Patrick Pearson
DG-FISMA
European Commission
Brussels
Belgium

15 November 2017

Dear Mr Pearson,

FIA Response to the European Commission's consultation "Post Trade in a Capital Market Union"

We set out below our contribution to the European Commission's consultation "Post Trade in a Capital Markets Union". We look forward to supporting the actions to be proposed in the forthcoming Communication on Post Trade planned for the end of 2017 as part of the CMU Mid Term Review. The key observation of our members with respect to CMU is that capital markets are global and require globally relevant policy solutions. We ask the European Commission to evaluate its post trade action plan against this principle, in line with the spirit of the FIA's response to the *Call for Evidence: EU Regulatory Framework for Financial Services* (Jan 2016).[1]

This is a critical moment in the development of the CMU and we encourage the European Commission to ensure that the strategic direction of the CMU project is true to the authentic values of the project as articulated by the EU27 Heads of State and the leadership of the European Union institutions in parallel to its work on the detail of the technical identification of regulatory and legal barriers. These values include promoting growth, competitiveness and greater cohesion of the Single Market in the context of tackling global challenges.

We agree that the ultimate purpose of strengthening the potential of the EU27 capital markets is to ensure that the EU27 can be globally competitive. We welcome that the EU27 leaders in the Rome Declaration of March 2017 calls for "a stronger Europe on the global scene", the CMU Mid Term Review of June 2017 recognises "increasing interconnectedness of financial markets, EU and globally" and the Five Presidents Report of June 2015 declares that "a complete Economic and Monetary Union is not an end in itself. It is a means "…to prepare the Union for future global challenges", whilst declaring that CMU is a key element of delivering this objective.

CMU should seek to successfully achieve two specific, mutual supporting, objectives: building a stronger European financial market, with the ultimate aim of ensuring that Europe's financial market is competitive in the global financial markets.

The very concept of a Union for Capital Markets (CMU) should be outward looking and be envisaged with a constantly evolving and dynamic competitive mind-set. It would be suboptimal to solely focus on internal coherence and a single point in time of regulatory implementation. To build stronger international financial centres in the EU, it is critical that it is attractive and accessible to global market participants, because the depth of serving the Single Market alone risks not being sufficient to thrive in international competition. A higher number of jobs and a greater amount of growth would be promoted through the creation of a successful and integrated European capital market that successfully competes with its global peers through an outward looking approach

To deliver this vision, it is critical that the regulatory framework applicable to capital markets is globally consistent, whilst also leaving room to address more regional market issues. Any action by the EU that is significantly diverging from actions taken in a coordinated, controlled fashion by fellow regulators in other major relevant non-EU markets risks causing a fragmentation of liquidity (so hampering the ability

[1] https://fia.org/articles/fia-response-european-commission-call-evidence-eu-regulatory-framework-financial-services

of end users to risk manage their exposures as part of their legitimate hedging strategies) and significant market disruption (as users and service providers move their business outside of the EU). If global regulations are not well coordinated, markets could balkanize along regional lines, harming participant access, lessening market liquidity, reducing market transparency and concentrating risk. This is particularly relevant for CCPs, given their heightened importance in the global financial system following the 2009 G20 Commitments. In practice, this means that it could beneficial for the EU to establish a dialogue with key global capital markets jurisdictions about the next phase of the CMU - this could include key jurisdictions in Asia, the US and (post-Brexit) the United Kingdom, as well as ensuring consistency with global standard setting bodies such as the G20, CPMI-IOSCO, the Basel Committee and the Financial Stability Board.

We welcome the enormous progress that has been made in overcoming barriers and through a mixture of legislation, harmonisation of market practice and system innovations such as T2S. We look forward to the next action plan and we believe there is tremendous potential to move towards and even more integrated and seamless post-trade market in Europe, and for end investors to enjoy the benefit of this.

The Commission should seek to ensure that no new unnecessary barriers[2] are created that would undermine hard won progress or reduce the ability of the European financial system to be globally competitive, accessible and attractive. We recognise the importance of continuing technical efforts to deliver solutions to the issues raised by the Giovannini and European Post Trade Forum processes.

Equivalence arrangements are a critical tool, given that the derivatives markets are truly global. For financial stability reasons, it is imperative that EU27 users of third country derivatives markets be able to access all third country trading venues and CCPs at which material levels of liquidity exist, in order to ensure that such firms can manage their risk. Likewise, EU27 trading venues and CCPs are the current dominant home of global liquidity in certain products that are traded by EU27 and third country users alike, and it is equally important that third country market participants have unfettered access to such EU27 pools of liquidity and risk management.

Appended to this letter are a series of responses to the specific questions raised in the consultation paper.

We strongly support the desire of the European Commission to ensure that EU laws are technologically neutral and do not become an active barrier to desirable, successful, innovation. Technology has the potential to create and drive significant further jobs and, in particular, growth across the European Union. We note the repeated references to distributed ledger technology within the draft consultation, but also encourage the European Commission to give further consideration to the roles that smart contracts, artificial intelligence, machine learning, big data analysis, cloud computing and other aspects of Fintech may play in post-trade markets over the next 5 to 10 years.

All of the simplification and digitalisation opportunities will depend upon the active engagement of legislators and regulators in efforts to harmonise common process and data standards, and to adopt a common approach to architectural design. If this does not occur then the post-trade landscape could become more expensive and less efficient that it is today, not least due to legacy IT architecture being layered with new architecture, in a still-silo'd and disjointed manner.

