BNP PARIBAS RESPONSE EC CONSULTATION ON CAPITAL MARKETS UNION MID-TERM REVIEW MARCH 2017

BNP Paribas welcomes the European Commission's consultation, which will form the basis of the Mid-term Review of the CMU Action Plan in June 2017. In response to the consultation, we would like to acknowledge the progress that has already been made on various specific initiatives, such as the finalization of revisions to the Solvency II capital requirements for certain types of infrastructure investments; the European Commission proposals to make permanent and extend the scope of the SME supporting factor and also the proposed introduction of an infrastructure supporting factor. At the same time, we caution the Commission that many other aspects of the current revision of CRR/CRD are actually highly punitive for Capital Markets activities, and therefore will impede the development of the CMU.

In addition to proposing areas where the Commission can go further and which may not have been included yet in the CMU action plan, we would also like to highlight recommendations made in our response to the Green Paper which are still valid. We would also add that Europe cannot achieve the development of vibrant capital markets, particularly in an area where they lag behind, without a strong incentive from public authorities: it is exactly what the American public authorities did by establishing Government Sponsored Enterprises with a public guarantee which accelerated the development of capital markets and allows to free up capacity in banks' balance sheets.[1] We would also like to emphasize that in the context of CMU, Europe needs to adopt a strategic approach in the definition and / or calibration of its financial regulatory framework (which unfortunately has not always been done in the past). This strategic approach must involve a-priori a reflection and definition of what financial sector model it desires to have.

1. FINANCING FOR INNOVATION, START-UPS AND NON-LISTED COMPANIES

Question1: Are there additional actions that can contribute to fostering the financing for innovation, start-ups and non-listed companies? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

- <u>Securitization (Note: We provide more comprehensive recommendations on this topic in our response to question 5):</u> The European securitisation market is currently subject to constraints that limit its ability to develop.
  a) High Capital Requirements for Insurance Companies (through Solvency II)
    - Type 1 Securitisation: While the Solvency Capital Requirement (SCR) has been loosened, the highest standard of securitisation is still relatively expensive in term of SCR (especially when compared to direct exposure to underlying loan portfolios).
    - Type 2 Securitisation: SCR remains prohibitive, also creating a distortion in capital requirement. For instance, a CLO AAA-tranche could require more

[1] See in annex the cover note to our response to the Green Paper on Building a Capital Markets Union

solvency capital than a direct exposure to portfolio whereas the CLO tranche benefits from a strong credit enhancement (≈40%).

Increasing retention requirements: For example, CLO managers (generally not banking entities) acting as sponsor of CLO transactions are subject to a retention obligation of 5% of each transaction. The probable strengthening of this retention rule (in the context of the STS) will limit the ability for CLO managers to launch new CLO transactions, therefore reducing the liquidity that CLOs provide to the corporate loan market.

This retention also raises a concern on the distortion in prudential treatment between securitisation (highly penalized) and investments on non tranched portfolios (even if individual assets held in such non-tranched portfolios are highly leveraged).

b) Low credit margins for private investors due to the ECB ABSPP Program

The ECB ABSPP Program, by reducing the credit spreads on securitisation, reduces the interest from private investors to invest in securitisation.

Loosening these constraints should promote the European securitisation and as a consequence should foster financing toward European companies.

- Crowdfunding: The Commission should seek to remove barriers to the development of appropriately regulated crowdfunding platforms. In this regard we welcome the report to be published shortly. Possible measures include:
    - Introduce a European passport which is a key factor to the development of this financial channel. This issue is of crucial importance for euro zone platforms which currently cannot benefit from the volume of this market
    - Set a European regulatory status appropriate to the risks these new actors generate which are twofold: consumer/investor protection and financial stability
    - Ensure that regulations for crowdfunding activities provide for a level playing field with those for established credit institutions along the principle of "same activity, same regulation" as well take into account any systemic or new risks that they may generate
- Regarding ways to promote information for investment in startups and SMEs, we would underline the value of a common EU level accounting standard for small and medium-sized companies listed on MTFs
    - There is value in such a standard, but emphasis should be on developing a simplified standard to foster its use and enhance its accessibility to SMEs
    - The accounting standard needs to be designed for all users including the management of these companies, in particular the issuers of securities and not only short term investors
    - Adoption at European level of the IFRS standard for SMEs, which, in addition to carrying over--and amplifying—some of the weaknesses of IFRS (conceptualized as

they are on valuation as an instant market value and being investor-biased, to cite but two issues), is too complex for SMEs and would not meet their needs

