Svensk Värdepappersmarknad
Swedish Securities Markets Association

May 2021

The Swedish Securities Markets Association's response to the targeted consultation on the review of the Directive on financial collateral arrangements

The Swedish Securities Markets Association was founded on 15th December 1908. The Association represents 23 Swedish, Nordic and global banks and securities firms active on the Swedish securities markets. The Association's overall mission is to work for sustainable and competitive Swedish securities markets. The Association's working groups discuss a wide range of topics including equity, derivatives and bond markets, investor protection issues and sustainable finance. The Association also owns SwedSec Licensiering AB which is responsible for licensing e.g. financial advisors in the Swedish market since 2001.

1. Scope

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

a) Payment institutions?

Don't know / no opinion / not relevant.

b) E-money institutions?

Don't know / no opinion / not relevant.

c) Central securities depositories?

Yes

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

The scope should comprise all relevant types of financial market participants that are systemically important. We do not see any reasons for excluding any particular type of entities that are active in the financial markets; excluding certain market participants could impede the development of the market, which would be unfortunate. We believe that a broad personal scope, that includes all relevant types of participants, would contribute to making the systems even more stable, which all market participants would benefit from. To ensure that the systemic risks do not increase because of the broadened personal scope, it would however be appropriate to determine certain criteria that the relevant market participants should fulfil to be included in the scope, e.g. be an undertaking under supervision, have a sufficient risk organisation, capital requirements, etc.

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?

No [We intended to answer "Yes", but in order to be allowed to respond to question 1.2.1, the survey format requires the answer "No".]

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

Please note that we intended to answer "Yes" to question 1.2, but in order to be allowed to respond to this question 1.2.1, the survey format requires the answer "No".

We understand the rationale behind the legislation to be to ensure financial stability and to limit systemic risks. As stated in our answer to question 1.1, we think that the personal scope of the directive should be reviewed and expanded to include all relevant types of market participants. In order to ensure financial stability, we do, however, think that only financial collateral arrangements where at least one of the parties is included in the personal scope of the directive, as revised and expanded, should be protected, which would not include

situations where neither of the parties are covered by the personal scope of the FCD.

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?

No

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)?

No

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

We understand that the national opt-out for retail/SMEs is only used in some member states today. Amending the FCD to be exclusively applicable to the wholesale market would limit the scope compared to how the rules are currently applied. Before any such amendments are considered, we think that further analysis is needed on the consequences in each member state.

2. Provision of cash and financial instruments under the FCD

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?

Yes, an explicit provision would be helpful.

Question 2.1.1 Please explain how this could be done:

The current wording in FCD article 1(5), requiring evidence in writing, should be replaced and modernised to make it future proof. A revised version of the provision should in our opinion be drafted in a general way, allowing it to encompass all eligible types of collateral, not requiring special solutions for e.g. interest, dividends or other types of specific cash flows related to certain assets.

It is not clear what is meant by "in writing" in the current version of the provision, and in any case the directive should allow for other forms of evidence of the arrangement that are commonly accepted in the market. The requirement regarding how the financial collateral could be evidenced should in our opinion not take the form of an exhaustive list, but rather focus on the qualitative aspects of the evidence, in whichever format they are presented.

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

Yes

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.

As exemplified by the Swedbank decision referenced in the introduction to this section, there are uncertainties regarding the concepts of being in "possession" or in "control" of collateral in the FCD. Clarifications of the concepts would be welcome, to enhance the legal certainty. Concepts such as being in possession or control of an asset or a collateral or acquiring something in good faith are however closely related to other aspects of property law, third party effects, etc. that differ between different member states. Any clarification of such notions should therefore be preceded by a thorough analysis of the interplay with other legislation (EU legislation and national legislation) and the effects any amendments or clarifications may have, in order to find solutions that are compatible with the legal concepts of all member state laws.

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

Question 2.3.1 Please explain how this might be done for 'cash' and 'financial instruments':

Clarifications of the notion of good faith acquisitions would be good, but we think that any clarifications should be narrowly limited to good faith acquisitions of such assets and in those situations that are within the scope of the FCD. The notion of good faith acquisitions in more general terms, and the effects such acquisitions would have, is closely related to other aspects of national legislation and principles of law that may differ between different member states. Clarifying the notion of god faith acquisitions would require careful analysis and we would recommend that any proposals for such clarifications are subject to public consultations.

3. 'Awareness' of (pre-)insolvency 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?

I see the need to clarify how a collateral taker can 'prove that he was not aware'.

