FÉDÉRATION BANCAIRE FRANÇAISE

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EUROPEAN COMMISSION CONSULTATION ON CAPITAL MARKETS UNION MID-TERM REVIEW 2017 FBF'S ANSWER TO THE CONSULTATION: A NEW CONTEXT, A NEW APPROACH

I. GENERAL COMMENTS:

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

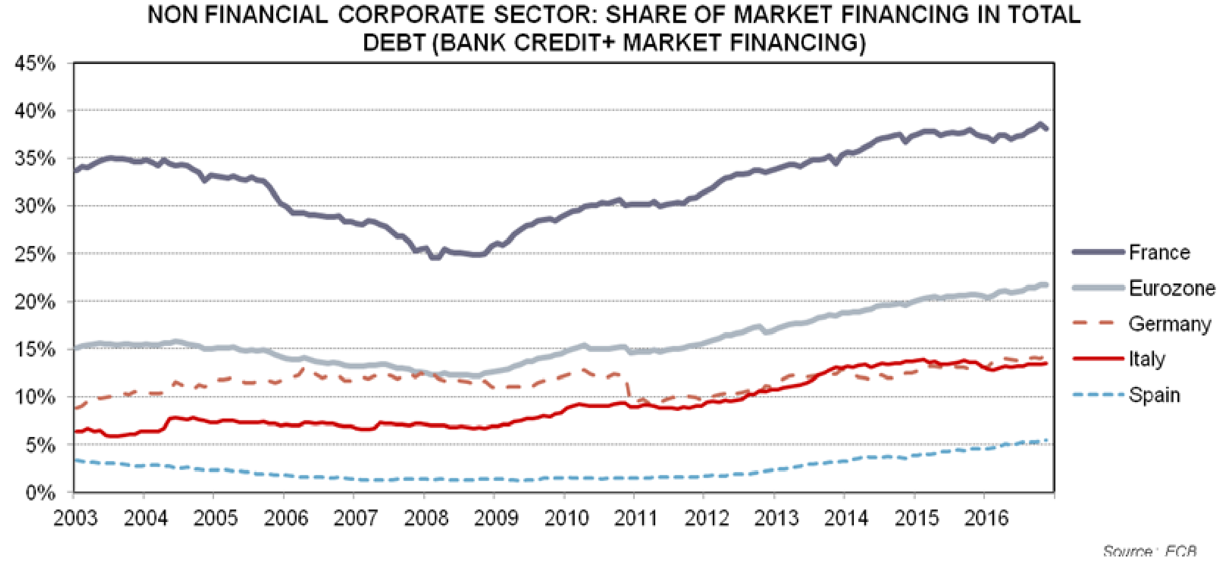
The French Banking Federation welcomes the opportunity to comment on the European Commission consultation on capital markets union mid-term review 2017.

II. ANSWERS TO THE CONSULTATION OF THE EUROPEAN COMMISSION:

A. General remarks

1. The market funding and the credit lending in the Eurozone

Since the launch of the CMU project in 2015, the financing by the markets continues to grow in the Euro zone. This situation is particularly significant in France, where the financing through the credit and through the market have risen at the same time. This is largely due to the universal banking model which promotes both market funding and bank lending for all companies.



2. The "*Capital Markets Union*" (CMU) must take into account the context of the BREXIT and the "*White Paper on the future of Europe*"

The CMU project has been launched by the European Commission two years ago when no one reasonably anticipated that the United Kingdom would decide to leave the European Union (EU).

So far the CMU action plan has generated several proposals and had mixed results. In addition, it is now facing a more challenging outlook, with the prospect of the UK leaving the EU. The Brexit by itself changes the dimension of the CMU approach, whatever the issue of the negotiation will be.

The CMU project should take into account the new context linked to the BREXIT, which represents for the EU a crucial event, not only from a political but also from a financial markets' viewpoint.

Indeed, the BREXIT will substantially impact the European financial landscape and the discussions on any future financial regulation, for various reasons: (i) the United Kingdom still represents the main European financial market place, (ii) all significant continental European banking groups have developed some of their financial activities in London (through subsidiaries or branches) and (iii) the United Kingdom, based on its own financial and regulatory expertise, has been deeply (and positively) involved in the numerous financial regulations and will remain involved until the BREXIT comes into effect.

