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EBF response to the EC Consultation on Post-Trade in a Capital Market Union

Key points:

- The European Banking Federation (EBF) welcomes the opportunity to share its views on the Consultation Paper issued by the European Commission on post-trade in a Capital Market Union: dismantling barriers and strategy for the future.
- Since we have been heavily involved in and have contributed to develop both the main EPTF Report and the Detailed Analysis of the European Post Trade Landscape, our response focuses on the section related to EU and global trends, new technologies and competition in post-trade rather than on questions regarding the EPTF report itself.
- We believe that, in order to implement the EC CMU strategy, it is imperative to work towards complete and timely dismantling of all identified barriers. This is a necessary pre-condition for full integration of EU capital markets. With the removal of the identified barriers, the post-trade services reform will significantly contribute to the global competitiveness of EU capital markets.
- It is also important to note that banks are seeking to embrace and develop new technologies, solutions and business models. However, the dismantling of EPTF Barriers should not be made dependent on possible future benefits deriving from disruptive technological developments (e.g. DLT).
- Furthermore, we would like to highlight the need to continue a close and institutionalised cooperation between the public and the private sector, especially through targeted dialogue amongst subject matter experts.
- Finally, we would like to encourage the Commission to implement some form of coordination over the implementation process towards the dismantling of all EPTF Barriers.

Question 1

The main trends in post-trade in the EU

The EBF strongly supports the Detailed Analysis included in the European Post Trade Landscape (Annex 3 to the EPTF Report). We believe this provides a comprehensive and detailed overview on the trends currently shaping EU post-trading services.

The EBF also believes all the suggested trends will be relevant to varying degrees (increased automation, new technological developments, more cross-border issuances, more use of regulated trading venues). More broadly, it is important to keep into account some general themes, mostly deriving from the several regulations implemented or currently under implementation:

- Investor protection (including data protection)
- Focus on transparency in the post-trade space with enhanced KYC processes and impact on preferred account structures
- Target2Securities that has only very recently been fully implemented
- Brexit, although the exact impact is still unknown
- Regulatory reporting requirements
- Liability and standards of care for Central Securities Depositories (CSDs)

The EBF also believes that there are some market trends in the post-trade area that should be taken into account. These include:

- Increased focus on Cyber Risks
- Reduction of available service provider in some markets
- Costs of compliance and management attention
- Potential consolidation
- Potential competition
- Increased use of secured financing and collateral
- Increased level of active participation in corporate life
- Changes of established roles, remits and functions. Creation of new roles and responsibilities and impacted processes and workflows, especially regarding increased automation.
- Change of personnel skills and mindset.

Last but not least, we would like to mention that the post trade landscape will continue to be shaped by new client demands in many aspects: real-time settlement, flexible choice, unbundled services, data transparency, fees and services to name but a few. New investor demands and new technologies could also result in the development of alternative investments like, for instance, non-security-assets or virtual assets and settlement in virtual currencies. Trading in virtual assets (e.g. initial coin offering, ICOs) may also result in changes to post trade activities.

Question 2

Technological developments and their implications for post-trade

The EBF broadly agrees with the list indicated by the Commission.

The EBF is interested to investigate Blockchain / DLTs as a smart way of boosting innovative solutions for multiple use cases in different business lines and with several purposes, both for new revenues sources enhancement and for processes streamlining.

However, it is fair to mention that the usage of these technologies is premature for massive adoption and before setting into production it will be important to ensure that any DLT-based solutions or other new technologies considered for broad implementation in the post-trade services area (e.g. smart automation, robotics, chatbots, artificial intelligence/machine learning) are bank-grade, scalable and able to address both privacy and security issues.

We are also in agreement that opportunities and potential risks have been and will be thoroughly analysed as they are identified. However, we feel that the DLT and similar innovative technologies will offer a number of benefits once the vital pre-requisites have been met. We believe that these innovative technologies could have a considerable impact on existing banking industry infrastructures, roles and functions of financial intermediaries, back office related securities processes, communication, interoperability and competition. Additionally, they might have a considerable impact on the customer experience and on the easiness to buy/hold financial instruments.