  - A simplified accounting standard should be based on a simplified version of IFRS for SMEs. But this standard should be drafted under EU control by a EU accounting standard setter – EFRAG could be a candidate
  - In addition to accounting standards, harmonisation of reporting for SMEs seeking cross-border funding would enhance their access to financing

- EU support to private placement markets: PP markets have been showing some success for mid-sized and large SMEs (Euro PP market in particular). The issue is how to develop PP markets for smaller SMEs. To that end, the EU could study the opportunity of :
  - Developing a Pan-European hybrid debt fund aimed at providing medium to long-term financing to smaller SMEs (leveraging Juncker Plan)
  - Encouraging Member States to give favourable tax treatment to investors
  - Exploring further how to enhance the liquidity of financial markets in Europe, in particular calibrating those provisions in Solvency 2 regarding equity investments in unquoted companies.
- Supporting equity investments by insurers : The Solvency II standard formula has a heavy capital charge for investments in equities which discourages insurers from investing in equities

2. MAKING IT EASIER FOR COMPANIES TO ENTER AND RAISE CAPITAL ON PUBLIC MARKETS

Question 2: Are there additional actions that can contribute to making it easier for companies to enter and raise capital on public markets? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

- Prospectus Regulation: The European Parliament, the Council of the European Union and the Commission have agreed on the text of a new Prospectus regulation. The Regulation will introduce new rules on prospectus as well as providing broader exemptions for small offerings where no prospectus is required. This new regulation achieves major changes such:
  - as capital raisings up to EUR 1 million will not need a prospectus,
  - shorter prospectus for secondary issuances,
  - shorter prospectus summaries using language which is easier for investors to understand,
  - paper prospectus will only be required if a potential investor explicitly requests one.
- The above changes were beyond others strongly expected by the industry. But irrespective of the above and considering that a substantive number of delegated acts will need to be adopted by the Commission and that draft regulatory and technical standards and guidance will need to be developed by ESMA in respect of various provisions of the Regulation, the

Bank will remain very vigilant as regards the level 2 making process. Indeed, dedicated Commission and ESMA prospectus work streams will work on the determination of the details and specificities of those new requirements. Some provisions will have to be carefully calibrated in the Level 2 legislation in order not to jeopardize the limited positive impact of the Level 1 legislation. The Bank will pay particular attention to :

  - the criteria for the assessment of the specificity and materiality of risk factors,
  - the content and number of risk factors to be included in the prospectus (notably the withdrawal of any requirement to categorise and hierarchize the risk factors included in the prospectus).
  - the content and size of the prospectus summaries: notably for the exemptions to the standard size of the summary , the cap of the risk factors and the issuer and guarantor key financial information to be included in the summary the supplements.

- Additional policy measures are needed to incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups

  - Achieve right calibration of Solvency 2 capital requirements (which presently penalize investments in equities, in particular unlisted ones)
  - The small current size of SME funds limits investment from institutional investors. A solution could be pan-European venture capital funds of much bigger size; also support from EIB could provide partial guarantees on investments
  - Review of accounting rules could reverse short-terminism behaviour and over-reliance on mark-to-market valuation
  - Develop guidelines and encourage Member States to promote L-T investment in SMEs through enhanced attractiveness and certainty of tax treatment

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3. INVESTING FOR LONG TERM, INFRASTRUCTURE AND SUSTAINABLE INVESTMENT

Question 3: Are there additional actions that can contribute to fostering long-term, infrastructure and sustainable investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

- Work on the tailored treatment of infrastructure investments

  - We welcome the provision in the CRR II / CRD V package to encourage infrastructure investment in Europe, which will lower bank capital charges for infrastructure and project finance loans, provided these are low risk and have predictable cash flows. Nonetheless, we would recommend clarifying certain provisions so as to avoid that significant parts of the project finance and infrastructure businesses are unintentionally excluded from this regime. Our suggested amendments that extend the Commission's proposal are in annex.