For all these reasons, the BREXIT should allow for a new analysis on the EU financial landscape, so as to preserve the effective and efficient functioning of European financial markets, the strength of European banking groups and their ability to play a central role in the financing of the European economy.

While the UK is about to trigger Article 50, it appears that, with regard to financial markets, services and banking rules, the current EU rules lack consistency across the board and some overarching principles governing the interaction of the Union with third countries.

It is therefore necessary to launch a reflection on the relationships between the EU and third countries, notably equivalence regimes and reciprocity.

Moreover, the CMU project should also take into account the "*White Paper on the future of Europe*" which presents various scenarios for 27 Member States of the EU for 2025. Even if the CMU is not threatened by one or another scenario that will be adopted, the choice of a specific scenario could influence the manner in which objectives are set or how they are delivered.

3. Despite the European financial disintermediation, the banking sector remains crucial for European issuers and investors

Further to the gradual financial disintermediation at work within the European Union, the financing of European companies is more crucial than ever.

The financing of European companies within a disintermediation context requires the building and preservation of a financial ecosystem enabling European companies to access the financial markets and to raise funds to ensure their growth. European policy makers should continue to focus on preserving and enhancing market liquidity, particularly by considering the calibration of the "*Fundamental Review of the Trading Book*" (FRTB), the application of the leverage ratio and the NSFR rules related to repos and derivatives.

Building an efficient financial ecosystem implies to preserve the liquidity of the EU financial markets and the capacity of the financial sector to ensure the access of their corporate clients to the markets, both from a financing and risk management perspective, as well as the access of international investors to European issuers. Indeed, the banking sector still plays a crucial intermediary role: banks assist their clients in the access to capital markets, banks assist investors to invest in single or diversified instruments that match their needs, banks access capital markets to raise funds to lend on to clients. While we are hearing at the same time strong calls for proportionality of the rules in Europe together with more extraterritoriality and balkanisation globally, it seems important that the European framework is also thought through from different perspectives, including the need to secure level playing field between the European Union and third countries.

In that field, it appears necessary not to rush ahead with the adoption of CRD 5 / CRR 2 before the EU has a clear view on its consolidated impact and the global picture of regulation and supervision in the European main competitors, such as the evolution of the prudential rules in the United States.

4. The EU financial regulation already completed or still in progress shows its side effects

The numerous European financial and prudential reforms adopted since 2007 / 2008 constitute a much more robust framework. However, they also have (and will have) a significant impact on the ability of the European financial sector to meet the needs of companies in terms of finance and investment. More particularly, without questioning the legitimacy of each reform, their cumulative impact already have (or will have) side effects on the financing of the European economy, notably of small and medium-sized European companies.

The evolution of the global framework towards more fragmentation, often requiring local capital and liquidity together with local risk management, is an additional constraint that requires adjustments to operating models. The impact of these evolution for the end clients is still to be analysed and seen.

5. Based on the above items, the FBF considers that the new European financial agenda promoted by the CMU should be based on the following major principles

a) An impact assessment of the EU financial reforms is needed

Up to date, there has been no comprehensive and holistic impact assessment done at the business line or product level. Impact assessment have been conducted at a very high macroeconomic level and/or with a siloed approach, ignoring the cumulative impact on a type of products or activity, type of clients…

Hence, it is not possible to understand the impact on the real economy / European competitiveness of past reforms. A comprehensive review and impact assessment of the financial measures and reforms adopted, individually but also cumulatively, should be endorsed and promoted by the European authorities.

Indeed, evaluating the consistency, relevance and impact of European financial regulations is a key priority, ahead of the adoption of a series of new measures; otherwise, it would seem inevitable that unwanted effects and detrimental impacts will increase.

b) A regulatory “break” is necessary

A regulatory “break” becomes urgent to take into account the risks and side effects linked to the new EU financial regulation framework.