[2] As noted by Robert Ophèle, head of the Autorité des Marchés Financiers, in a speech[2] given on 13 November 2017: "Any measure that involves abrupt relocation of clearing, whether in the case of a hard Brexit or in the case of the implementation of the currently planned measure planned in the revised European Market Infrastructure Regulation will hurt firstly the European economy. It must then, in my point of view, be avoided."

However, with the right vision and stewardship across industry participants and regulators, the next 5 to 10 years could prove a truly transformational opportunity for post-trade in a Capital Market Union.

We would be delighted to discuss these issues with you further.

Yours sincerely,

Simon Puleston Jones
Head of Europe, FIA

Question 1 – main trends in post-trade in the EU

1(a) Most relevant trends

From the list suggested in question 1(a), “new technological developments such as DLT” will prove the most impactful in post-trade processing. This is based on additional criteria, listed below, that need to be factored in promoting efficiencies in post-trade processing:

1. Sustainability of increasing operational complexity and costs with shrinking revenues; and
2. Lack of standardisation and regulatory harmonisation across asset classes, functions and jurisdictions, resulting in duplication and increased complexity.

Of these, harmonisation of regulatory requirements and promotion of industry standards are critical to facilitation of the planned adoption of emerging technologies, so as to avoid perpetuating the bifurcation in existing infrastructure.

1(d) Main trends over the next 5 years

1. Adoption of new technology/DLT
2. Further harmonisation of clearing and settlement, driven by leveraging T2S and increased regulatory harmonisation
3. Consolidation/reduction of market players/infrastructure

Question 2 – Technological developments and their implications for post-trade

2(a) Elements of possible benefits of DLT

In general, we are in agreement with the themes identified. In order of priority, the greatest benefits of a shared persistence model through the use of a DLT framework in post-trade processing are as follows:

1. Drive standardisation of non-differentiated processes/events and associated data
2. Elimination of duplication and reconciliation across market participants
3. Simplification of front-to-back flows, by elimination of redundant steps
4. Promotion of faster and transparent data access, with direct access to data by regulators
5. Reduction of risk and improved capital efficiency, due to shortened settlement lifecycles
6. Promotion of market competition, via enhanced services for workflow automation (especially for OTC products)
7. Significant efficiencies in current run costs across market participants

2(b) DLT risks

The identified risks can be mitigated through common standards underpinning adoption of DLT and related technologies. Lack of such standards will:

1. Perpetuate the fragmentation across asset classes and functions, resulting in disparate infrastructure and thereby requiring high levels of maintenance and operational support
2. Significantly increased adoption cost
3. Inhibit realisation of the full benefit from evolving technological advances in related areas

Significant additional testing is required to prove the resilience of DLT platforms, many of which can currently be considered emerging technologies.

DLT is not yet ready for wholesale use across the industry. The path to broad adoption of DLT is only achievable if it is implemented as a market-wide solution. Most current industry offerings are in an interim state, which involve tokenising existing inventory by delivering securities to a trust account and receiving equivalent digital tokens to trade on the chain. Because not all inventory is managed in this way, firms now have to maintain separate management of tokenised and legacy inventory and also often require integration with legacy payment rails for the cash side of settlement. Financial market infrastructures must have a significant role in driving forward DLT as a market-wide solution, given their high levels of regulation and supervision, and the central role that they play in markets.

The Consultation Paper assumes that DLT will provide certainty on “whom owns what”, where no intermediaries are involved. However, it is likely that if cross-border investors use a market-specific DLT solution (e.g. a US investor buying French assets), then they may well want to use an intermediary to manage those assets on their behalf and to provide market-specific advice, such as tax advice.

2(c) Existing legal environment

To the extent that the legal environment refers to enforceability of contractual agreements, relevant technologies can help facilitate and improve the current environment through standardised contract definitions, data transparency and lineage and simplified, timely processing.

Variation across historical counterparty agreements may inhibit adoption of certain use cases.

Legal processes and structured have not kept pace with technology and as such legal and compliance-related issues will likely slow the advancement of platforms.

2(d) Specific proposals as to how the existing post-trade legislation could be made more technologically neutral

A critical element in making current and future legislation technology-neutral is through the adoption of common data and process standards across industry participants, regulators and jurisdictions. Lack of such standards have resulted in significant complexity in current processes and infrastructure that cannot be sustained in the long run.

<u>Question 3 – the areas of post-trade that are most prone to systemic risk</u>

Questions 3(a)-(c) Areas, drivers and solutions for systemic risk

Collateral availability, liquidity and mobility

Regulation has improved the quality of collateral provided to CCPs, which in turn has reduced systemic risk. However, the global pool of such high-grade collateral is ultimately finite and demand for that collateral has correspondingly increased.

Challenges relating to access to liquid pools of high-quality collateral can be met through increased harmonisation of collateral management activities. In that regard, we note the work of the Collateral Management Harmonisation Task Force of AMI SeCo[3] and encourage the European Commission to monitor and support the work of that task force.

Post-trade risk reduction services (e.g. "compression", as to which, see the following page of our response below) and the cross-product netting of exposures at CCPs should also be encouraged, as a means of alleviating some of this burden on collateral sourcing, increasing collateral efficiency and reducing operational risk.

