical and often non-transparent. They resulted in uncertainty as to the effectiveness and enforceability of 'financial collateral arrangements', also as a means of protecting cross-border transactions. The FCD protects collateral takers notably by: ensuring that financial collateral arrangements can be mobilised and realisable without delay due to national formalities; providing for close-out netting provisions to be enforceable in accordance to their terms and ring-fencing the operation of financial collateral arrangements should one of the parties become insolvent. Where applicable, these protections may constitute exceptions to the principles of equal treatment of creditors upon the opening of insolvency proceedings and universality of insolvency proceedings. In such a way, they help to avoid systemic contagion risks throughout the EU. The FCD does not fully harmonise national laws applicable to financial collateral arrangements but partially harmonises certain provisions whilst dis-applying others. By doing so, the FCD aims to remove barriers to the timely cross-border creation and operation of such arrangements.

Article 12a of the Settlement Finality Directive (SFD) requires the Commission to report on the SFD by 28 June 2021. To this end, the Commission is reviewing the SFD. Since the FCD is closely related to the SFD, the Commission has decided to review the FCD in parallel. For the FCD to continue to serve its purpose, it is important to consider developments that could affect its functioning and to ensure coherence across legislative frameworks. Relevant issues can arise from market developments (economic, financial or technological) and/or regulatory changes. Two issues that are dealt with in this consultation are also important for the SFD: recognition of 'close-out netting provision' and 'financial collateral' ('cash' and 'financial instruments' the two most commonly used forms of 'collateral security' under the SFD). The Commission does not intend to deal with the (re-) use of financial collateral given under 'security financial collateral arrangement' by the collateral taker in this review because it was recently addressed in the Securities Financing Transactions Regulation (SFTR), which provided for improved transparency and monitoring. As reporting under the SFTR only started in July 2020, it is too early to draw any conclusions . A first discussion with Member States on both, SFD and FCD related issues, took place in October 2020.

Responding to this consultation

The purpose of this consultation is to receive stakeholders' views and experiences regarding the functioning of the FCD. The responses to this consultation will provide important guidance to the Commission services in preparing a legal proposal where appropriate.

Please note: In order to ensure a fair and transparent consultation process **only responses received through our online questionnaire will be taken into account** and included in the report summarising the responses. Should you have a problem completing this questionnaire or if you require particular assistance, please contact fisma-sfd-fcd-review@ec.europa.eu.

More information on

- this consultation
- the consultation document
- financial collateral arrangements
- the related targeted consultation on the review of the Settlement Finality Directive (SFD)
- the protection of personal data regime for this consultation

About you

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* Language of my contribution

- ○ Bulgarian
- ○ Croatian
- ○ Czech
- ○ Danish
- ○ Dutch
- ◉ English
- ○ Estonian
- ○ Finnish
- ○ French
- ○ German
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- Spanish
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* I am giving my contribution as

- Academic/research institution
- Business association
- Company/business organisation
- Consumer organisation
- EU citizen
- Environmental organisation
- Non-EU citizen
- Non-governmental organisation (NGO)
- Public authority
- Trade union
- Other

* First name

Farrah

* Surname

Mahmood

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farrah.mahmood@isla.co.uk

* Organisation name

255 character(s) maximum

The International Securities Lending Association

* Organisation size

- (○) Micro (1 to 9 employees)
- (●) Small (10 to 49 employees)
- (○) Medium (50 to 249 employees)
- (○) Large (250 or more)

Transparency register number

255 character(s) maximum

Check if your organisation is on the transparency register. It's a voluntary database for organisations seeking to influence EU decision-making.

575888466-70

* Country of origin

Please add your country of origin, or that of your organisation.

(○) Afghanistan	(○) Djibouti	(○) Libya	(○) Saint Martin
(○) Åland Islands	(○) Dominica	(○) Liechtenstein	(○) Saint Pierre and Miquelon
(○) Albania	(○) Dominican Republic	(○) Lithuania	(○) Saint Vincent and the Grenadines
(○) Algeria	(○) Ecuador	(○) Luxembourg	(○) Samoa
(○) American Samoa	(○) Egypt	(○) Macau	(○) San Marino
(○) Andorra	(○) El Salvador	(○) Madagascar	(○) São Tomé and Príncipe
(○) Angola	(○) Equatorial Guinea	(○) Malawi	(○) Saudi Arabia
(○) Anguilla	(○) Eritrea	(○) Malaysia	(○) Senegal
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(○) Antigua and Barbuda	(○) Eswatini	(○) Mali	(○) Seychelles
(○) Argentina	(○) Ethiopia	(○) Malta	(○) Sierra Leone