This is all the more necessary that the two major initiatives launched by the European Commission for developing Europe's capital markets revealed somewhat disappointing. Indeed, the new Prospectus regulation will be rather positive for small and medium-sized companies but will not allow for any further development of the EU capital markets, and the STS securitisation proposal appears so complex that it may hinder the revival of the EU securitisation market (see our answer to question 5).

c) A full harmonisation of the EU regulation should not be a EU objective

While action is necessary to avoid any fragmentation of the EU capital markets, a full mandatory harmonisation does not seem necessary while it could have negative unwanted effects on local markets. An appropriate balance should always been sought between costs and benefits of further mandatory harmonisation.

The CMU should not be used as a "Trojan horse" to full harmonization of legislation. Conversely, it should be used either to preserve some national laws if needed (e.g. the French Euro-PP private placement and covered bonds) or to promote at European level any national best market practices.

This request is also linked to the fact that some areas (e.g. securities law) have not yet been harmonised because of the complexity in obtaining a consensus from Member States, and other areas (e.g. tax law) require a unanimous agreement between Member States which hinders any global approach.

While the FBF generally supports the proposal to revise insolvency proceedings, we would ask the Commission to take into account the various domestic regimes applicable within the EU in order to preserve the efficient regulation already in force in EU countries (e.g. the French "*conciliation regime*"), to consider the economic impact of the proposed regime on secured creditors and their ability to lend back into the economy and to consider a balanced approach between the interests of both debtors and creditors.

d) The promotion of the European long-term financing and investment is crucial

The EU should favour long-term investment and financing as highlighted by the European Commission since 2014. Indeed, this goal meets the interests and needs of both issuers and investors.

The current EU financial disintermediation may be used as an instrument to achieve this goal. But this requires also that no further financial or prudential regulation challenges the ability of the banking sector to accompany clients and investors on the capital markets.

Within this context, a dedicated European task force could be created, which composition and mandate should be discussed further. The former CESR's "*Wise Men Committee*" may be considered positively in this regard.

e) A reflection on the ESMA's objectives and missions should be favoured

The BREXIT raises the issue of the EU's future supervision. Within this context, and based on the former proposals made by Fabrice DEMARIGNY in 2015, the CMU project may give the opportunity to analyse the potential evolution of the role of ESMA.

The FBF would support an initiative to reconsider the ESMA's role and governance. The BREXIT is likely to impact materially the ESAs, their governance, their expertise and their mission.

As a first thought, it could be envisaged that the ESMA Board did not include only national competent authorities but also covered the EU's global interest while the ESMA missions could be reviewed in order to strengthen its capacity to ensure a EU convergent regulation, and even to promote the reinforcement of its role in the EU regulation, notably concerning market infrastructures and benchmarks. Some further thoughts should be spent on the ability of ESMA to publish, when necessary, statements on regulatory tolerance that would amount to some kind of the US regulators' "no action letters" in order to allow for a temporary delay in the application of a regulation where it is acknowledged that the latter raises operational or contractual issues.

Of course, the increase in the ESMA competence should rely on the adequate "checks and balances" and the current ESMA's consultation process with stakeholders should be enhanced while (based on negative precedents such as MIFID 2 discussions) the prohibition for ESMA either to decide to adopt Level 2 measures without being explicitly entitled to do so by a Level 1 text or to proceed to any gold plating measures at level 2 or level 3 should be recalled.

B. <u>Specific answers to the Commission's questions</u>

<u>2. MAKING IT EASIER FOR COMPANIES TO ENTER AND RAISE CAPITAL ON PUBLIC MARKETS</u>

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.

Yes, there are additional actions that can contribute to making it easier for companies to enter and raise capital on public markets

<u>Prospectus</u>

The FBF supports notably one of the main purposes of the new Prospectus Regulation, i.e. to ease the market access for small and mid-sized enterprises (SMEs) and to this effect to alleviate under some conditions the disclosure requirements imposed on them.

However, and although the Level 1 legislation (recently adopted) globally answers the FBF's major concerns on this issue, the proposed text is not ambitious enough to really stimulate the SMEs' market fundraising.