As regards the process of tracking collateral re-use and ownership, innovations such as distributed ledger technology may improve transparency, reduce disputes between counterparties and improve collateral mobility.

Counterparty credit risk

Following implementation of the G20 2009 policy objectives, such as the central clearing of derivatives and the introduction of various risk mitigation techniques (e.g. margining requirements), counterparty credit risk has become re-focused towards post-trade clearing relationships rather than bilateral relationships. Despite the changes, the need to manage and reduce counterparty credit risk, and thus systemic risk, is still imperative.

Reduction of counterparty credit risk – inside CCPs and bilaterally – can be achieved by the use of post trade risk reduction services. The use of such services would also lead to less initial margin and/or collateral having to be posted bilaterally or to CCPs, thus alleviating the stress to find acceptable assets.

The lack of an overall G-20 framework for governing the regulation and supervision of post-trade risk reduction activities such as portfolio rebalancing is an existing barrier that could be preventing post-trade risk reduction services from being used to relieve this stress.

In the absence of such a framework, the market-risk-neutral, multilateral, all-or-nothing transactions arising from the post-trade risk reduction process are at risk of being miscategorised as secondary market, price forming, trading transactions. The regulatory treatment of trades that result from portfolio compression should be clarified: for example, it should be made unequivocally clear that such trades are not subject to the mandatory trading obligation under MiFIR nor the mandatory clearing obligation under EMIR.

In parallel, work is needed to develop *international* principles governing the regulation and supervision of "post-trade risk reduction" activities, so as to promote horizontally consistent and appropriate

[3] The Eurosystem's Advisory Group on Market Infrastructures for Securities and Collateral

supervisory oversight, provide clarity for market participants and safeguard future risk reduction in the EU and global financial markets.

Other issues

Other issues include:

1. operational risk in sustaining complexity in post-trade processing;
2. a large amount of legacy technology is in use across the industry; and
3. lack of standards and harmonisation in regulatory requirements.

The European end-user and buy-side community is quite diverse. However, it does almost universally agree that a European single-market needs more standardised processes. The excess costs trickle down to institutional and retail clients. Therefore the priorities in clearing and settlement often cited by clients are:

1. on-going focus on the public sector barriers (originally defined by the Giovannini Group in 2001 and 2003), which require legislative action to overcome national differences;
2. continued focus on reduced settlement cycles, to encourage higher levels of automation and reduced operational risk;
3. regulatory action, via mandates or incentives, to promote higher levels of automation amongst buy-side firms, especially smaller entities that still make extensive use of fax, email etc. in their post-trade processes;
4. increased standardisation of the asset servicing processes, particularly on corporate actions, where differentiated processes introduce excess cost and risk; and
5. a consolidated and more standardised community of CSDs, which would lower the barriers to entry, increase competition and enhance user choice.

Technology enablers alone cannot alleviate these issues – their adoption needs to be facilitated through common standards, principles and interoperability requirements.

<u>Question 4: the international dimension and competition in post-trade</u>

Question 4(a) Main trends shaping post-trade internationally

FIA agrees with the trends identified in Question 4(a) and place them in the following order of importance:

1. Growing importance of collateral (as identified by the increasing requirement for comprehensive collateral cover to reduce risks in the market), which requires more comprehensive collateral management systems etc.
2. Internationally agreed principles
3. Lack of full harmonisation of internationally agreed principles

We would also add "shortened settlement cycles" to this list.

Question 4(b) Fields of EU post-trade legislation that would benefit from more international coherence

1. Reporting: due to complex cross-border jurisdictional rules and data requirements.
2. Clearing: such international coherence can better promote positive equivalence assessments of third country CCPs.
3. Mandatory trading obligations: such international coherence can better promote positive equivalence assessments of third country trading venues.

Question 4(c) Making EU financial market infrastructures more attractive internationally

The removal of operational barriers and harmonisation of rules.

Question 4(d) Competition and consolidation

EU post-trade services would particular benefit from more competition, guided through adherence to industry-wide standards and principles.

A number of risks exist in the post-trade landscape as a result of pending regulation that could hinder the Capital Markets Union. These could all be broadly covered under the barrier of inconsistent regulatory framework for financial services between EU and other global markets. Examples include the following, each of which could make Europe less competitive internationally:

1. Cross-jurisdictional differences in risk mitigation requirements (e.g. as regards physically-delivered FX forwards);
2. The BRRDII proposals regarding moratoria, which could have a significant impact on netting[4]; and

[4] Cf. the comments of ECB Board member Yves Mersch on 10 November 2017 at the Cumberland Lodge Financial Services Summit:

"Another example relates to issues arising with regard to the proposed moratorium tool under the BRRD. The recent proposal to amend the BRRD, empowers competent and resolution authorities to suspend certain payments and delivery obligations, if this would help facilitate recovery and resolution. Of course, the proposal ensures exemptions from the moratorium tool related to FMIs, including CCPs. It may be necessary to consider whether there is a need to exempt recognise third-country central securities depositories and third-country payment systems subject to a cooperative oversight arrangement involving at least one central bank in of the ESCB.

The rationale is that a suspension prohibiting a participant (e.g. a credit institution) from making any payments to an FMI will de facto cause that participant to no longer be able to meet its obligations as they fall due. For payment obligations to FMIs, this would place the participant

3. The inclusion of initial margin haircutting as a tool in the CCP Recovery and Resolution Regulation.

In the composition of regulation, consideration should be given to:

1. How similar regulation is, or may in future be, implemented in other jurisdictions, so as to ensure that the EU is aligned with global standards; and
2. How such regulation can be applied to non-EU market participants seeking to use EU financial market infrastructures and/or transact with EU counterparties.