Regarding possible benefits, risks and the potential impact on EU-legislation in connection with post trade services, the EBF responded to ESMA's dedicated discussion paper on DLT applied to Securities Markets ESMA/2016/773. For further information, please refer to our response to the ESMA Discussion paper. [\[LINK\]](#)

Additionally we concur with the opinion expressed by ECB AMI-SeCo Report on "The potential impact of DLTs on securities post-trading harmonisation and on the wider EU financial market integration" [\[LINK\]](#) as its membership includes members nominated by the EBF.

Also, this opinion is in line with our views expressed in the EC fintech consultation 2017 [\[LINK\]](#).

Regarding proposals as to how the existing post trade legislation could be more technology neutral it should be born in mind that digitalization of assets or rights can take a completely new approach in the legal context. Paper form and signatures are recognized by many national laws in order to evidence certain rights, circumstances or events. These concepts cannot be the only manners of holding and transferring securities. DLT registered securities should also be recognized. In relation to the issuance of securities, for instance, the paper certificated form is still required in many Member States (be it by company law, property law or securities law). In order to make them fungible, securities need to be held by CSDs. Even dematerialised securities are required to be registered by CSDs.

At the same time, a digital register such as a DL could serve the same purpose like a global note of securities and could be recognised as the means for the registration of securities in book-entry form.

Question 3

Financial stability issues

It is important to note that post trade services have proven safe and resilient even in periods of stress as in 2007/08. Post-trade FMIs – including CCPs, CSDs and payment systems – have worked well throughout the crisis. No post-trade FMIs in fact failed in their tasks or became insolvent. Additionally, T2S and several regulatory initiatives in the past decade have further improved safety in the post trade space. However, we would also note the risk of an inappropriate spill-over of regulation and supervision over post-trade services. This is why we would like to highlight the need to focus regulation and supervision in the post trade services to those areas that could have

an impact on systemic risks, as a complement to regulation and supervision on trading, where the majority of risks arise. Taking the above into account, we believe systemic risk in the post-trade areas are coming from:

- Increased use of centralised clearing leading to concentration of counterparty risk in very few (thinly-financed) institutions. Regulatory clearing obligation will possibly further increase such risk.
- CCPs Recovery & resolution programs
- Operational failures of Financial Markets Infrastructure (FMIs) that have an impact on the settlement efficiency and on collateral fluidity of settlement operations
- Increased need of collateral for liquidity purposes with higher regulatory restrictions, formal obligations (like detailed reporting and risk disclosure in written form) and haircutting and/or capital requirements at the same time
- Cyber crime

Some solutions to address such systemic risk concerns might include:

- Back-up / contingency systems in place at FMIs
- Harmonisation of risk-mitigation techniques of Market Infrastructures to prevent a race to the bottom on margining processes
- Elimination of uncertainty as to the legal soundness of risk mitigating techniques used by intermediaries and of CCPs' default management procedures, e.g. as proposed by the EPTF
- Cyber-crime prevention measures.
- Increased capital requirements for CCP to increase their "skin in the game"
- Enhanced CCP supervision, appropriate recovery and resolution planning with the involvement of CCP clearing members and under recognition of the "no creditor worse off" principle.

Question 4

The international dimension and competition in post-trade

The EBF believes that internationally agreed principles for financial markets infrastructure, in particular the principles set out by CPMI / IOSCO (PFMI), are a very useful tool to reduce risk and increase efficiency at a global level. Additionally, we believe it would be important to focus on reduction of systemic risks also at international level and not only at EU level. Please see our response to Q3.

In order to accomplish some progress internationally, we believe that having a coherent regulatory regime by implementation of operational and legal harmonisation and standardization, would be essential. This should also mean, that the above principles are applied in a standardized way and not necessarily stricter in some markets, while not at all in other markets.

Although the EBF believes that the CPMI / IOSCO PFMI continue to be a driver for further global harmonization, not all markets seem to implement all principles and elements in the same way. CCPs apply, for instance, different risk management procedures, risk mitigation techniques and margin requirements; also, in some cases regulators seem to have different interpretations as to how to apply the PFMI. A recent example is the differing interpretation of Article 35 CSDR by ESMA and national regulators. This could lead to an unnecessary cost for transaction processing for the entire EU industry or even in disallowing CSD-

participants to communicate with CSDs on matters which are not covered by the international standards.¹

The EBF therefore believes that the PFMI should also be subject to revision and update.