Besides, the Level 1 legislation includes some provisions to be carefully calibrated in the Level 2 legislation in order not to jeopardize the limited positive impact of the Level 1 legislation. It is the case for:

- the content and size of the prospectus summaries (notably for the exemptions to the standard size of the summary and the cap of the risk factors to be included in the summary), and

- 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).

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.

Yes, there are additional actions that can contribute to fostering long-term, infrastructure and sustainable investment as well as covered bonds:

For infrastructure investment:

The FBF welcomes the Commission CRR revision proposal to encourage infrastructure investment needs in Europe, which will lower banks charges for lending to infrastructure projects, providing these are low risk and have predictable cash flows.

Nonetheless, we believe the current wording has the unexpected consequence to exclude important shares of the project financing and minor technical change would correct the effect without modify the intended perimeter.

Paragraph 1 of article 501a allow banks to multiply by a factor of 0.75 capital requirements for credit risk calculation provided the exposure complies with all the criteria listed.

As a matter of general comment to the proposed Article, the complete list of conditions to be fulfilled appear to be quite too restrictive to fit with the existing infrastructure financing market. While we appreciate the merit of selecting the best projects, we would suggest to introduce some flexibility in replacing the above introducing wording by "[…] *provided the exposure complies substantially with all the following criteria*:"

Regarding criteria to be eligible to the discounting factor, some change shall be done to extend the perimeter:

- Exposure to SPV (cf. 501a.1.b):

  The definition should include « *economically comparable exposure* » to extend the criteria to structure that gives the same level of control as an SPV over the security package even if the legal status is an incorporation.

  Financing could be provided to an existing corporate which has been restructured without changing the legal status, e.g. by adding limitations on the borrower like limitation of activity, of additional indebtedness, of new investment, etc or features are included to give the same degree of control as with an SPV, for example:

  - control over assets and their revenues
  - limitation of total indebtedness
  - dividends distribution limitation
  - control of the development of new assets (purchase of assets, capex, …)

  Also in some cases, the assets are not directly financed, but the rights to operate such assets are financed. For example: it can be the case of certain concessions in some jurisdictions (like some roads in France), oil extraction, certain PPP.

- Lenders high degree of protection on the contractual arrangements(cf. 501a.1.g):

  - o Explicit termination amount (cf. 501a.1.g.i): Requesting termination amounts covering debt amount in case of termination of the offtake contract would exclude the majority of projects which benefit from offtake contracts. In case of termination of the offtake contract, as long as the good or service can be sold on an existing spot market or other possible offtakers (counterparties of a sale contract) and as long as the project meets the conditions of 1(e) and 2(a).iv- last alinea, ie predictable cash flows notably in case of low demand, **the project should be considered as eligible to 501a,** even though there is no termination amount. Generally, when the project is located in a region where there is no real spot market, termination indemnities are included in the offtake contract, like in the Middle East for example. If not included, it is because the project could find another offtaker or sell on the spot market, getting also an indemnity for the offtake contract termination in court, such indemnity completing market revenues.

    Also, the sale of electricity for example, can be to a large number of users, through a trading company which sells to distributors, which themselves sell to end users.

  - o Restricting dividend distribution (cf. 501a.1.g.vi): Not allowing dividend distributions, (as long as it is controlled by lenders through fulfillment of cover ratios) would exclude the vast majority of projects. Sponsors (investors) of the project need to be incentivized and to get the dividends as long as cover ratios are met. They are key in a project along its whole life. We therefore propose to authorize dividend distributions subject to conditions (no event of default and fulfillment of cover ratios for distribution if any)

- Structure with completion guarantee (cf. 501a.1.j): Completion guarantees are not frequent and it seems very restrictive. Reducing the cases of projects eligible to article 501a to the ones with completion guarantees would strongly reduce the number of projects eligible, notably in renewable energy for example. We therefore propose to extend the criteria to experienced constructor providing adequate Liquidated damages as confirmed by the technical advisor (to be provided by credit worthy counterparts or covered by acceptable LC).