- Armenia
- Aruba
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- Bhutan
- Bolivia
- Bonaire Saint Eustatius and Saba
- Bosnia and Herzegovina
- Botswana
- Bouvet Island
- Brazil
- British Indian Ocean Territory
- British Virgin Islands
- Falkland Islands
- Faroe Islands
- Fiji
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- France
- French Guiana
- French Polynesia
- French Southern and Antarctic Lands
- Gabon
- Georgia
- Germany
- Ghana
- Gibraltar
- Greece
- Greenland
- Grenada
- Guadeloupe
- Guam
- Guatemala
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- Guinea
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- Mayotte
- Mexico
- Micronesia
- Moldova
- Monaco
- Mongolia
- Montenegro
- Montserrat
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- Namibia
- Nauru
- Nepal
- Netherlands
- New Caledonia
- New Zealand
- Nicaragua
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- Singapore
- Sint Maarten
- Slovakia
- Slovenia
- Solomon Islands
- Somalia
- South Africa
- South Georgia and the South Sandwich Islands
- South Korea
- South Sudan
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- Sri Lanka
- Sudan
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- Sweden
- Switzerland
- Syria
- Taiwan
- Tajikistan
- Tanzania
- Thailand
- The Gambia

- Brunei
- Bulgaria
- Burkina Faso
- Burundi
- Cambodia
- Cameroon
- Canada
- Cape Verde
- Cayman Islands
- Central African Republic
- Chad
- Chile
- China
- Christmas Island
- Clipperton
- Cocos (Keeling) Islands
- Colombia
- Comoros
- Congo
- Cook Islands
- Costa Rica
- Côte d’Ivoire
- Croatia
- Haiti
- Heard Island and McDonald Islands
- Honduras
- Hong Kong
- Hungary
- Iceland
- India
- Indonesia
- Iran
- Iraq
- Ireland
- Isle of Man
- Israel
- Italy
- Jamaica
- Japan
- Jersey
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- Kazakhstan
- Kenya
- Kiribati
- Kosovo
- Kuwait
- Nigeria
- Niue
- Norfolk Island
- Northern Mariana Islands
- North Korea
- North Macedonia
- Norway
- Oman
- Pakistan
- Palau
- Palestine
- Panama
- Papua New Guinea
- Paraguay
- Peru
- Philippines
- Pitcairn Islands
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- Puerto Rico
- Qatar
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- Romania
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- Togo
- Tokelau
- Tonga
- Trinidad and Tobago
- Tunisia
- Turkey
- Turkmenistan
- Turks and Caicos Islands
- Tuvalu
- Uganda
- Ukraine
- United Arab Emirates
- United Kingdom
- United States
- United States Minor Outlying Islands
- Uruguay
- US Virgin Islands
- Uzbekistan
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- Denmark
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- Lebanon
- Lesotho
- Liberia
- Russia
- Rwanda
- Saint Barthélemy
- Saint Helena Ascension and Tristan da Cunha
- Saint Kitts and Nevis
- Saint Lucia
- Wallis and Futuna
- Western Sahara
- Yemen
- Zambia
- Zimbabwe

* Field of activity or sector (if applicable):

- [ ] Auditing
- [ ] Central Counterparties (CCPs)
- [ ] Central Securities Depositories (CSDs)
- [ ] Clearing house
- [ ] Credit institution
- [ ] Credit rating agencies
- [ ] E-money institution
- [ ] European supervisory authority
- [ ] Insurance
- [ ] Investment firm
- [ ] Investment management (e.g. hedge funds, private equity funds, venture capital funds, money market funds, securities)
- [ ] Market infrastructure operation (except CCPs, CSDs, Stock exchanges)
- [ ] Member State Authority other than a National supervisory authority
- [ ] National supervisory authority
- [ ] Organisation representing European consumers' interests
- [ ] Organisation representing European retail investors' interests
- [ ] Payment institution
- [ ] Pension provision

- [ ] Publically guaranteed undertaking
- [ ] Settlement agent
- [ ] Stock exchanges
- [ ] System operator
- [ ] Technology company
- [ ] Other
- [x] Not applicable

Is there anything else you would like to mention?