- Introduction of standardised, cross-border pension products

- The present landscape is very fragmented and there are strong cultural and technical differences between the available products in the EU.

- Improving the EU passport with a better harmonisation of prudential rules, for instance for occupation pension activity, would be a better solution in the short to medium term to give larger choice to customers and improve competition between financial service providers

4. FOSTERING RETAIL INVESTMENT AND INNOVATION

Question 4: *Are there additional actions that can contribute to fostering retail investment*? *Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.*

- Technology is driving rapid change in the financial sector and has the power to increase the role of capital markets, and bring them closer to companies and investors. It also benefits consumers by offering a wider choice of services which are more convenient to use or more easily accessible.
- The ESAs can further contribute to ensuring consumer and investor protection by
    - The current regulatory framework encompasses numerous investor protection provisions, which embrace most challenges to the investor/ consumer protection identified in the aftermath of the crisis. At the same time, however, it is necessary to avoid a cumulative effect and duplication of requirements.
    - The implementation of a single Rulebook relating to the protection of investors and consumers could lead to positive consequences and repercussions. Codification could contribute to the increased effectiveness of markets, because of the simplification of the legislation, and to a better integration of the market and in consequence strengthen the Single Market. Codification of rules aiming at the protection of investors and consumers could also reinforce the control of actors and therefore lead to better supervision.
- Policy measures to increase retail investment
    - The distribution of financial products is subject to more and more constraints. At the same time, business models are under pressure from legislators and regulators. The pros and cons of such policies should be weighed carefully against the ambition of developing long term investment.
    - Undertake measures at EU level aimed at boosting awareness and education of consumers and also of policy makers
    - Implement fully the ongoing regulations and do not consider any additional rules regarding retail financial products before the impact of the recent requirements have been assessed.

- National best practices in the development of simple and transparent investment products for consumers which can be shared
    - Euro PP (France) has developed a Euro PP Charter, proposing a code of conduct, best practices, and standard documentation for non-listed bonds and a model agreement for loans. Over the last three years, some € 10bn have been issued through Euro PP (mostly to large SMEs and mid-sized companies)
    - UCITS: There are approximately 36 000 UCITS operating, accounting for more than €8 trillion assets under management. This success is the result of a cleverly designed framework benefiting European households. UCITS is also regularly sold to investors outside the EU where they are highly valued due to the high level of investor protection they embody. It is internationally recognised that UCITS is a successful cross-border product (40% are cross-border assets)
- Encouraging take up of ELTIFs
    - Facilitate the marketing of ELTIFs to retail investors: Investor protection as provided by the MiFID suitability and appropriateness test is the most efficient safeguard for retail investors in ELTIFs
    - Relax rules for ELITFs open to professional and semi-professionals to allow for wealth management investors to fully explore their significant potential to invest in long-term financing projects
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    - Adjustments to the standard capital requirements of Solvency II and IORPs in view of encouraging in concrete investments in ELTIFs will be essential to the success of ELTIFs
- Financial literacy has been increasingly considered by policy and decision makers as a life skill of the 21st century necessary to enable individuals to achieve a long term financing of the economy. This is key for further promoting investments by individual investors in Europe.

5. STRENGTHENING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY

Question 5: Are there additional actions that can contribute to strengthening banking capacity to support the wider economy? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

Additional CMU actions are needed to further strengthen banking capacity to support the economy. In particular fine tuning existing proposals such as the securitization package and the review of the CRR-CRD IV to ensure that calibrations do not hamper banks’ ability to finance the economy. Moreover, the impact of any future regulation should be fully assessed through growth- and CMU-support lenses.

Securitization: Securitization is a fundamental tool to rebalance the source of funding of the European economy. For this rebalancing to occur, banks must be able to securitize at a cost which is commensurate with the risk transfer. The Commission's proposal for securitization was a major achievement and some aspects are particularly helpful such as the recognition of securitization in the leverage ratio. However in our view there are still key issues that, if not properly addressed, could significantly undermine the prospects of a vibrant securitisation market in Europe and defeat the Commission's own objectives. Insurers have completely exited the market due to application of Solvency 2. For a market worth € 500bn, banks are key investors (which could exit as well due to STS constraints). Others investors such as BlackRock and Pimco, which represent 50% of the market, will also be subject to additional constraints and they may well exit the market. There is a risk that the market will be further reduced.