For sustainable investment:

The key challenge is to reduce the relative cost of investing in the energy transition, by cutting either equipment costs or financing costs. Industrialization and rising volumes have had highly positive effects on the cost of equipment. Despite the low-interest rate environment and growing awareness of the low-risk nature of these assets, the cost of financing the energy transition remains a major challenge.

Therefore, to support and accelerate the financing of these assets in an economy where 70% of finance comes from banks, it is essential to recognize the beneficial nature of such assets for the energy transition and, ultimately, for the mitigation of systemic risk to the planet.

In this context, an « *appropriate prudential approach* » to financing and investment in the energy transition (incentivizing decarbonisation of bank balance sheets) to recognize the macro-prudential benefits of these assets in reducing the probability of these climatic risks is relevant. From a regulatory perspective, this should mean lower capital requirements for financing and investing in these assets. To achieve this we are asking for the introduction of a supporting factor applicable to capital requirements for exposure to assets that support the energy transition: the «Green supporting factor». This would work in a similar way to the already proven SME supporting factor.

<u>For covered bonds</u>:

The European covered bond market has demonstrated its robustness during the last years' financial turmoil. The Eurosystem's covered bond purchase program (CBPP3) naturally contributes to such robustness and dynamism, but this also confirms that covered bonds remain a major financial tool for a sustainable economy (including real estate market and other publicly guaranteed instruments). Investors remain attentive to the quality of the paper offered by covered bonds issuers regardless on whether they are CRR compliant or not.

For this reason, any legislative initiative launched by the European Commission based on the recently published EBA recommendations should be attentive not to create any suspicious distinction with respect to covered bonds which wouldn't be compliant with the CRR Article 129 requirements. On this respect, investors remain the only decision-makers based on their own analysis and financial objectives.

We understand from the recommendations proposed in the latest EBA Report on Covered Bonds that the principle based recommendations for harmonisation as previously targeted by the European regulators was no longer considered as sufficient on a regulatory perspective. In this context, we would like to recall that the current fragmented legal framework for covered bonds is not analysed by investors as an obstacle of a strong covered bond market. As a matter of fact, investors raise very few questions regarding the applicable legal framework and its robustness. Covered bonds bear different spreads depending on the issuer's localization insofar as the nature of the collateral which guaranty the repayment of such bonds is linked to the local economy of the concerned country: public exposures are directly linked to the rating of the relevant State and mortgage loans directly linked in terms of risk analysis to the economic situation of the relevant country.

For this reasons, we still strongly believe that no European legal initiative is necessary since the current European legal framework based on article 52(4) of the UCITS Directive combined with a voluntary convergence with best practices has demonstrated its resiliency.

However, if any European legislative initiative was decided to strengthen such convergence, it should only be made on minimum standard principle basis by means of a directive. This remains the best way to achieve a well calibrated harmonisation of the European covered bond framework, leaving each Member States free to adapt such principles in accordance with its internal legal constraints such as internal insolvency or third party enforceability of asset transfers' regimes, which remain non harmonised topics at European level.

Beside the quality of the underlying portfolio assets and the capacity monitor its components remain important from both the investor and the regulator point of view. In this respect, the harmonised transparency template initiated by the European Covered Bond Council (ECBC) is an appropriate assessment tool.

<u>5. STRENGTHENING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY</u>

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.

Among the subjects listed by the European Commission to strengthen bank capacity to support the wider economy, the following actions should be taken into consideration:

Securitisation:

The STS proposals submitted by the Commission in September 2015, together with revisions to the CRR prudential treatment of securitisation for E-U banks, aimed at defining sound principles to foster a revival of the market; this would help bank grow their lending to the economy by diversifying funding sources and transferring risk exposures.

The proposals, including different versions approved by the Council (December 2015) and Parliament (December 2016), have become a long collection of complex rules, adding numerous constraints on transactions and parties to the market, not only to obtain STS eligibility but also more widely on the whole market. Some of these constraints, such as very tight limitations on authorized investors, could severely reduce the market. The addition of all constraints clearly threatens the very existence of the market. And to cap it all, the proposed "benefits" are inexistent so far: capital necessary to hold securitisation positions will increase for banks compared to the existing situation, and any reductions for insurers (which have almost completely disappeared from the market since Solvency 2) have not yet been defined.