A "regulatory uncertainty" barrier also exists, due to the patchwork of equivalence determinations that are required in order for global businesses to operate, combined with a series of no-action relief statements, both of which could be disapplied by regulators. It is unclear precisely what the impact is on the validity of existing contracts if the cross-border rules change during the lifetime of an arrangement or transaction (e.g. through enforcement of a CCP location policy pursuant to the EMIR Review). To mitigate this concern, FIA recommend that as much transparency and forewarning be provided to the industry with respect to such decisions, with appropriate lead times, so as to enable industry to consider the impact of such changes on the market, give due consideration to the operation of outstanding arrangements and, to the extent possible, restructure their business models and practices.

in default. Without an exemption for this type of payment, the moratorium would actually have the potential to amplify systemic risk before the FMI safeguards kick in."

<u>Question 5(a): the future of post-trade markets over the next 5 to 10 years</u>

Question 5(a)(i) EU post-trade markets in 2022

Post-trade services will be significantly simplified, even over a 5 year timeframe. This process will be driven by necessity, to promote sustainability of the industry and to spur growth.

Ongoing consolidation of custodians will continue and that the process of consolidation of CSDs has started.

The cycle of post-trade regulation has largely now been completed in Europe[5] and most of the major EU rules have now been implemented or are in the process of being so. The EU regulatory changes during this decade have significantly increased settlement efficiency, particularly through the mandating of on-venue execution and the central clearing of derivatives.

DLT

A very small number of distributed ledger technology-based solutions have been implemented in the financial services industry to-date, although a large volume of work and innovation is in progress across the EU and more internationally. One of the several benefits of DLT is that such technology can promote the adoption of large-scale changes that can be built for whole-market solutions. One of the primary barriers is adoption – specifically, procuring a material number of market users to adopt the technology at or about the same time.

Enhanced co-operation agreements with third countries

Further to our letters of 6 June 2017[6] and 7 September 2017[7] to European Commission Vice-President Valdis Dombrovskis and as noted above, FIA's view is that rather than forcing the relocation of the clearing of certain derivatives contracts so that they can only be cleared through EU27 CCPs, a more proportionate, effective and efficient model to address the valid and legitimate concerns of the EU27, the UK and the US is for regulatory and supervisory authorities in those jurisdictions to enter into enhanced co-operation arrangements.

We have seen limited progress to overcome legal and tax fragmentation within the EU. However, we envisage that the Withholding Tax Code of Conduct adopted by the EU markets will have been implemented and adhered to by 2022.

Question 5(a)(ii) EU post-trade markets in 2027

It is challenging to accurately see so far into the future, but we would anticipate that the current trends of consolidation, technological innovation and the "utilisation" of various aspects of financial services will continue and, in many areas, accelerate.

Maturity of relevant technology enablers and broad-based industry adoption is expected to take at least until the end of the next decade.

We foresee that utilities, which could be run by market infrastructures, authorities or by bank-mandated consortia will be established for numerous post-trade activities in the coming years. These could focus

[5] The EU's proposed regulation on CCP recovery and resolution is an important outstanding part of the process.
[6] https://fia.org/articles/fia-cautions-against-forced-relocation-euro-clearing
[7] https://fia.org/articles/fia-relocation-not-necessary-enhanced-central-counterparty-oversight

on standardising and centralising processes related to asset servicing, safekeeping, KYC and AML, custody, regulatory reporting, tax processing, registration, shareholder information, General Meeting processes, static data management, management of Standard Settlement Instructions, identity management, risk management etc. ESMA's current outsourcing rules could constitute an inhibitor to these developments in the short term. Cloud computing has the potential to add cost, security, scalability and time to market benefits, however the "one size fits all" approach to the definition is a barrier to this.

Much more focus will be put by banks on core functions. While this could lead to streamlined and efficient processes it could also mean that knowledge will be lost at the banks and potentially not developed further by the utilities.

As noted above, FIA encourages the European Commission to give further consideration to the roles that smart contracts, artificial intelligence, machine learning, big data analysis, cloud computing and other aspects of Fintech may play in post-trade markets over the next 5 to 10 years.

Question 5(b) Main challenges over the next 10 years

1 = address first
8 = address last

Trend	1	2	3	4	5	6	7	8
fragmentation of EU markets				X				
need for greater EU harmonisation of legal and operational frameworks		X						
need for more competition within the EU						X		
need for greater consolidation					X			
lack of international competitiveness			X					
need for more regulatory coherence internationally	X							
financial stability issues							X	
others								X

Our feedback above regarding the need for greater consolidation solely refers to CSDs, rather than other financial market infrastructures.

Question 6: overcoming barriers

Question 6(a) Barriers removed over the last 15 years

There are fewer barriers for cross-border provision of clearing and settlement services and processes than 15 years ago – notable successes include:

1. equivalence arrangements relating to mutual recognition of third country trading venues, CCPs and trade repositories
2. T+2 settlement
3. standardised settlement protocols
4. the benefits that CSDR will bring
5. harmonized non-business days[8]
6. unified messaging standards in the T2S communication and corporate action standards[9]

Question 6(b) Drivers for removal of barriers

Equivalence arrangements are a critical tool, given that the derivatives markets are truly global. For financial stability reasons, it is imperative that EU27 users of third country derivatives markets be able to access all third country trading venues and CCPs at which material levels of liquidity exist, in order to ensure that such firms can manage their risks. Likewise, EU27 trading venues and CCPs are the current dominant home of global liquidity in certain products that are traded by EU27 and third country users alike, and it is equally important that third country market participants have unfettered access to such EU27 pools of liquidity and risk management.