- There is a need to amend the proposals as they contain fundamental weaknesses that will hamper reviving the securitization market in Europe. This is particularly important in the area providing certainty for issuers and investors. With this perspective, we highlight areas that remain major concerns regarding the proposal:
    - Restrictions on permitted market participants (Art. 2a and Art. 2b in the European Parliament text)
    - Risk retention (see answer to question 1)
    - Transparency provisions which are applicable to public (€80bn) and private transactions (€ 120bn) but do not consider that for the latter a certain degree of confidentiality is necessary. Moreover, their implementation presents practical problems to be solved such as how to organize transparency and which entity will be in charge, as well as allowing sufficient transition periods
    - Existing / legacy transactions and grandfathering (still not well targeted);
    - Third country issues: (restrictions for unregistered countries, participants having to be based in the EU or befitting from an equivalency regime)
    - ABCP maturity limitations that remain overly restrictive
    - Sanctions for which negligence / omission standard should apply
    - Widening the possibility for banks to resort to SEC-IRBA in order to be able to analyze the performance of a portfolio at aggregated level if they have sufficient historical data

- Beyond the proposed securitization package, a European backstop for mortgage securitization should be duly studied by the Commission as it could be a critical catalyst to develop a deep, simple and safe securitization market. Given the need to provide funding to the economy and alleviate the structural funding gap for the banking sector, the creation of a European body for mortgages could be envisaged with the aim at increasing standardization among the markets and products necessary for an efficient capital market.

- CRR 2 / CRD 5 While BNP Paribas recognizes the need to transpose additional Basel requirements in the EU (NSFR, Leverage, TLAC), to ensure international consistency we believe it is key to implement those new constraints in a manner that will enable the EU banking sector to continue to support economic growth, as stated by Commissioner Dombrovskis "we want to make our legislation more growth friendly". It is also of utmost importance to calibrate the new regulations impacting Capital Markets activities in a way that would not hamper the development of the CMU, as this project is critical to reduce the reliance on bank funding in Europe. The European authorities should monitor closely the implementation of Basel regulations by other jurisdictions and avoid putting European banks at a competitive disadvantage in the regional and global landscape.

- In this context, BNP Paribas welcomes the "targeted adjustments" made by the European Commission to adapt the legislative proposals to European specificities, broader policy considerations and sound risk management practices, but believes there is room to go further in some areas. As far as the timetable is concerned, we urge the European Commission to clarify various implementation dates, taking into account multiple considerations:
    - Consistency with current regulatory or accounting schedules
    - Extent of RTS and other reports required from EBA, which will delay the development of models by banks until final specifications by EBA are published and validated by the Commission
    - Major IT investment required to comply with some of the new measures (FRTB, NSFR, Reporting, disclosures etc…)
    - Considerable burden on banks and supervisors to validate the new models once developed, ahead of implementation
    - In order to improve consistency and facilitate the sequencing of the introduction of the package, we believe that some proposals could benefit from a "fast-track approach (Phase-in of IFRS 9 prudential impact) while other components should be further delayed and/or benefit from a sufficient monitoring/observation period (FRTB).

- We fear that the combined effect of FRTB, NSFR and the leverage ratio will severely restrict international banks' market-making activities (and aggravating market liquidity) in particular for less liquid sovereigns/corporate bond markets which will become unviable. We would also underline the importance of Capital Markets Union, not only for the EU as whole, but also in particular for the smaller Member States which do not have domestic investment banks.

- <u>NSFR:</u> We welcome the modifications in the Commission's proposal but several key issues remain to be addressed to ensure market making and liquidity in support of CMU:
    - Asymmetry of treatment of repos vs reverse repos is reduced but maintained: (Reduction of RSFs for reverse repos with financial customers <6months from 10% to 5% if secured with HQLA level 1 and from 15% to 10% if unsecured or secured with other assets.) The stated aim is "to discourage extensive short term funding risks between financial customers which are a source of interconnection". This would be highly detrimental to market making activities which are fundamental for the development of the Capital Markets Union, and would most probably detrimentally affect market liquidity. It would also disincentive banks which are long on liquidity from lending into the market.
    - We continue to believe that all HQLA level 1 assets should receive a 0% RSF and ASF, whether held in principal or through reverse repo transactions.
    - Non-level 1-Secured lending with Regulated Financial Customers should receive a symmetrical treatment of secured borrowings (i.e., 0% RSF for shorter than 6 months non level 1 secured lending).