Unfortunately the proposed regulations are proving to be a missed opportunity: securitisation will become, even more than it already is, a financing tool so constrained by regulation as to render it widely unusable. One of the ironies of the STS proposals is that the only areas of the market currently enjoying strong activity or interest (balance sheet synthetic structures used by banks to transfer risks, structures to transfer portfolios of non-performing loans, for example in Italy) have been excluded from STS eligibility, proving that investor interest is not defined by STS rules.

At this late stage in the legislative process (trilogue under way since January), our recommendation to the co-legislators can only be to exercise maximum possible restraint in the creation of new rules in order to minimize the damage that will be done to the market. It would also be useful to mandate E-U regulatory entities (EBA, ESMA...) to assess and possibly amend the new rules where they prove not to work properly.

SSM:

In line with the SSM approach, the CMU project should review:

- The fragmentation of the liquidity within the ECB-supervised banking groups. Indeed, Promoting free-liquidity movements in the SSM perimeter would help ensuring an adequate matching between the financing resources and the EU27 real needs. Conversely, creating disconnected liquidity pockets as a result of an insufficient harmonization through the SSM framework would be detrimental to this objective ;

- The calculation of the G-SII requirement partly based on cross-border activities. Indeed, the "cross-border activities" is defined as "cross-border activity of the group, including cross border activity between Member States and between a Member state and a third country". This entails that intra-Eurozone banking activities are accounted for in the cross-border activity indicator, thereby increasing the measured systemic relevance of Eurozone banking institutions.

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.

Yes, there are additional actions that can contribute to facilitating cross-border investment.

A. Taxation issues

Taxation is a key factor in any investment decision-taking. An efficient, simple and investor-friendly environment is a fundamental prerequisite to a CMU. However, the changes in tax matters have not particularly facilitated the CMU over the last two years.

1. **One of the ongoing European projects which is overly damageable for the European country is the implementation of the Financial Transaction Tax (FTT).**

As EU Member States did not agree to apply the initial 2011 project for a FTT, the Commission issued a revised proposal for a Directive to introduce a common FTT in only 11 Member States under an enhanced cooperation procedure which is now reduced to 10 Member States.

A FTT would have a very negative impact on the European economy and would definitely be a strong barrier to the development of the CMU. It would have significant negative impacts on the financial sector's profitability, affecting in turn the European economy in general.

The introduction of the FTT would distort competition and give an unjustified comparative advantage to the financial centers where the tax is not implemented.

The French banking sector is still very strongly opposed to the implementation of a European FTT.

2. **While we support the Member States will to tackle abusive behaviors of taxpayers, we believe that the new proposal on hybrid mismatches (ATAD 2) may damage the level playing field rules for banks.**

As a reminder, the ATAD directive is part of a January 2016 package of Commission proposals to strengthen the rules against corporate tax avoidance. The package builds on 2015 OECD recommendations to address tax base erosion and profit shifting (BEPS). The compromise version of ATAD II now agreed by the Council will amend ATAD to add rules on mismatches with third countries that apply to taxpayers subject to corporate tax in one or more Member States, including permanent establishments (PEs) of non-EU entities.

EU is a good student and pioneer and going faster than others, but we have to make sure that the others follow and that we are not alone in implementing BEPS OECD “Action Plan Against Tax Optimization”.

Furthermore, no specific rules have been put in place to surpass double taxation in while dealing with hybrids.

3. EU has a role to play to help European companies to face international tax competition.

Some US regulations impact European banks and create a situation which favors US banks. For example, the US tax initiative on derivatives (Section 871(m) of the US Internal Revenue Code) should limit the ability of European banks to deal on derivatives with US underlying stocks.

Indeed, through the introduction of this Section, the US congress aims to prevent non US-persons from using derivative instruments to avoid US withholding tax on US equities. This new rules will apply withholding tax at the rate of 30 % to dividend equivalent amounts received by non-US persons from derivatives that reference dividend paid by US equities.