Multiple Infrastructure Memberships are still needed from a clearing perspective and largely also for CSDs - this market access issue results from the silo'd group structures of exchanges and CCPs.

More links have been opened through CDSs - through T2S, a majority of markets could potentially be accessed through one CSD account. However, differences in local market laws may limit the take up of such an approach.

T2S has been a significant driving factor in the abolishment of the differences in operating hours and settlement deadlines. A large portion of the European markets are adhering to this harmonised calendar.

National differences in settlement periods have been eliminated by CSDR, however the suggestion has been driven by the work of CESAME and the respective industry led sub-group analysing the optimal settlement period from a risk and efficiency perspective.

Intra-day settlement finality has been driven by CSDs and the introduction of new settlement models, with the use of central bank money rather than commercial bank money.

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[8] However such harmonisation should operate cross-systems, e.g. between T2 and T2S. T2S markets also continue to work on a harmonised approach to the respective opening hours on specific holidays such as Good Friday, Easter Monday or 1st May.

[9] Albeit these barriers have not yet been fully dismantled

Question 7: Remaining barriers to post-trade

Leverage Ratio

FIA note the concerns of the European Commission regarding on-going limitations on access to central clearing, as expressed in Part 1 of the EMIR Review (REFIT) during 2017.

It is the leverage ratio under the Capital Requirements Regulation that, for many clearing brokers, constitutes the binding constraint of their capacity to provide clearing services to their clients.

For the last several years, FIA's key advocacy message has been that the leverage ratio under CRR should be amended to recognise the exposure-reducing effect of margin that clearing brokers receive from their clients. We are pleased to see that the European Commission have acknowledged the very detrimental impact that the leverage ratio, as currently drafted, has on access to client clearing and the fetter that it places on the successful implementation of the EMIR mandatory clearing obligation by all firms whom are subject to such obligation. To that end, we look forward to the completion of the proposed changes to CRR as soon as possible, such that the leverage ratio provide for such a margin offset.

EMIR Review – Conflict with national EU Member State insolvency laws

EMIR recital 64 provides that the requirements in EMIR on the segregation and portability of clients' positions and assets should prevail over any conflicting laws, regulations and administrative provisions of Member States that prevent the parties from fulfilling them. However, it is unclear whether EMIR actually overrides national Member State insolvency laws. Some member states have implemented changes to insolvency laws to implement EMIR fully, notably the UK, Germany and Italy. Other countries have amended their legislation only to protect arrangements involving national CCPs (e.g. France) and others have done nothing, relying on interpretations of EMIR recitals but having conflicting national insolvency laws (e.g. Netherlands, Belgium, Luxembourg). Some of these member states are important venues for derivatives clearing, being the place of business for some CCPs and many clearing members and the location for the holding collateral through central securities depositories. Some member states' regulators whose legislators have not addressed insolvency issues have raised enforcement and compliance issues with CCPs and their clearing members; this seems rather inequitable, given that these are matters for the legislature and regulators to resolve. The UK has amended Part VII of its Companies Act to align UK insolvency laws with the intent of EMIR, but we note the limitations of this approach are that such amendment only operates to protect payments to a client where the parties in the chain are all located in England or Wales. Germany has made similar changes to its domestic legislation. In practice, most indirect clearing facilities will involve parties in different jurisdictions. More broadly, it remains subject to debate whether European Union legislation is capable, under the EU treaties, of overriding member state insolvency laws.

EMIR Review – no over-ride to property laws

EMIR portability provisions should also mandatorily over-ride property laws. The bankruptcy trustee of MF Global US asserted that it owned property rights in proprietary account margin that had been transferred to various CCPs to cover proprietary account positions of its affiliated clearing member, MF Global UK and that CCPs had acted contrary to those rights in applying the margin against proprietary account liabilities or porting. The possibility of such challenges being successful and EMIR's acquiescence in their existence may mean that some European CCPs are reluctant to engage in porting.

EMIR Review - Reporting

The complexity of reporting requirements are a continuing, and possibly worsening, barrier within the EU, due to the plethora of overlapping, and in places inconsistent, reporting obligations across a range of regulations.

FIA welcomes the proposals relating to the simplification of the EMIR reporting regime. We continue to believe that ETD reporting should not be required under EMIR, given that the relevant details are reportable under MiFIR. Should single sided reporting of exchange traded derivatives still be required under EMIR, then FIA encourages the Commission to clarify the following:

1. will the clearing member-to-client trade still be reportable?
2. if it is still reportable, does the CCP have to report both the CCP-to-clearing member trade and the clearing member-to-client trade?
3. what, if any, are the ongoing obligations of the clearing member and/or client to check the accuracy of the data that has been reported on their behalf by the CCP?
4. do the reporting requirements apply to trades cleared through a third-country CCP?