The International Securities Lending Association (ISLA) is a leading non-profit industry association, representing the common interests of securities lending and financing market participants across Europe, Middle East and Africa. Its geographically diverse membership of over 160 firms includes institutional investors, asset managers, custodial banks, prime brokers and service providers.

Working closely with the industry, as well as national, regional, and global regulators and policy makers, ISLA advocates, amongst other things, the importance of securities lending to the broader financial services industry. It supports both the Global Market Securities Lending Agreement (GMSLA) legal framework, including the Title Transfer and Securities Interest over Collateral variants, as well as the periodical enforceability and security enforcement across global jurisdictions.

Through member working groups, industry guidance, consultations and first-class events, ISLA plays a pivotal role in the creation and promotion of market best practices and processes, thought leadership, standards for legal frameworks, and securities lending guides and related documents.

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. **Fo r 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

The Commission will publish the responses to this public consultation. You can choose whether you would like your details to be made public or to remain anonymous.

- ( ) **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.

Public

Organisation details and respondent 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. Your name will also be published.

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1. Scope

The scope of the FCD determines who benefits from its protections. It has to be considered carefully, since the removal of national safeguards to the enforcement of financial collateral arrangements could contribute to moral hazard. At the same time, to achieve the FCD's objective of avoiding systemic risk, the scope of the FCD should cover systemically important collateral takers and providers.

To benefit from the FCD's protections, the collateral taker and the collateral provider must be covered by the FCD. The following are currently within the FCD's scope: public authorities; central banks; financial institutions; central counterparties; settlement agents and clearing houses. In addition, a person other than a natural person (including unincorporated firms and partnerships) can also be within the FCD's scope, provided that the other party to the financial collateral arrangement is one of the afore-mentioned entities (Article 1(3) FCD). Member States can opt-out of the latter provision. By applying this opt-out, Member States are able to exclude from the scope of the FCD financial collateral arrangements entered into by SMEs with their credit institutions for instance, that primarily belong to the retail rather than wholesale financial markets covered by the FCD.

Furthermore, new financial entities have emerged in the EU capital markets acquis (e.g. payment institutions, e-money institutions or central securities depositories) which are currently not covered by the FCD and could be considered to be included in the scope.

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

a) Payment institutions?

- Yes
- No
- Don't know / no opinion / not relevant

Please explain your anwer to question 1.1 a):

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

In line with the Commission's statement, the personal scope of the FCD should be extended to cover systemically important collateral takers and providers. As central securities depositories are a key part of EU financial market infrastructure it is logical to extend the personal scope of the FCD to include them (to the extent that there are not separately already within scope).
In addition, we note that the market continues to evolve and, on that basis, suggest that payment institutions and e-money institutions could be usefully added to ensure that the market retains the protections set out within the FCD.
The FCD provides an important function in recognising the efficacy of netting mechanisms and giving effect to security arrangements. These arrangements permit the efficient mitigation of credit risk and promote efficient markets. These mechanisms also underpin the analysis for the regulatory capital treatment, where applicable, and correspondingly it is desirable for there to be as much certainty as possible in respect of such arrangements.
On that basis, we consider it advantageous for the personal scope of the FCD to be as broad as possible.

b) E-money institutions?

- (●) Yes
- ( ) No
- ( ) Don’t know / no opinion / not relevant

Please explain your anwer to question 1.1 b):

5000 character(s) maximum
including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Please see 1.1 (a)

c) Central securities depositories?

- (●) Yes
- ( ) No
- ( ) Don’t know / no opinion / not relevant

Please explain your anwer to question 1.1 c):

5000 character(s) maximum
including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Please see 1.1 (a)

d) Any other entity(ies)? Please explain:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Please see 1.1 (a)

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

- Yes
- No
- Don't know / no opinion / not relevant

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

As noted above, the protections provided by the FCD support the credit mitigation techniques that support efficient markets and we therefore consider it advantageous for those protections be as broad as possible. On that basis, we consider it advantageous for the personal scope of the FCD to be as broad as possible.