It results in a distortion of competition between US and European financial institutions. Whereas US financial institution could take advantage of the Tax Treaty and apply, if necessary, the reduced rate, European Banks should finally have to apply the normal rate.

The European Commission should intervene to limit the negative effects of theses specific foreign legislation.

4. EU has to ensure a truly harmonized EU VAT system.

The current VAT system, as currently applied by EU members, is a major source of legal insecurity which creates many tax inefficiencies and discrepancies that impact the European banks. The lack of Europe-wide harmonization of VAT policies does not promote intra-European trade, nor does it help attract foreign investment within the EU.

Some future judgments of CJEU could questioning the system of independents group of persons. It creates an unfair competition for Member States which did not implement the VAT groups.

FBF asks that EU establish a harmonized VAT system.

5. Removing withholding taxes on cross-border flows

Withholding taxes on dividends and interest are a natural obstacle to cross-border flows and an endless source of tax disputes. A true CMU can only be efficient if cross-border flows between Member States are totally free of any tax barrier. This means that withholding taxes should be totally removed on such flows within the EU.

We therefore call for an exemption of all Capital income flows for intra-Community trade. Member states of European Union should remove all withholding taxes especially on interest and dividends when paid to a resident of another member state of European Union.

This proposal would clearly facilitate intra-Community trade. Europe's Internal Market will not be segmented and all the Member State will follow the same rules with respect to cross-border flows.

B. Post-trading issues

GENERAL COMMENTS:

FBF and AFTI are in the opinion it is necessary to stabilize and secure the post-trade sector that should serve the development of cross-border transactions and favor the integration of capital markets in Europe.

The main objectives pursued by FBF are safety, level playing field between the different actors and a greater European harmonization in the context of enhanced investor protection and renewed confidence of the investors in financial markets.

DETAILED COMMENTS:

FBF and AFTI contribute on Section 6 dedicated to facilitating cross-border investment. In addition to the actions identified so far by the European Commission, part of the consultation paper, FBF is of the opinion that 2 additional topics should deserve due consideration when reviewing the functioning of the post-trade landscape.

- **First, as regards the requirement for CCPs to use preferably direct accounts in the books of a SSS under Article 47.3 of EMIR. This requirement leads to uncompetitive behaviors and unfair advantages in favor of the few entities that can be selected by CCPs to hold security collateral, with the additional disadvantage of risk concentration with a limited number of players.** As already stated in other contributions (in particular to the Call for evidence on the cumulative impact of the financial reform), FBF is of the opinion that CCPs should have the option to either deposit the assets received as collateral / Default Fund contributions with a direct account at an SSS or use a highly secured arrangement with a regulated entity such as a bank.

Indeed, an intermediary acting as a custodian is subject to a stringent regulation and supervision by regulators and in general benefits from significantly higher financial resources than the CSDs.

Moreover, as a result of new regulations, CCPs are expected to receive more assets in collateral, including securities, and more diversified (i.e. financial instruments registered with different issuers CSD (SSS). In order to hold these assets without becoming direct member of each and every SSS, CCPs are likely to use "global" SSS services.

Currently only two SSS do provide these services and therefore can benefit from the current reading of Article 47.3. This leads to an undue **monopolistic advantage** and a high **concentration of risk** with these two entities. FBF and AFTI are of this the opinion that is undesirable and should be discouraged.

- **Second, as regards Market Union for services provided to investments funds**, FBF and AFTI expect that:

* All European regulated investment funds available to retail investors appoint a fund depositary in order to ensure investor protection,

* When investment funds are marketed cross-border within the European Union, mechanism to ensure investor protection are properly considered. In particular, local administrative arrangements, such as local agents, acting as contacts for the national competent authorities (NCAs) should be considered.

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Targeted action on securities ownership rules and third-party effects of assignment of claims:

In the context of the CMU, FBF and AFTI support a conflict-of-law rule which brings clarity and legal certainty to all actors, final beneficiary of the securities and account providers. FBF and

AFTI support the option of the conflict-of law rules provided in article 9 of Collateral Directive. From this acquis, FBF and AFTI would expect Article 9 of the Collateral Directive to be improved 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 each securities account in the chain is opened by an account-provider to an account-holder (i.e. “the relevant account”).