EMIR Review – Bankruptcy Remoteness (Article 39)

FIA notes the desire of the European Commission to improve the level of asset protection that is granted to client collateral relating to centrally cleared derivatives. As regards the European Commission's proposals in the EMIR Review, FIA recommends that:

1. the proposal be extended to address indirect clearing arrangements: direct clients providing indirect clearing services should also be required to hold client collateral on a bankruptcy remote basis and the proposals should clarify how clearing members (CMs) should treat the assets and positions of their clients in the event of a client default (when their direct clients are providing clearing services to indirect clients);
2. the proposal should not cover the situation of a CCP default. CCP resilience, recovery and resolution should be solely addressed in a separate EU regulation;
3. EU authorities obtain one or more independent, reasoned, external legal opinions confirming the legal effectiveness of the proposed drafting under EU and national insolvency laws - further consideration should also be given to existing national EU member state insolvency frameworks (e.g. UK's Part VII of the Companies Act 1989, Articles L.440-7 to L.440-9 of the French *code monétaire et financier*, or Article 102b of the German Introductory Act to the Insolvency Statute). FIA is concerned that, as drafted, the current proposals are not legally effective.

EMIR Review – FRAND

As noted in our response to such proposals - in principle, FIA agrees with the objective of CMs offering clearing services on fair, reasonable and non-discriminatory terms (FRAND). However, FRAND requirements will not of themselves promote better access to clearing –rather it is *economic, commercial and risk* considerations that restrict a potential client's access to clearing.

Further clarity is required on:

1. the interaction between FRAND under EMIR and other conflicting EU regulation such as MiFID II (that requires clearing services to be provided on "reasonable commercial terms" and for clearing members to "publish the conditions under which it offers clearing services", etc.);

2. the meaning of FRAND requirements, especially the words "non-discriminatory"; and

3. the geographical (EU only?) and product scope (OTC derivatives clearing, but not exchange-traded derivatives) of the FRAND requirements;

FRAND requirements should be set out in the level 1 text. They should not result in a mandatory obligation on clearing brokers to offer a clearing service to all potential clients or on mandatory terms but should enable them to offer a clearing service in a competitive, commercial and prudent risk-mitigating manner.

Brexit – avoiding new barriers

It is essential that mutual market access be preserved as between the EU27 and the UK. Cutting off market participants from global pools of liquidity serves to no-one's benefit and risks actively increasing systemic risk.

FIA supports the European Commission's commitment to ensuring that third country CCPs are appropriately supervised as part of a well-regulated central clearing system. However, the forced relocation of clearing could distort markets, fragment liquidity, and raise costs for market participants globally.

As noted by Robert Ophèle, head of the Autorité des Marchés Financiers, in a speech[10] given on 13 November 2017: "Any measure that involves abrupt relocation of clearing, whether in the case of a hard Brexit or in the case of the implementation of the currently planned measure planned in the revised European Market Infrastructure Regulation will hurt firstly the European economy. It must then, in my point of view, be avoided."

FIA agrees with the G20 Leaders' St Petersburg Declaration of September 2013 that jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulatory regimes. It also agrees with the G20 Leaders' Brisbane declaration of November 2014 that called on regulatory authorities to make further concrete progress in swiftly implementing the agreed G20 derivatives reforms. FIA encourages jurisdictions to cooperate and to defer to each other when it is justified, in line with the St Petersburg Declaration.

If a third country CCP offers clearing to EU customers for a market which becomes systemically important to the financial stability of the EU, on the basis of the liquidity support that it may require in a time of crisis from an EU central bank, FIA acknowledges that deference alone may be insufficient.

The European Commission can better achieve the goal of improving the oversight of third country CCPs by updating its proven equivalence regime and entering into enhanced co-operation agreements with regulatory and supervisory authorities of third countries that host CCPs that are systemically important to the European Union.

[10] http://www.amf-france.org/Actualites/Prises-de-paroles/Archives/Annee-2016?docId=workspace%3A%2F%2FSpacesStore%2F26cccda1-590f-4e58-86e4-7b9ebaec0de8&xtor=RSS-1&utm_source=POLITICO.EU&utm_campaign=288a5f98f4-EMAIL_CAMPAIGN_2017_11_14&utm_medium=email&utm_term=0_10959edeb5-288a5f98f4-189897573

Question 8: Questions on specific barriers

4.4 Complexity of post-trade reporting structure

FIA agree with the definition and scope of the barrier.

Examples include local Spanish reporting requirements and very detailed reporting requirements from Euroclear France, each of which duplicate existing regimes.

In addition to complexity, FIA note the challenges regarding the entity and transaction scope of reporting requirements:

1. as regards entity scope, the reporting often imposes a disproportionate burden on smaller counterparties – this is an issue that has been noted in the EMIR Review Part I (REFIT) proposals; and

2. as regards transaction scope, the territorial scope of certain reporting rules remain unclear.

To the extent that the scope is determined to be broad, this could place European entities at a competitive disadvantage to their non-EU counterparts, to the extent that similar reporting requirements are not in place globally. In addition, the data required by venues for post-trade reporting requirements from clients globally could prove a disincentive to non-EU clients seeking to access EU markets.

A solution to the messaging paralysis is essential with a single, standardised, messaging standard implemented to meet each regulatory regime. The current cost to institutions of complying with today's fragmented, uncoordinated, reporting regimes across various EU regulatory reporting regimes is significant. We also encourage EU regulatory and supervisory authorities to further educate market participants as to how reported data is used by them.