    - The high ratios of RSF for gross derivative liabilities: . EC proposals for the treatment of margined derivatives and other potential alternatives need to be properly impact-tested before becoming binding measures. The full impact of the current proposals has not been assessed, resulting still in excessive funding burdens and the adoption of an inappropriate measure from a funding risk perspective. The Basel Committee is currently reviewing the RSF 20% add-on which could be excessively punitive. Therefore at EU level this treatment should be put on hold and the final new Basel Committee proposal better assessed.

- <u>FRTB</u> may be a major headwind for CMU objectives, in particular due to its negative impact on market making, and should not be part of the CRR review
    - Many key technical components are still actively discussed at Basel level. It is impossible for banks to provide reliable quantitative impact analysis. The own fund requirement may fluctuate massively around 40%, whereas BCBS claimed that this review should not result in an increase of own funds requirements.
    - It would be contrary to European “Better Regulation” principles to pass this new regulation in the absence of a clear quantitative impact analysis
- Impact on less liquid European markets would be significant
    - We believe it is important to raise the awareness of Member States whose domestic banks are performing limited capital markets business and who may therefore be less familiar with FRTB potential unintended consequences, including in their own domestic market.
    - As a matter of fact, the FRTB, combined with NSFR and leverage ratio, will severely damage international banks involvement in market-making, further aggravating therefore market liquidity issues. As a consequence, those banks are likely to withdraw from the market-making of the less liquid sovereigns/corporate bonds markets as those will become non-viable. This may be a major set-back for some medium and small countries, where the existing market making business is performed by international rather than domestic banks (Annex 1)
    - As several Sovereign and corporate debts may be subject to the NMRF (Non Modellable Risk Factor), and/or some desks may not pass the P&L attribution tests, large international banks will be forced to operate on SA (Standardised Approach) and/or apply a stress value to their positions. At best, the increase in capital costs will further increase issuer costs but, most probably, large international banks will have no other choice than withdraw from such markets; which would decrease further the liquidity and lead to a vicious circle, and an exacerbation of the fragmentation within the EU.
    - We believe this indirect impact must be better understood.
- Counterparty exposure: The current formula is going to significantly increase Credit Institution exposures and reduce their financing capacities accordingly. We believe the calibration should be carefully reviewed based on an updated impact analysis.

- <u>Leverage Ratio:</u> We welcome the EC confirmation that the minimum requirement is 3%. The February 2017 EBA study demonstrates that at 3%, the leverage ratio is a meaningful backstop for a large number of EU banks. In terms of CMU, we would emphasize the need for a more appropriate treatment of derivatives for the non-risk based Leverage Ratio in order not to unduly penalize the Capital Market Activities

- Basel IV: The economic costs of the proposals under discussion exceed by far their incremental benefits in terms of additional financial stability. They would increase the overall level of capital requirements to an extent that would be detrimental to growth, in an economic environment which is already fragile.

- Banking Union: A well-functioning Capital Market Union must rely on free flow of capital and liquidity across the Banking Union, to allow for proper allocation of savings to investment across the monetary union. In order to achieve this, large financial institutions should not be penalized when they operate on a pan-European basis, notably with regard ... to the calculation of capital surcharges for global systemically important banks. The revision of the CRR/CRD should be the opportunity to take stock of progress realized and pave the way for a truly integrated euro area financial market. The priority should be to remove the inclusion of intra Euro area assets and liabilities in the calculation of the "cross-border" G-SIB score as this also puts European banks at a significant competitive disadvantage compared to US peers, who benefit from a large domestic market. Other issues related to capital and liquidity requirements include the requirement to comply at individual level, which in our opinion is simply European gold plating, as the Basel framework only imposes compliance at consolidated level.

- Better regulation: The Commission should fully explore the potential of new technologies to reduce the administrative burden for market participants in complying with regulatory and reporting requirements. Developments in regtech solutions provide a promising area of policy and regulatory innovation for the EU which will facilitate the goals of CMU.