- Connecting factor: with regard to the location of the relevant account, FBF and AFTI are 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 being maintained (i.e. Head office or the place of location of the branch when the account is maintained by a branch of the account provider).

Review progress in removing remaining Giovannini barriers:

FBF welcomes the European Commission initiative with regard to EPTF work. FBF and AFTI agree that some existing barriers should be reviewed and whenever necessary updated.

Some additional barriers may be identified, but FBF and AFTI have strong reservations about the fact that diverging views on European post-trade regulations and/or implementation issues would by themselves qualify as “barriers”. Therefore FBF and AFTI would expect the qualification of «barrier» to be restricted to strong and evidenced circumstances where targeted actions are feasible and would concretely contribute to facilitate cross-border investments.

Please find here after our detailed comments.

<u>Among the existing Giovannini barriers</u>:

FBF and AFTI agree 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

FBF and AFTI 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 (see above),
- Differences in national rules relating to corporate actions and beneficial ownership and custody,
- Differences in domestic withholding tax regulations,
- Barriers relating to legal certainty (see above).

In addition, please find hereafter some specific comments and need for clarification concerning the following barriers:

- Concerning the specific issue relative to national differences in information technology, interfaces and messaging standards:

FBF and AFTI 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. In addition it is necessary to keep in mind that a delay is required for a full migration to the ISO20222 format. It could be quite long due to the issues mentioned above and the investments required for such a transition.

- Concerning legal uncertainty on property rights in securities and claims

FBF and AFTI concur with the overall objective of the EPTF to improve certainty on legal aspects. More specifically, FBF agrees with the objective of extending the conflict of law rules of Art. 9 of FCD and SFD. FBF and AFTI, however, 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 hampered by the current situation.

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-law rule, which determines the law applying to 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

FBF and AFTI are of the opinion that the close out netting regime provided for in the Financial Collateral Directive is adequate and efficient. It covers the very vast majority of use-cases of close out netting. Indeed, 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 in the FCD. This regime has been taken as a model for the Unidroit principles for close-out netting that enjoy worldwide acceptance. This serves as the evidence that the current European regime is adequate.

On potential new barriers

FBF and AFTI are of the opinion that only evidence and consensual issues should qualify as new barriers. FBF and AFTI agree that some issues may remain in a number of areas and should not be under-estimated. However, as mentioned above, very often these issues relate to diverging views across the industry and/or implementing issues. Thus, identification of new "barriers" as a problem-solver is not advisable. In this context, FBF and AFTI are of the opinion that the following issues do not qualify as "barriers":

- *Segregation requirements*: in spite of intense debate around segregation requirements, FBF and AFTI are of the opinion that this issue does not qualify as barrier, since full individual segregation (i.e. by end-investor) is not imposed all along the custody chain. Indeed, this option was not retained as feasible, including under the AIFMD and the UCITS V Directive where the two options ESMA recommends (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 get clarification as soon as possible on the final rules and ensure that they will apply consistently across the EU

- *CSDR*: FBF and AFTI do not share the opinion that new requirements due to CSDR as regards settlement in foreign currencies qualifies as a barrier.

- *Post-trade reporting*: The introduction of new reporting obligations with lack of harmonised approach introduced complexity in data analysis and resulted in increasing costs. Difficulties are linked to the lack of coordination between the authorities as regards the scope of data to be reported and the reporting channels/infrastructures to be used. 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.

Study on discriminatory tax obstacles to cross-border investment by pension funds and life insurers

FBF and AFTI welcome the Commission's initiative regarding withholding tax procedure since the absence of a single standardized framework leads to additional costs and complexity for investors and eventually, may deter them to invest cross border.

C. Saving and retirement issues

Developing a European pension solution would be useful and complementary with existing tools such as French life-insurance companies. Reinforcing the prudential level playing field between these different vehicles while maintaining each Member States social choice in the area of pensions is critical. This solution must be opened to a wide range of assets including notably term deposits and ETFs.