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

- Yes
- No
- Don't know / no opinion / not relevant

Question 1.3.1 Please explain why the exclusion in Article 1(3) presents a problem to the cross-border provision of collateral in your opinion:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

The partial implementation of the SME opt-out in a handful of Member States limits the scope of financial products and service providers available to certain unregulated corporates. We believe that financial institutions should benefit from the protections of the FCD when facing unregulated corporates in all Member States. This would mitigate the risks to financial institutions of conducting such activity and improve the cross-border provision of collateral in Europe.
Any variance in the application of the protection provided under the FCD requires participants to individually assess the risks for each relevant counterparty in each applicable jurisdiction and this could be mitigated if the protections provided by the FCD were as broad as possible. The present system requires complex legal analysis for cross border transactions and this promotes a lower level of legal certainty regarding the application of the credit mitigation techniques that the FCD seeks to protect.

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

- ○ Yes
- ◉ No
- ○ Don't know / no opinion / not relevant

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

5000 character(s) maximum
including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

As noted above, the protections provided by the FCD support the credit mitigation techniques that support efficient markets and we therefore consider it advantageous for those protections be as broad as possible. We note that most Member States did not implement the corporate opt-out in full and we consider that making the SME opt-out into a binding provision would adversely affect the cross-border provision of collateral in Europe.

2. Provision of cash and financial instruments under the FCD

The FCD applies to financial collateral once it has been provided and if that provision can be evidenced in writing. Where the FCD says 'provided' and 'provision' what is meant is that the financial collateral must be delivered, transferred, held, registered, or otherwise designated so as to be in the possession or under the control of the collateral taker or its representative. The question was raised whether the concepts of 'possession' and 'control' in the FCD are sufficiently clear or might need further clarification.

In case C-156/15 (Judgment of the Court (Fourth Chamber) of 10 November 2016. 'Private Equity Insurance Group' SIA v 'Swedbank' AS - "Swedbank decision") the Court of Justice of the European Union underlines that the FCD does not specify the circumstances in which the criterion requiring the collateral taker to be in 'possession' or 'control' of collateral is fulfilled in the case of intangible collateral, such as monies deposited in a bank account.

Furthermore, the FCD does not explicitly specify how the provision of financial collateral consisting of "claims relating to or rights in or in respect of" financial instruments (e.g. dividend or interest) which are provided as financial collateral separately from the underlying financial instruments in a security financial collateral arrangement should be evidenced.

Moreover, in the context of title transfer financial collateral arrangements, the lack of harmonised rules on good faith acquisition might undermine the legitimate expectations of a good faith acquirer.

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

- (●) No, there should be flexibility
- ( ) Yes, an explicit provision would be helpful
- ( ) Don't know / no opinion / not relevant

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

- (●) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

Question 2.2.1 Please explain why you think that the concepts of 'possession' and 'control' in the FCD require further clarification and for which type of collateral.

Please elaborate how this should be done in your opinion:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

National implementing legislation has provided guidance on the concepts of "possession" and "control" under the FCD. This has not been sufficient to preclude litigation in respect of the meaning of the terms (including in the UK, while the UK was still a part of the EU). Although it remains appropriate for detailed guidance to be provided at a national level, as each jurisdiction has its own laws on security and insolvency procedures, we consider that further high-level guidance could be usefully provided at the EU level. It is essential that such guidance should provide market participants with additional flexibility and not introduce any prescriptive formalities or requirements. We agree with the specific proposals made in the consultation response provided by ISDA.

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

- ( ) Yes
- (●) No
- ( ) Don't know / no opinion / not relevant

3. ‘Awareness’ of (pre-)insolvency proceedings

The FCD provides in Article 8(2) that Member States must ensure that “where a financial collateral arrangement or a relevant financial obligation has come into existence, or financial collateral has been provided on the day of, but after the moment of the commencement of, winding-up proceedings or reorganisation measures, it shall be legally enforceable and binding on third parties if the collateral taker can prove that he was not aware, nor should have been aware, of the commencement of such proceedings or measures.”

The European Post Trade Forum (EPTF) pointed out that it was not clear as to what exactly was protected by Article 8 (2) of the FCD (EPTF’s 2017 report, sub-sub-section 1.2.1, 2nd bullet point, p. 76.), mainly in the context of OTC financial collateral arrangements. In practice, it would be difficult for a collateral taker to prove that he was not aware nor should have been aware of the aforementioned proceedings.