- Abandoning legislative initiatives that are contrary to CMU: In this regard we would highlight the proposals for a European Financial Transaction Tax and Bank Structural Reform.

6. FACILITATING CROSS-BORDER INVESTMENT

Question 6: Are there additional actions that can contribute to facilitating cross-border investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

As a major global custodian, BNP Paribas is very supportive of the public consultation process launched by the European Commission which aims at collecting feedback on targeted input to revise the CMU action plan. **On post-trade**, we are in the opinion that it is necessary to stabilize and secure the post-trade sector which should serve the development of cross-border transactions and favor the integration of capital markets in Europe. In our view, the main objectives in this area should be safety, level playing field between the different actors and greater European harmonization in the context of enhanced investor protection and renewed confidence of investors in financial markets.

We would like to comment more specifically on the following issues:

- Comments made in the consultation paper on costs relating to post-trade for cross-border trades and investments

- Targeted action in securities ownership rules
- Review progress in removing Giovannini barriers

1. **On Cost**

Page 16 contains explanations on cross border investment costs being up to 10 times more expensive than domestic settlement and links this to post-trade services and more specifically identifies "securities law" as the only quoted factor of impact.

We invite the EU Commission to examine the costs that CSDs charge for settlement and compare this to the settlement ticket and to elaborate on the relation between cost and "legal uncertainty".

The entire debate around the cost of post trade has been going on in identical terms for the last 15 years, although the market has profoundly changed.

The current average settlement tickets is 120.000 eur - 225.000 eur for a settlement price of 0.25 to 0.75 euros per ticket. This is easily verifiable information.

The settlement costs that a Global custodian charges are higher, due to connectivity to several systems and provision of a larger variety of services than those that CSDs provider. However, we are still talking about negligent amounts of settlement costs compared to the settlement ticket.

A cross-system (rather than "cross-border") settlement can be twice as expensive; never 10 times more expensive. We strongly contest such figure. And when we mean twice as expensive, the reality is 7 eur settlement as opposed to 3 or 4 eur settlement for a settlement ticket of 120.000 to 225.000 eur.

Therefore, if the fund industry argues that a cross-border transaction can be 10 times more expensive than a domestic transaction, it is certain that this is not related to post-trade.

2. **On Securities Ownership Rules**

The debate on legal (un)certainty has started 15 years ago and progress was booked on important issues, namely thanks to the collateral directive. However, all EU member States laws are clear and legal differences don't mean that there's legal uncertainty. The very objectives of various attempted reforms were never clear: was it about addressing material malfunctioning and uncertainty? Or rather about a change of paradigm in securities holding, allowing intermediaries to reap the benefits of billions worth of securities they hold in securities accounts for clients?

It is very disappointing to read the EU Commission stating that costs are due to post-trade and within post-trade this is caused by legal obstacles. This is ungrounded and only repeating issues that date from the years 2002 – 2006. Many things have changed since then.

This being said, we deem necessary to support, in the context of the CMU, conflict-of-law rules which bring clarity and legal certainty to all actors, of the securities and account providers. This is the rationale to put forward options of the conflict-of law rules provided in article 9 of Collateral

Directive. From this base, we would expect Article 9 of the Collateral Directive to be implemented with the following principles:

- A definition of its scope (*rationae materiae*): rules shall be applicable to material rights on securities, to procedures and effects of booking of securities and should therefore be disconnected from the actions being the cause for the book-entry (insurance, sale, pledge …).

- Geographical scope (*rationae loci*): conflict-of-law rules should recognize the law of the Member State where the account is open for an account-provider to an account-holder (i.e. "the relevant account"). Consequently, should exclude the application of the conflict-of-law rules in this Member State.

- Connecting factor: with regard to the location of the relevant account, AFTI is of the opinion that said location should be determined by a material criterion, and not, in any circumstances, by contractual arrangements. The preferred criterion should be the place where the account is open (i.e. Head office or the place of location of the branch when the account is maintained by a branch of the account provider).

3. On review progress in removing of remaining Giovannini barriers

We welcome the European Commission initiative with regard to the European Post-Trade Forum (EPTF) work. As a major global custodian, we have always been involved in initiatives relating to improvement of post-trade efficiency and safety and we have taken our part in the main working groups mandated to review the Giovannini process.