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'/ 'prove that he should not have been aware' could be done:

We do not agree with the current wording of article 8(2), which is mirrored in the wording of the question, that the burden of proof for not being aware should lie with the collateral taker. Having to prove that a certain situation is not at hand is extremely difficult and is not compatible with general principles of law. The feasibility for the collateral taker to effectively make sure that there is no ongoing (pre-) insolvency proceeding varies depending on e.g. the applicable insolvency legislation, the practical set-up for insolvency proceedings such as the level of system support for publishing insolvency decisions, etc. In addition, the work effort and resources required to try to prove that the collateral taker was not or should not have been aware of a (pre-) insolvency proceeding are likely to be huge, without much benefit to the involved parties or the system as a whole. Hence, requiring that the collateral taker show that he was either not aware or should not have been aware is an inefficient solution and unacceptable from a legal security perspective.

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

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

Yes

Question 4.1.1. What were these problems related to?

both [for use within one Member State and for cross-border use]

Question 4.1.2. What did these problems concern?

both [for OTV transactions and for transactions carried out on an SFD system]

Question 4.1.3 Please describe the problems and the outcome:

The problems encountered are related to what we understand to be partly conflicting objectives between the FCD and the BRRD and the resulting legal complexity. The complex regulatory situation gives rise to legal uncertainty, with the effect that it is hard for market participants to get sufficiently clean and/or comprehensible legal opinions. This may cause the institutions' estimated regulatory risks to increase, which in turn will affect the institutions' capital requirements. We anticipate similar complications and legal uncertainties in relation to the interaction between the FCD and the framework for the recovery and resolution of central counterparties, which might affect the market participants' possibility to get sufficiently clean and/or comprehensible legal opinions.

There are problems with the recognition and application of close-out netting provisions both within a member state and cross border, but the problems are amplified in cross border situations.

We are not sure why there is a distinction between OTC transactions and transactions carried out on an SFD system in question 4.1.2 and consider the distinction to be incorrect and somewhat misleading; many trades are done outside of a regulated market, an MTF or an OTF – i.e. traded OTC – but still settled in a settlement system.

Question 4.1.4 Please describe a solution that you consider appropriate:
It would be appropriate for the EU legislator to clarify that the close-out netting provisions are applicable and enforceable, despite the adoption and application of the BRRD and the framework for the recovery and resolution of central counterparties. Such a clarification would be helpful in reducing the complexity of the regulation and should allow for clean and comprehensible legal opinions, which would reduce the institutions' regulatory risks. The clarification could e.g. be made in relation to the netting provisions in the relevant capital requirement legislation such as the CRR. The anticipated effect of such a clarification is that close-out netting is recognized for capital adequacy purposes despite covered institutions being subject to resolution actions by the relevant resolution authority under the BRRD.

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

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

The legal opinions regarding enforceability of close-out netting provisions are expected to be changed in light of the framework for the recovery and resolution of central counterparties, similarly to the development in relation to the revision of the BRRD.

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

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

For the legal opinions covering credit institutions and investment firms the sections regarding enforceability of close-out netting provisions were changed in connection with the revision of the BRRD. In some cases, this had the effect that the legal opinions were no longer sufficiently clean and/or comprehensible, causing an increase of regulatory risk.

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

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

Especially in cross-border contracts there are legal uncertainties, which is one of the reasons behind the counterparties' getting legal opinions. Even with the legal opinions some legal uncertainties remain since the opinions often include carve-outs or reservations regarding e.g. recovery rights.

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

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

The problems encountered are related to what we understand to be partly conflicting objectives between the FCD and the BRRD and the resulting legal complexity. As pointed out in the EPTF report, the conflicting objectives

give rise to legal uncertainties, with the effect that it is hard for market participants to get sufficiently clean and/or comprehensible legal opinions. As a consequence, the institutions' estimated regulatory risks increase.

It would be appropriate for the EU legislator to clarify that the close-out netting provisions are enforceable despite the application of the BRRD and the framework for the recovery and resolution of central counterparties. Such clarification would be helpful in reducing the complexity of the regulatory situation and would reduce the institutions' regulatory risks. The clarification could e.g. be made in relation to the netting provisions in the relevant capital requirement legislation such as the CRR. The anticipated effect of such a clarification is that close-out netting is recognized for capital adequacy purposes despite covered institutions being subject to resolution actions by the relevant resolution authority under the BRRD.

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

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. W UD (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:
As described above, the problems encountered are related to what we understand to be partly conflicting objectives between the FCD and the BRRD and the resulting legal complexity. The complex regulatory situation gives rise to legal uncertainty, with the effect that it is hard for market participants to get sufficiently clean and/or comprehensible legal opinions. This may cause the institutions' estimated regulatory risks to increase, which in turn will affect the institutions' capital requirements.