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

- [x] I see the need to clarify how a collateral taker can ‘prove that he was not aware'
- [x] I see the need to clarify how a collateral taker can ‘prove that he should not have been aware’

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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

4. Recognition ‘close-out netting provisions’ in the FCD and its impact on SFD systems

Close-out netting is an arrangement commonly used in financial markets, to set off and replace all agreed but not yet due liabilities and claims vis-à-vis a counterparty, by one single claim/liability. It ordinarily covers instances where a counterparty defaults or becomes insolvent. It is commonly used alongside a contract termination provision. Close-out netting is important for the efficiency of financial markets, as it reduces credit exposures from gross to net. By doing so, it enables financial institutions to reduce their settlement, counterparty credit and liquidity risks. It thereby reduces systemic risk.

The FCD acknowledges the importance for market participants to be able to rely on a legally protected close-out netting mechanism in the event of the (pre-) insolvency of their counterparty. This is done by providing that a “close-out netting provision can take effect in accordance with its terms”, notwithstanding the onset of (pre-) insolvency proceedings vis-à-vis other counterparties and without regard to other matters that might otherwise affect the rights arising from a close-out netting provision. SFD systems rely on the FCD to protect their close-out netting provisions, notably in the context of their default management arrangements should a participant default, come under resolution or be subject to (pre-) insolvency proceedings. Therefore, any uncertainties regarding the enforceability of close-out netting under the FCD could also have a knock-on effect on SFD systems.

Nevertheless, the EPTF’s 2017 report states that the FCD does not sufficiently protect close-out netting provisions in cross-border settings since parties still need to carry out due diligence in order to ascertain whether a close-out netting provision is enforceable in case of the insolvency of the other party. This is because the FCD is silent as to the application of avoidance actions in (pre-)insolvency proceedings to a close-out netting provision[1]. By contrast, avoidance action is expressly dis-applied to ‘netting’[2] in the SFD (Article 3(2) SFD).

The Bank Recovery and Resolution Directive (BRRD - Directive 2014/59/EU), amended the FCD to include Article 1(6) of the FCD which was then amended by the Framework for the Recovery and Resolution of Central Counterparties (CCP RR - Regulation (EU) 2021/23). Article 1(6) of the FCD dis-applies the protections in Article 7 (Recognition of close-out netting provisions) of the FCD to any restriction on the enforcement of a close-out netting provision including any set-off that is imposed by virtue of a resolution action of a resolution authority. Under the BRRD and the CCP RR such restrictions are subject to the respect of specific safeguards. Article 1(6) of the FCD is intended to avert the immediate enforcement provision as provided for in the FCD so as to not precipitate the failure of a systemic institution and jeopardise any effective resolution. Thus, it intends to reconcile the operation of close-out netting arrangements with the effectiveness of resolution of banks and CCPs to the benefit of financial stability. However, the EPTF raises the issue that the BRRD might create uncertainties[3] as to whether a close-out netting provision is enforceable in accordance with its terms under the FCD in the context of the resolution of a financial institution.

[1] Article 8(4) FCD. See also Annex 3 of the EPTF’s 2017 report, p. 230

[2] Article 2(k) SFD, which refers to multi-lateral netting used in the operation of an SFD system as opposed to close-out netting used for the realisation of collateral security in an SFD system. According to Annex 3 of the EPTF’s 2017 report, p. 230, most Member States have used the SFD to protect ‘netting’ between direct SFD participants and their clients)

[3] EPTF’s 2017 report, sub-section 1.1, 2nd bullet, p. 74 as well as Annex 3 of the EPTF’s 2017 report, which cites Articles 49, 68, 76 and 77 BRRD, p. 230.

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

Yes

- ○ No
- ○ Don’t know / no opinion / not relevant

Question 4.1.1. What were these problems related to?

- ○ use within one Member State
- ○ cross-border use
- ◉ both

Question 4.1.2. What did these problems concern?

- ○ OTC transactions
- ○ transactions carried out on an SFD system
- ◉ both

Question 4.1.3 Please describe the problems and the outcome:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

As noted above, the protections provided by the FCD provide significant comfort in respect of credit risk mitigation techniques used in the market and, where relevant, support the analysis in respect of regulatory capital requirements. We consider it advantageous for the FCD to have as broad an application as possible and for national divergence to be minimised. When there are discrepancies in the requirements for the FCD's protections to be provided (for example, arising from variations in personal scope, acceptable financial collateral or governing law requirements) this impedes the certainty in the market and can lead to fewer market participants being willing to transact with particular counterparties or in certain fact patterns (as well as creating additional expense in determining the level of comfort regarding the application of the protections of the FCD).