Globally we agree that some existing barriers should be reviewed and whenever necessary updated to take into consideration the various types of evolutions experienced in the post-trade landscape. Some additional barriers may be identified, however we have some reservations about the fact that diverging views on European post-trade regulations and/or implementations would by themselves qualify as barriers. Therefore we would recommend the qualification of « barrier » to be restricted to strong and evidenced circumstances where targeted actions are feasible.

Please find here after our detailed comments.

Among the existing Giovanninni barriers, we agree first that some barriers have been removed, namely those related to:

- National clearing and settlement restrictions that require use of multiple systems,
- Absence of intraday settlement finality,
- Practical impediments to remove access to national clearing and settlement systems,
- National differences in settlement periods,
- National differences in operating hours / settlement deadlines,
- National restrictions on the activity of primary dealers and market makers.

Migration of settlement to the single T2S platform and adoption of the CSD Regulation have been strong drivers in the removal of these barriers. Improvements mainly result from strong coordination between the industry and the public sector in the review and identification of appropriate remedies.

In addition we also agree with the need to pursue efforts to remove the following barriers:

- National difference in information technology and interfaces used by post-trade providers,
- Differences in national rules relating to corporate actions and beneficial ownership and custody,
- Differences in domestic withholding tax regulations,
- Barriers relating to legal certainty.

These barriers are clearly the most complex ones as they refer to national differences stemming from long-time established local market practices and/or require substantial investments for effective transition to a harmonized framework. Despite Intensive work already carried out to figure out how to get further harmonization, no optimal solutions have been identified so far. In the future it will be necessary to focus on issues that require effective harmonization (i.e. which are essential in the process of cross-border investments) with a pragmatic and prioritization approach to ensure a successful outcome.

We have some more specific comments on the following barriers:

- On national differences in information technology, interfaces and messaging standards:

  We are in favor of a harmonization under a common ISO Format (ISO20022). However it is worth noting that different versions can be used to implement the ISO22022 format, which creates difficulties in the communication between the different ISO20022 formats. Initiatives (as the one launched by SWIFT) to try to harmonize the different ISO20022 subset of formats or version should be supported. At the same time everyone should be aware that the time required for full migration to the ISO20222 format will be quite long due to the issues mentioned above and the investments required for such transition.

- Concerning legal uncertainty on property rights in securities and claims:

  As mentioned above, we support the objective of extending the conflict of law rules of Article 9 of the Financial Collateral Directive. However we are of the opinion that the readers of the future EPTF report and more globally users should not be misled by overstatement on the consequences of this legal issue. Indeed, there is no evidence that the market is empowered by the current situation, contrary as one could conclude from some documents.

  Legislative initiatives are necessary for legal certainty regarding the ownership of securities. This applies, in particular, to the law applicable to securities held through securities accounts (at the level of CSDs or other financial intermediaries) and the rights stemming from these securities. A key aspect is the conflict of laws rule, which determines the law governing the proprietary rights over securities. In cross-border collateral transactions legal certainty should be insured. This should include the definition of the law that governs the enforcement of the collateral and the rights flowing therefrom. Currently, the place of relevant intermediary approach (PRIMA) is the rule applied in the FCD and SFD. However, this approach only covers certain items and thus, the introduction of a clarified connecting factor would be desirable to increase the legal certainty.

- On close-out netting rules

  The close out netting regime provided for in the Financial Collateral Directive is good and efficient and covers the very vast majority of use-cases of close out netting. Namely, close out netting is mainly applied between a collateral taker and a collateral giver, and allows for the netting of the principal obligation and the collateral. This is precisely covered already in the FCD. That regime has been used as a model for the Unidroit principle for close out netting, that are being used worldwide, which also evidences that the European regime is functioning very well.