We are supportive of the work conducted by the European Commission via its Financial Data Standardisation project and by ESMA under its Financial Instruments Reference Data System (FIRDS) projects. It is imperative that the respective initiatives are aligned to one another and cater for common definition of data fields to be reported, as well as setting out in detail how each field should be completed, through the use of standardised inputs wherever possible.

Moreover, we strongly support the creation of a Regulatory Reporting Market Practice Group, which should review regulatory reporting on a global level and provide for standardised definition of reporting fields as well as develop suggestions for a "one-trade-one report" approach.

The increased amount of personal data included in reporting requirements comprises a barrier. This is particularly an issue where the personal data relates to an individual from a third country. Whilst it constitutes a civil offence to fail to report such data under EMIR or MiFIR, in some third countries the reporting of such data to trade repositories or ARMs would constitute a criminal offence in that jurisdiction. The Global Data Protection Regulation (GDPR) will also impose limits on data transfers.

As such data privacy rules, and cyber risk relating to the potential transfer of such data between entities, each create potential barriers.

4.5 Unresolved issues regarding reference data and standardised identifiers

FIA recommend that the current projects separately run by the European Commission, ESMA and the ECB should each be combined, in order to establish and promote a single data dictionary for the definitions of data-fields in the regulatory reporting requirements.

FIA strongly encourages European legislators and regulatory bodies to co-operate with their global peers whom are working on similar regulatory initiatives, in order to agree upon a global library of data-fields and to specify how they should be interpreted or derived. Ideally this would occur prior to the European initiatives, in order to better promote global consistency and avoid the need for later amendments to systems and practices that would be caused by having to align revised EU requirements to the newly agreed global standards.

Whilst MiFID II requires Legal Entity Identifiers (LEIs) as a pre-condition to trade execution and CSDs require notification of their participants' LEI, LEIs are *not* mandated in settlement messages and are not used to identify the end beneficiary (it is recognised though that for natural persons a different identifier would have to be found, such as an International Depot Number). FIA encourages the adoption of such requirements, as they would promote improved disclosure and transparency to securities holdings chains, which in turn will bring value to any digital solutions.

A firm decision needs to be made as to whether or not to require counterparties to obtain and maintain LEIs. The adoption of LEIs may better promote the success of services implemented via distributed ledger technology.

Unique Trade Identifiers (UTIs) should also be standardised and mandated to flow from execution through to asset servicing. Identification of asset ownership and legal entitlement should be a priority focus.

Given the global nature of the capital markets, the initiatives of Financial Stability Board and CPMI-IOSCO regarding the implementation of a harmonised Unique Product Identifier (UPI) and UTI should also be significantly progressed.

4.6 Uncertainty as to the legal soundness of risk mitigation techniques used by intermediaries

FIA agrees with the definition and scope of the barrier. There is a need for further action to remove the barrier.

Standardised credit worthiness and risk management guidelines are required for issuers, investors, CCPs and CSDs in order to prevent weaknesses and contagion in the Eurosystem.

Many of FIA's members would prefer to see a more stringent requirement for CCPs and CSDs, including stress and risk testing requirements that include requirements for minimum thresholds of regulatory standards and regulatory oversight.

CCPs should be in a position to:

1. stress test clearing members' positions
2. consider wrong-way risk and portfolio concentration risk; and
3. test their own recovery or resolution capacity

Because risk management sits at the heart of the rationale for the existence of the cleared derivatives industry, default management is one of the most discussed topics across the market. Uncertainty is a concern. The following challenges remain to be addressed:

1. Difference in Price / Initial Investment: Low barrier entry in to the EU clearing system will create risk in the event of member default

2. Difference in CCP Entry Criteria: Risk of credit / operationally challenged parties in the EU clearing system
3. Performance / Risk Standards: No set of common standards to support and monitor clearing members' performance and risk status, e.g. timely payment of margin.
4. Margin models and default fund structures: more transparency and validation is required in these critical areas, whether via the EMIR Review or through the European Commission's proposed regulation on CCP Recovery and Resolution. In particular:
   a. How do each CCP's margin requirements translate in supporting a risk scenario?
   b. Are the calculations transparent?
   c. What are the waterfall and default fund scenarios? Are they stress-tested? If stress-tested, who reviews and assesses the outputs?
   d. How much of a CCP's own resources should be available to cover losses incurred during CCP recovery? To what extent should the size of a CCP's "skin in the game" be determined by reference to the scale of that CCP's business?
5. Participant Default / Insolvency: Disparity between the national laws of each EU Member state's national laws may result in the relevant protections contained within EMIR not being enforceable under a defaulting clearing member's national insolvency law. These divergences are a barrier to optimum use of T2S.

4.7 Deficiencies in the protection of client assets as a result of the fragmented EU legal framework for book entry securities

Long intermediation chains can make the identification of the end investor versus the account holder a complex, if not impossible, task.

4.8 Shortcomings of EU rules on finality

FIA agree with the definition and scope of the barrier.

Several areas of uncertainty remain, notwithstanding the implementation of the Settlement Financial Directive several years ago, in particular in specific cases of interpretation linked to new market features.

External legal counsel are unable to give sufficiently strong comfort to their clients on certain specific areas of uncertainty.