Question 4.1.4 Please describe a solution that you consider appropriate:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

n/a

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

- (•) Yes
- ( ) No
- ( ) No legal opinions collected / don't know / no opinion / not relevant

Question 4.2.1 please specify why and how the legal opinions you have collected were changed:

5000 character(s) maximum
including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

ISLA commissions a wide range of legal opinions to support the securities lending agreements published by ISLA. These opinions focus on the set-off/netting analysis in a range of jurisdictions and also consider whether certain security arrangements qualify as security financial collateral arrangements. These opinions relate to uncleared transactions and therefore the framework for the recovery and resolution of central counterparties will only be relevant to the extent the opinions consider the analysis when facing central counterparties acting in private capacity.
These legal opinions will consider in detail the effect of BRRD2, as implemented into applicable national law, and will include all appropriate qualifications arising from the regime. These will typically include any stay or moratorium on termination and/or enforcement of security and firms will consider the implications of these qualifications when considering any contractual arrangement with a potential counterparty.

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

- (•) Yes
- ( ) No
- ( ) No legal opinions collected / don't know / no opinion / not relevant

Question 4.3.1 please specify why and how the legal opinions you have collected were changed:

5000 character(s) maximum
including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

ISLA commissions a wide range of legal opinions to support the securities lending agreements published by ISLA. These opinions focus on the set-off/netting analysis in a range of jurisdictions and also consider whether certain security arrangements qualify as security financial collateral arrangements. These opinions relate to uncleared transactions and therefore the framework for the recovery and resolution of central counterparties will only be relevant to the extent the opinions consider the analysis when facing central counterparties acting in private capacity.
These legal opinions will consider in detail the effect of BRRD2, as implemented into applicable national law, and will include all appropriate qualifications arising from the regime. These will typically include any stay or

moratorium on termination and/or enforcement of security and firms will consider the implications of these qualifications when considering any contractual arrangement with a potential counterparty.

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

- (●) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

There are currently no applicable provisions on the EU level which aim to harmonise the avoidance provisions in the context of insolvency or similar proceedings in the national laws of the Member States. We would welcome close-out netting, to the extent it relates to financial obligations, being exempted from national avoidance provisions.

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

- ( ) Yes
- ( ) No
- (●) Don't know / no opinion / not relevant

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

- (●) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

Question 4.5.1 Please explain your reasons as well as possible solutions taking into account possible interactions with other national or EU law (e.g. WUD (Directive 2001/24/EC), BRRD (Directive 2014/59/EU), CCP RR (Regulation (EU) 2021/23)) and the importance of close-out netting for risk management and the calculation of own funds requirements for credit institutions and investment firms under the CRR:

5000 character(s) maximum
including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We consider that it would be helpful for EU legislation to provide for further harmonisation of the treatment of contractual netting in general, and close-out netting in particular, irrespective of whether such arrangement forms part of a financial collateral arrangement.
This is a broader issue and will affect other sections of the market more significantly than securities lending agreements in particular, since the standard documentation includes a collateral component so the FCD protections should apply (subject to the discussions above on the expansion in scope of the FCD) unless parties have modified the documentation to enter into uncollateralised transactions.
It is not uncommon, however, for parties to agree to enter into uncollateralised transactions and create a netting set that consists of a mix of collateralised and uncollateralised transactions or consists solely of uncollateralised transactions giving rise to exposures to each party. The benefits of close-out netting for either type of netting set are recognised in the regulatory framework of the financial market in the EU (e.g. in the CRR and BRRD) but, without additional protections in the local implementation or under other local law, the FCD currently only clearly safeguards close-out netting in connection with a financial collateral arrangement. The FCD does not, without additional protections in the local implementation or under other local law, create a general legal framework for close-out netting regarding netting sets of uncollateralised financial obligations and on that basis we consider that the FCD could be helpfully expanded to address this. If considered preferable, this issue could instead be dealt with in legislation addressing the efficacy of close-out netting arrangements more broadly.

5. Financial collateral

To keep up with market and regulatory developments affecting financial collateral that is currently used or may be used in future by market participants the current list of eligible financial collateral under the FCD ought to be put under review either to broaden or update it.