On potential new barriers, we globally consider that no real issue should deserve creation of effective new barriers. We agree that some concern persist in a number of areas. However, as mentioned above, in most cases these concerns relate to diverging views across the industry and/or implementing issues that should be solved in a different way than creating new barriers. We have more comments on the following aspects:

- Segregation requirements: in spite of intense debate around segregation requirements, we do not consider these should qualify as a new barrier, as long as full individual segregation (i.e. by end-investor) is not imposed all along the custody chain. This option has not been retained so far as a viable one by policy makers, including under the AIFMD and the UCITS V Directive where the two options recommended by ESMA (i) are based on a segregation by categories of end-investors and (ii) do not include the issuer CSD in the scope of segregation. In our view the key priority is to get clarification as soon as possible on the final rules and ensure that they will apply similarly across the EU

- Registration of securities: in certain jurisdictions, registration of securities does pose some operational challenges. However, in other jurisdictions, the process is automated; and automation is also often a question of internal organisation of custodians. It is of upmost importance that issuers who want to know their shareholder base are in a position to get that information, especially ahead of a General Meeting. This is an evident question of good corporate governance and stimulation of shareholder involvement and long-term investment. Also, shareholder registration before a general meeting should not be confused with the shareholder identification provided for in the recently reviewed shareholders rights directive. Any question of harmonisation of registration processes should be understood against that background of corporate governance and removing operational barriers (that intermediaries can often remove themselves) should not create corporate governance impediments.

- Post-trade reporting: it is obvious that the introduction of new reporting obligations with lack of harmonised approach has introduced complexity in data analysis and has resulted in increasing cost. Difficulties mainly lie in the lack of coordination between the authorities regarding the scope of data to be reported and the reporting channels/infrastructures to be used. Some actions should be undertaken in this area get further standardisation on data to be reported, mechanisms for reporting, definition of data standards (e.g. LEI, UTI, UPI) and formats to be used.

Additional actions that can contribute to facilitating cross-border investment include the following:

- <u>Removing barriers to the free movement of capital</u>: The success of CMU can only be ensured if Member States are determined to work to dismantle existing unjustified national barriers to the free movement of capital. In terms of additional actions, completing the third pillar of Banking Union, which aims at having a common deposit guarantee for Eurozone banks, is critical. A political consensus on the proposal for a European Deposit Insurance Scheme, in particular with regard to sovereign risk, has not yet been reached due in part to the heterogeneous economic conditions in the different Member States. However, a solution must be found as completing the Banking Union is key to making it fully credible. At a minimum, two actions are needed to find a way forward and to avoid moral hazard: First, finalizing the setting up of all the national deposit guarantee schemes and fully funding them and second, finalizing the harmonization of supervisory practices for all banks. As mentioned by the Commission, effective and consistent supervision is essential to ensure investor protection, promote the integration of capital markets and safeguard financial stability. These two measures would allow the creation of a reinsurance mechanism, as proposed by the Commission, which in our view is the appropriate solution for the protection of depositors in the Eurozone. Adopting a gradual approach would also leave time for dealing with any significant risks remaining in the balance sheets of banks that have not yet been subjected to a standard review.

- Inefficiencies and differences in national insolvency frameworks generate legal uncertainty, obstacles to recovery of value by creditors, and barriers to the efficient restructuring of viable companies in the EU, including for cross-border groups.

- Measures that could improve the cross-border flow of collateral should aim at resolving issues regarding the use of credit claims as collateral. To that end the Commission should extend and clarify the application of the Collateral Directive. It should also calibrate MIFID II – title transfer collateral arrangements with retail clients as the directive restricts the scope of small and medium sized companies to access the title transfer collateral markets as regards derivative transactions. Additionally, the Commission should further improve the legal framework relating to the cross border flow of collateral and close out netting arrangements.

- Removing obstacles to integrated capital markets arising from company law:

    - Corporate governance: There is a need to carefully assess the potential impact of the trend to require more and more shareholders votes on decisions that would, under national law, be under the management's competence. This can have anti-competitive effects and limit business efficiency. As regards corporate law, the process of creation of a European company and its transfer from one member state to another should be simplified to facilitate the cross-border movements of companies within the EU. On insolvency laws, we welcome the legislative initiative on business insolvency and the recent public consultation. We would stress the need to harmonise insolvency laws in order to support the emergence of a pan-European capital market. More predictability and transparency with respect to the companies' solvability is needed, as well as further harmonization regarding preventive restructuring proceedings so as to change the global perception of insolvency proceedings and avoid the stigma attached to insolvency, which is generally seen as a preventable failure. Insolvency procedures should also be simplified and clarified.