As proposed above, it would be appropriate for the EU legislator to clarify that the close-out netting provisions are enforceable, despite the adoption and application of the BRRD and the framework for the recovery and resolution of central counterparties. Such clarification would be helpful in reducing the complexity of the regulatory situation and would reduce the institutions' regulatory risks. The clarification could e.g. be made in relation to the netting provisions in the relevant capital requirement legislation such as the CRR. The anticipated effect of such a clarification is that close-out netting is recognized for capital adequacy purposes despite covered institutions being subject to resolution actions by the relevant resolution authority under the BRRD.

In addition, the legislator could consider whether netting should be regulated in a directly binding regulation. With a regulation with binding legal effect, the same requirements would apply across all EU member states. This should open the way for reducing the regulatory requirements to obtain legal opinions regarding netting, such as those in the CRR. When all counterparties are situated within the EU, the need to ascertain the likely regulatory and legal effects through legal opinions would be smaller, since the parties are bound by the same provisions. This would reduce the need for institutions to obtain expensive legal opinions and hence lower the costs for market participants.

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5. Financial collateral

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

Question 5.1.1 If so, please elaborate which type of collateral and why:
The legislation should allow for new types of collateral, in order to be future-proof. The legislator should in our opinion be proactive when it comes to types of eligible collateral, to give enough leeway to technical advancements and other developments within the area. At the same time, it is worth noting that the general

acceptance for new types of collateral normally takes time.

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 *financial instruments* should be done:

If financial instruments in a DLT environment are to be included, we see a need to update the definition of financial instruments in order to clarify the scope of eligible collateral and eliminate some of the issues described in the introduction to this section of the consultation paper. The legislation should take into account both situations where, in a DLT environment, shares or other securities are provided as collateral and situations where the collateral is represented e.g. by tokens.

Financial instruments

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

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

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

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

Further clarified/specified.

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

The current notion of "account" is not well suited to the DLT technology, hence we see a need to review the concept and clarify or replace the current definition, as appropriate.

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

Further clarified/specified.

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

The current notion of "book-entry" is not well suited to the DLT technology, hence we see a need to review the concept and clarify or replace the current definition as appropriate.

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

Yes

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

We would like to encourage the Commission to make use of the information already gathered or which is in the process of being collected, e.g. in the consultation regarding an EU framework for markets in crypto-assets during the spring of 2020, the pilot regime for market infrastructures based on distributed ledger technology and the proposed Markets in Crypto-Assets Regulation (MiCA).

Credit claims

/…/

6. The FCD and other Regulations/Directives

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)
Don't know / no opinion / not relevant

6.1.2 Second Chance Directive (Directive (EU) 2019/1023)
Don't know / no opinion / not relevant

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

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

Please also explain how this matter might be solved:

As described above, we understand there to be partly conflicting objectives between the FCD and the BRRD, which creates legal uncertainty. The complex regulatory situation gives rise to legal uncertainty, with the effect that it is hard for market participants to get sufficiently clean and/or comprehensible legal opinions. This may cause the institutions' estimated regulatory risks to increase, which in turn will affect the institutions' capital requirements.

As proposed above, it would be appropriate for the EU to clarify that the close-out netting provisions are enforceable, despite the application of the BRRD and the framework for the recovery and resolution of central counterparties. Such a clarification would be helpful in reducing the complexity of the regulatory situation and should allow for clean legal opinions, which would reduce the institutions' regulatory risks. The clarification could e.g. be made in relation to the netting provisions in the relevant capital requirement legislation such as the CRR. The anticipated effect of such a clarification is that close-out netting is recognized for capital adequacy purposes despite covered institutions being subject to resolution actions by the relevant resolution authority under the BRRD.

In addition, the legislator could consider whether netting should be regulated separately, in a directly binding regulation. With a regulation with binding legal effect, the same requirements would apply across all EU member states. This should open the way for reducing the regulatory requirements to obtain legal opinions regarding netting, such as those in the CRR. When all counterparties are situation within the EU, the need to ascertain the likely regulatory and legal effects through legal opinions would be smaller, since the parties are governed by the same binding requirements. This would reduce the need for institutions to obtain expensive legal opinions and hence lower the costs for market participants.

6.1.4 Framework for the recovery and resolution of central counterparties (Regulation (EU) 2021/23)
Don't know / no opinion / not relevant.

7. Other issues

/…/

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

Many concepts in the FCD, for example the notion of good faith acquisitions, being in possession or control of intangible assets and insolvency legislation, are closely related to other aspects of national legislation and principles of law that may differ between member states. Any clarification or further regulation of such concepts should therefore be preceded by a thorough analysis of the interplay with other legislation (EU legislation and national legislation) and the effects any amendment or clarification would have, in order to find solutions that are compatible with the legal concepts of all member state laws. Any proposal for such clarification or legislative action should be subject to public consultations.

Moreover, we think that it would be beneficial if the provisions in the FCD and SFD on conflict of laws were further clarified in order to avoid legal uncertainty, and we would like to encourage the Commission to continue the work in this area.