Possible updates of the definition of financial collateral under the FCD also have an impact on SFD collateral security, which covers all realisable assets including FCD financial collateral. Currently, financial collateral under the FCD consists of cash, financial instruments and credit claims.

In the light of the development of crypto-assets the question arises if the financial collateral definition in the FCD ought to be extended to encompass such so-called stable-coins once they are regulated in the EU (the Commission published a proposal for a Regulation on Markets in Crypto-assets, and amending Directive (EU) 2019/1937). These questions concern especially e-money tokens (which aim to maintain a stable value by referencing one single currency) or asset-referenced tokens (which do so by referencing several fiat currencies, one or several commodities / other 'crypto-assets').

Furthermore, although FCD financial instruments encompass transferable securities, money-market instruments and units in collective investment undertakings that are listed in MiFID 2, the FCD definition differs from the MiFID 2 definition: FCD financial instruments do not include derivatives listed in MiFID 2, except for certain options in respect of shares or bonds; nor do they include emission allowances. The exclusion of emission allowances was due to the fact that they were not in existence when the FCD was first adopted and were only recently listed as financial instruments under MiFID 2.

The FCD intends to be technologically neutral. Therefore, one could assume that financial instruments issued by means of distributed ledger technology (DLT) that fall within the definition of financial instruments of the FCD are within the scope of the FCD and could also be eligible as financial collateral under the FCD. However, questions could arise regarding the FCD requirement that financial collateral must "be in the possession or under the control of the collateral taker or of a person acting on the collateral taker's behalf". To be covered by the FCD, possession or control of the collateral by the collateral taker would have to also be ensured in a DLT environment. According to the public

consultation on markets in crypto-assets, possession and control can be challenging in the context of DLT as, in many models, what might constitute legal ownership in a DLT may be unclear. This is primarily a matter for national securities, corporate, contract and/or property law. Moreover, regarding enforcement, respondents indicated that in some cases the enforcement of rights relies on the actions of others (e.g. where private keys from different parties are needed to transfer an instrument and/or validation of transfer requires consensus from different nodes). The afore-mentioned issues raise the question of whether crypto-assets qualifying as FCD financial instruments should be included within the scope of eligible financial collateral under the FCD (and if so under which conditions) and whether clarifications in the FCD would be needed. Furthermore, there might possibly be the need for clarification whether records on a DLT could qualify as book-entries on a 'relevant account' in relation to 'book-entry securities collateral' under the FCD.

Regarding credit claims it has been suggested by some stakeholders to amend the FCD to exclude a debtor's set-off rights for credit claims that are provided as collateral to central banks. This exclusion should also cover in their opinion any third party to whom the credit claim is subsequently assigned. Set-off rights give the debtor of a credit claim the right to reduce the outstanding amount of its debt by the amount of counterclaims it has against the lender. They are, therefore, important for the debtor in case of an insolvency of the lender. On the one hand, set-off rights pose a risk in taking credit claims as collateral, in particular for central banks. This risk varies across jurisdictions and across banks. It is also volatile as it depends on the daily value of the debtors' counterclaims. Hence, this makes the valuation of a credit claim taken as collateral more difficult. Moreover, the cost of low operational efficiency of such collateral may not be negligible. As a result, many central banks do not accept credit claims as collateral unless set-off rights are excluded. On the other hand, this might raise legal issues in the context of consumer and debtor protection. Prohibiting set-off would shift the risk of insolvency of the bank, which assigns the credit claim as collateral to a central bank, from that central bank to the original consumer (e.g. account holder) / debtor (e.g. mortgagee). Thus, potentially worsening the debtor's position in the event of the failure of its bank. This could potentially have an impact on the real economy, in particular on households and SMEs.

General questions

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

- ○ Yes
- ◉ No
- ○ Don't know / no opinion / not relevant

Question 5.2 Do you see the need to update the definitions of currently eligible collateral?

- ☑ I see the need to update the definition of **cash**
- ☑ I see the need to update the definition of **financial instruments**
- ☐ I see the need to update the definition of **credit claims**

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We consider that updates could be helpfully made to the definitions of cash and financial instruments and agree with the specific proposals made in the consultation response provided by ISDA.

We do not see a need to update the definition of credit claims, although note it is less relevant to securities lending arrangements.