Another field that would benefit from more international coherence would be the legislation on clearing. Following the post-crisis arrangements by G20, various jurisdictions have developed their own legislation. With EMIR, the EU has gone further than other jurisdictions in several aspects. This explains for example the complexities in declarations of equivalence of CCP regimes (few jurisdictions are “as good as” EMIR) and the mandatory reporting of derivatives transactions (forbidden in some jurisdictions).

Considering all the above, the EU (post) trade industry would probably benefit from a focused and analytical review of existing regulation, in order also to align with third country regimes. Any further regulatory changes should be targeted and follow the strict rule of making markets more secure and more efficient.

We also note that generally the overall level of competition in the post trade space has significantly increased over the last decade. Competition is likely to increase even more in the coming years due to T2S at the FMI level and the dismantling of EPTF Barriers.

Question 5

Future strategy for European post-trade services

As previously mentioned, we believe increased competition opportunities will arise in the coming years. At the same time, we believe the Commission should closely monitor this process, in order to avoid the risk that such competition opportunities lead to a decrease in actual competition. In fact, increased competition might also lead to a situation where a market becomes more attractive for larger players at the expense of small and medium sized players.

However, it would be important to continue with the consolidation of infrastructures and market providers, while trying to limit fragmentation. One of the biggest challenges to limit fragmentation will derive from the yet unclear impact the exit of the UK from the European market will bring.

Obviously, Brexit remains an important issue to consider when looking at the future strategy for European post-trading services. Depending on how the negotiations will end, what will the consequences of Brexit to entire value chain be? How will the post-trade landscape develop post Brexit? The evolution of the post trade is therefore dependant on the Brexit implications.

Data and Privacy are becoming increasingly important factors. Hence finding a trade-off between open information flows, privacy and confidentiality requirements will be of paramount importance.

Risk mitigation and harmonised standards are of critical importance both in respect of competition and consolidation. It should be clarified that CCP clearing members and their clients cannot be held liable beyond their CCP margins and default fund contributions, so that reducing margin requirements cannot be a potential for competition.

¹ Contrary to ESMA's interpretation, the EBF believes article 35 and the recital of the CSDR should be read not as prohibiting other communication standards, but as requiring CSDs to accept messaging in international standards from a participant or another infrastructure that request to communicate with a given CSD in an international and open standard for a certain type of instruction or event, if the international standard for it exists already. Otherwise, it could lead to an increase in costs for transaction processing for the entire industry or even to disallowing participants to communicate with CSDs on the matters not covered by international standards.

EU post trade services would also benefit from a more functional approach as regards reporting obligations. A reportable trade should only be reported once to one single recipient (e.g. TR or dedicated supervisory authority). A dialogue should take place between regulators and industry in order to analyse which data are to be reported for which purpose and in order to build appropriate reporting tools and define field populations that serve such purpose. Such dialogue could ensure clear reporting strategies and regulatory consequences to be taken resulting from the received and analysed data. It would also ensure that all data needed is actually received and stands ready to be used for supervisory purposes.

It is also likely that post trade services will become more and more commodity types of services (i.e., clearing, settlement, safekeeping, collateral management, CeBM settlement, shareholders rights protection). There will also be more automation and robo activities in the entire value chain, linked to more newcomers, competition, consolidation, but also much more outsourcing or partnerships. However, policymakers should consider the importance of ensuring that a high regulatory standard is applied and supervised across all market participants. In a nutshell, the concept of "same services, same rules, same supervision".

Handling the customer relationship will be the key driver, like for other banks' digitalised businesses. The EBF thus encourage the EC to supervise any developments and, where possible, to facilitate the adoption of these new practices.

Finally, the future EU strategy on post-trade services should also take into consideration the new challenges and uncertainty coming from geo-political pressures and technological innovation. Those challenges have the potential to completely reshape the financial industry as we are traditionally used to know it.