FIA note that a new EU Regulation would be beneficial in order to limit potential local interpretation and to promote better harmonisation. It would also help address settlement finality issues that arise in a Brexit context as regards the enforcement of settlement finality in the event of the insolvency of an EU27 clearing member of a UK CCP. A remaining major gap in the EU legislative framework for post-trade is the lack of any third country equivalence regime under the Settlement Finality Directive. Presently, EU institutions participate in numerous non-EU clearing houses and settlement systems. However, in the absence of an EU regime for third country systems, there is no assurance that matters governing participation in such systems would be governed by relevant system laws (as opposed to local member insolvency laws).

As noted by ECB board member Yves Mersch in his 10 November 2017 speech[11], addressing the Cumberland Lodge Financial Services Summit:

[11] http://www.mondovisione.com/media-and-resources/news/evolving-regulatory-environment-for-ccps-the-perspective-of-a-central-bank-s?disablemobileredirect=true

"…the EU's Settlement Finality Directive provides that only payment, clearing and securities settlement systems governed by the law of an EU Member State may be 'designated' by Member States, and only such 'designated' systems may benefit from the finality protections under the SFD. Systems governed by the law of a third country are not eligible for designation under the SFD, and will not benefit from those protections. As a result, if EU participants in a third country system were to become insolvent, the courts could, based on their national insolvency laws, and depending on whether or not their national legislator has activated the option provided for in Recital 7 of the SFD, require the unwinding of transfer orders that they have entered into the third country system, thereby undermining the system's integrity and affecting other participants in that system. Regulatory accommodations may need to be made, to mitigate the adverse effects of the loss of SFD designation. However, it remains to be seen whether this will prove possible and, if so, what form these will assume."

Insolvency claw-back challenges under EU laws following an EU participant insolvency could apply to unwind transactions done in non-EU systems or holdings of financial instruments held through non-EU systems. This acts as a disincentive to financial groups using EU entities for global group booking purposes and increases the risks of non-EU systems admitting or facing EU members or users. The UK has in many respects "solved" this through the protections for overseas clearing houses and EMIR-recognised third country CCPs in its Companies Act 1989, but this regime is apparently unique in Europe. After Brexit, the lack of a third country recognition regime under SFD will be exacerbated, since UK CCPs and UK CSDs will no longer benefit from EU settlement finality rules post-exit day. This means that in an EU member insolvency, system rules on finality may be overturned by national insolvency claw-back rules and moratorium rules, potentially meaning that UK infrastructure needs to cut off EU membership due to risks of admitting such members. The default rules of UK CCPs and CSDs would not benefit from EU27 statutory protections or deference to UK system rules in the event of an insolvency of an EU27 clearing member. This may result in certain EU27 clearing members being unable to remain as clearing members of UK CCPs or as participants in UK CSDs.

Question 11 – Barriers not listed by the EPTF

FIA's members have identified a number of risks in the post-trade landscape as a result of pending legislation that could hinder CMU. These could mostly be covered under the barrier of "inconsistent regulatory framework for financial services as between EU and other global markets – if not addressed, they could drive potential business away from the EU:

1. Cross-jurisdictional differences in risk mitigation requirements (e.g. physically delivered FX forwards);
2. BRRDII proposals regarding moratoria could have an impact on netting[12]; and
3. The inclusion of initial margin haircutting as a tool in the CCP Recovery and Resolution Regulation.

The potential misclassification of post-trade risk reduction services and their resulting transactions as "trading transactions" is a barrier to the ability of the market to reduce its risk exposures.

This barrier requires industry participants to hold more collateral than should be required, in order to cover capital requirements, liquidity requirements or CCP/bilateral exposures.

Giving assurance to the market that the output of post-trade risk reduction 'runs' do not fall under mandatory clearing or trading requirements, would enable participants to take advantage of these services, which will reduce counterparty credit risk, and thus systemic risk, and increase the availability of much-sought after collateral across financial markets.

A "regulatory uncertainty" barrier also exists, due to the patchwork of equivalence determinations that are required in order for global businesses to operate, combined with a series of no-action relief statements, both of which could be disapplied by regulators. It is unclear precisely what the impact is on the validity of existing contracts if the cross-border rules change during the lifetime of an arrangement or transaction (e.g. through enforcement of a CCP location policy pursuant to the EMIR Review). To mitigate this concern, FIA recommend that as much transparency and forewarning be provided to the industry with respect to such decisions, with appropriate lead times, so as to enable industry to consider the impact of such changes on the market, give due consideration to the operation of outstanding arrangements and, to the extent possible, restructure their business models and practices.

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[12] Cf. the comments of ECB Board member Yves Mersch on 10 November 2017 at the Cumberland Lodge Financial Services Summit:

"Another example relates to issues arising with regard to the proposed moratorium tool under the BRRD. The recent proposal to amend the BRRD, empowers competent and resolution authorities to suspend certain payments and delivery obligations, if this would help facilitate recovery and resolution. Of course, the proposal ensures exemptions from the moratorium tool related to FMIs, including CCPs. It may be necessary to consider whether there is a need to exempt recognise third-country central securities depositories and third-country payment systems subject to a cooperative oversight arrangement involving at least one central bank in of the ESCB.

The rationale is that a suspension prohibiting a participant (e.g. a credit institution) from making any payments to an FMI will de facto cause that participant to no longer be able to meet its obligations as they fall due. For payment obligations to FMIs, this would place the participant in default. Without an exemption for this type of payment, the moratorium would actually have the potential to amplify systemic risk before the FMI safeguards kick in."