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

5000 character(s) maximum
including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We consider that updates could be helpfully made to the definitions of cash and financial instruments and agree with the specific proposals made in the consultation response provided by ISDA.
We do not see a need to update the definition of credit claims, although note it is less relevant to securities lending arrangements.

Financial instruments

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

- (●) Yes, they are a commnly used financial collateral and should therefore be eligible as collateral under the FCD
- ( ) No, emission allowances do not provide a sufficiently stable value to be used as financial collateral under the FCD
- ( ) Don’t know / no opinion / not relevant

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

- ( ) Yes
- (●) No
- ( ) Don’t know / no opinion / not relevant

Question 5.5.1 Should the notion of *‘account’* be retained, replaced or further clarified/specified for the purposes of evidencing the provision of cash or securities collateral provided through DLT?

- (●) Retained
- ( ) Replaced
- ( ) Further clarified/specified
- ( ) Don’t know / no opinion / not relevant

Question 5.5.1.1 Please explain why you think so and how this matter might be solved:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

The FCD defines "relevant account" in relation to book entry securities collateral which is subject to a financial collateral arrangement, as the register or account – which may be maintained by the collateral taker – in which the entries are made by which that book entry securities collateral is provided to the collateral taker.
This definition is sufficiently broad to cover a register or account that may be maintained using DLT. In this context, however, please note our response to 7.3.

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

- (•) Retained
- ( ) Replaced
- ( ) Further clarified/specified
- ( ) Don't know / no opinion / not relevant

Question 5.5.2.1 Please explain why you think so and how this matter might be solved:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

The FCD defines "book entry securities collateral" as financial collateral provided under a financial collateral arrangement which consists of financial instruments, title to which is evidenced by entries in a register or account maintained by or on behalf of an intermediary.
This definition is sufficiently broad to cover a register or account that may be maintained using DLT.

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

- ( ) Yes
- (•) No
- ( ) Don't know / no opinion / not relevant

Credit claims

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

- ( ) Yes

- No
- Don’t know / no opinion / not relevant

6. The FCD and other Regulations/Directives

The proper functioning of the FCD also requires clarity regarding its interaction with other relevant legislation.

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

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

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

- Yes
- No
- Don’t know / no opinion / not relevant

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

- Yes
- No
- Don’t know / no opinion / not relevant

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

- Yes
- No
- Don’t know / no opinion / not relevant

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

- Yes
- No
- Don’t know / no opinion / not relevant

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

n/a

7. Other issues

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

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

Please provide examples of such instances:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

n/a

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

n/a

Question 7.3 Is there anything else you would like to mention?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Prior to proposing any amendments to the FCD (or any similar or related legislation) to facilitate or promote the use of either DLT or crypto assets within the EU, we would encourage the Commission to conduct a thorough review and impact assessment on the potential impact of any such modifications on financial transactions not making use of DLT or crypto assets.

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

Creating a precise definition or taxonomy of different types of DLT system and/or crypto asset or digital asset is challenging, due in part to 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. This lack of taxonomy presents difficulties in determining the extent to which DLT-based collateral systems might fall within or outside of the scope of the FCD. For example:

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

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

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

Additional information

Should you wish to provide additional information (e.g. a position paper, report) or raise specific points not covered by the questionnaire, you can

upload your additional document(s) below. **Please make sure you do not include any personal data in the file you upload if you want to remain anonymous**.

The maximum file size is 1 MB.
You can upload several files.
Only files of the type pdf,txt,doc,docx,odt,rtf are allowed

6b06ee46-74d5-4f2d-9e99-f7d21283cd10/ISLA_-_FCD_2021_consultation_response_Final.docx

Useful links

More on this consultation (https://ec.europa.eu/info/publications/finance-consultations-2021-financial-collateral-review_en)

Consultation document (https://ec.europa.eu/info/files/2021-financial-collateral-review-consultation-document_en)

Related targeted consultation on the review of the Settlement Finality Directive (https://ec.europa.eu/info/publications/finance-consultations-2021-settlement-finality-review_en)

More on financial collateral arrangements (https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/post-trade-services/financial-collateral-arrangements_en)

Specific privacy statement (https://ec.europa.eu/info/files/2021-financial-collateral-review-specific-privacy-statement_en)

More on the Transparency register (http://ec.europa.eu/transparencyregister/public/homePage.do?locale=en)

Contact

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