Questions 6-9 and 11-12

EPTF Barriers

The EBF agrees with the EPTF Report and its proposed solutions and their prioritisation. We are in favour of dismantling the narrowly defined EPTF Barriers in the context of the CMU project to the highest extent possible as the next step in the process of European Post Trade Reform.

With respect to the potential solutions proposed, the EBF would like to stress that EU-wide solutions are to be preferred to solutions modifying only the law of one specific EU member state (e.g. proposed solution regarding EPTF barrier 3 "lack of harmonisation and standardisation of Exchange Traded Funds (ETF) processes").

We believe that changing the national law of a single member state might be complex from an EU perspective. This is why we take the view that the EU Commission should analyse the problems, leading to a certain barrier, in an EU-wide context.

The EBF strongly supports the approach of the Commission based on dialogue and discussion between the public and the private sector. This is why we would be in favour to maintain the momentum created by the work of the EPTF by creating a monitoring group, increasing thus the chances of EPTF Barriers being successfully dismantled.

Question 10

Inefficient Withholding Tax procedures

With specific reference to the section on inefficient withholding tax procedures, we are thankful to the Commission for the work performed together with Member States' tax administrations and we look forward to the publication and rapid adoption of the announced Code of Conduct on more efficient WHT procedures. This is an area of very significant costs and concerns for all investors and intermediaries, and a clear hindrance to efficient and competitive financial markets in Europe. We believe that clarification and simplification of procedures, digitalization of the application and refund processes, and the strengthening of the relief at source procedures are three key aspects where urgent action will be needed. On all these areas, as we still see initiatives contradicting the above-mentioned principles in different Member States, we would encourage the Commission to focus on harmonising and standardising the existing processes. We are hopeful that the Code of Conduct will lead to more significant progress than what has been accomplished over the last 10-15 years, in spite of its non-binding nature; at the same time, we would like to encourage the Commission to ensure as much as possible a very high degree of adherence to the Code by all Member States.

Furthermore, it is important to underline that the OECD has developed the TRACE Implementation Package (IP) years ago. This model suggests that Financial Institutions can enter into Authorised Intermediary (AI) agreements with the tax authorities of the source country. In their capacity as Authorized Intermediaries, they can then claim withholding tax relief on behalf of customers on a pooled basis. Investors have to provide a properly completed standardised Investor Self Declaration (ISD) to the Authorised Intermediary, which is then required to report investor-specific information to the source country. This regime would abolish the need to obtain certificates of tax residency per investor and there would be no requirements to pass confidential investor information upstream. The TRACE Implementation Package includes an application for a Financial Institution to request authorisation from source countries to act as an Authorized Intermediary and includes a sample contract that could be used between the source country and the Financial Institution. The investor self-declaration forms would enable the investor to benefit from tax relief at source under the regime when presented to a participating Authorized Intermediary.

The Commission's Tax Barriers Business Advisory Group (T-BAG), which had been set up in 2010 with the aim to consider the follow-up to the Commission's Recommendation on Withholding Tax Procedures from a business perspective, and to identify any remaining fiscal barriers affecting the post-trading environment, released in 2013 a report in which it suggested that the TRACE approach be implemented in EU Member States.

Governments should take steps to implement a standardised and harmonised system for both simplified tax refund procedures and tax relief at source procedures. The most advanced work in this area has been the development by the OECD of Treaty Relief and Compliance Enhancement (TRACE), including the TRACE Implementation Package which was approved by the OECD Member states in 2013. TRACE aims to simplify and streamline the process for cross border portfolio investors claiming treaty relief. The OECD continues to elaborate on and improve the TRACE system by taking advantage of appropriate synergies with other information exchange systems already implemented and running in a large number of countries around the world, such as investor self - declaration, financial institution due diligence aligned with AML and KYC and information exchange systems for tax purposes between governments. Business believe a robust consolidated system will contribute to the G20's aim of greater tax certainty. An international system for relief at

source and simplified tax refund procedures should be designed in a way that it maintains a level playing field and is workable for most investors and custodians, big and small.

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