ISLA Response – Targeted Consultation on the Integration of EU Capital Markets

1. Simplification and burden reduction

The focus of this targeted consultation is to remove barriers to enhance the integration of the EU capital markets and to support their modernisation. By doing so, it will contribute to simplify the framework of EU capital markets and support the Commission's initiative to make Europe faster and simpler. This section seeks stakeholders' view on general questions regarding simplification and burden reduction of the EU regulatory framework in the trade, post-trade and asset management and funds sectors. Respondents are asked to provide concrete examples to support answers provided, and, where possible, quantitative and qualitative information.

1) Is there a need for greater proportionality in the EU regulatory framework related to the trade, post trade, asset management and funds sectors? Please choose from 1 (strongly agree) to 5 (strongly disagree) or 'no opinion'. If yes, please explain and provide suggestion on what form it should take.

1 2 3 4 5 No opinion

Please, explain [5000 Character Limit]

ISLA is a non-profit industry association, representing the common interests of securities financing market participants across Europe, the Middle East, and Africa focusing primarily on securities lending and borrowing (SLB) activity. ISLA has a geographically diverse membership of over 220 firms that includes institutional investors, asset managers, custodial banks, prime brokers and service providers.

ISLA works closely with the industry, as well as policy makers and regulators to advocate for, amongst other things, the importance of securities lending to the broader financial services industry. We also support and maintain the **Global Master Securities Lending Agreement (GMSLA)**. Most importantly, ISLA plays a pivotal role in the creation and promotion of market best practices and works with members to navigate the European regulatory landscape.

'Greater proportionality' for ISLA, means regulatory frameworks that are tailored to the risks, scale, and complexity of the entities and activities they govern. It implies a shift from rigid, prescriptive rules that apply equally to all, towards a more nuanced approach that differentiates based on a number of things, for example, Systemic Importance. Securities lending, is vital for the healthy functioning and competitiveness of the financial market in Europe. While it can sometimes be misconceived as a niche or complex activity, it underpins many fundamental market processes and provides significant benefits across the entire financial ecosystem.

It makes financial markets more liquid and more efficient, providing access to securities for banks and brokers to meet their market-making commitments and obligations towards clients and EU governments.

It reduces operational risk in the system, making securities available where they are needed, thus ensuring timely settlement of financial transactions, and ensuring market stability.

It is vital for the ability of EU financial institutions to meet their risk management regulatory capital requirements, thus reducing systemic risk in the system. EU legislation requires banks and other market participants to reduce risk by 'collateralising' their exposures to counterparties.

It is an important part of market operations of the ECB & NCBs to implement EU monetary policy and promote financial stability. Central banks can use SLB for quantitative easing to increase supply, by purchasing government bonds and other financial assets from banks and then lending them back into the market.

It provides a low risk means for investors to generate additional portfolio income. Lenders/owners of securities are the ultimate beneficiaries of the income generated from the securities they lend in return for a fee. The revenue can be used to offset operational costs thus improving the overall performance of the portfolio and increasing returns for long term investors.

Furthermore, the Risk Profile of the activity should be considered: Securities lending and borrowing is a long established and well-functioning market in Europe, where an investor temporarily lends securities to a borrower, in return for a fee. In addition to the fee, the borrower provides the lender with collateral in the form of cash or other securities. This protects the lender from the risk of potential loss if the borrower becomes insolvent and is unable to return the lender's securities. The value of the collateral provided by the borrower is normally greater than the value of the borrowed securities, providing additional protection for the lender. To further protect both parties from market fluctuations during the life of the transaction, securities and collateral on loan are revalued on a daily basis and adjusted if needed.

Overly burdensome and disproportionate regulation directly impacts firms willingness and capacity to engage in securities lending. This reduces market liquidity, widens spreads, and ultimately increases costs for end-investors and the real economy. From the perspective of the lender, securities lending is considered a discretionary activity. For the vast majority of institutional lenders (e.g., pension funds, insurance companies, mutual funds, sovereign wealth funds) that engage in securities lending, it is a discretionary investment activity, managed either internally or, more commonly, outsourced to a securities lending agent.

When it comes to creating legislation, to enhance agility in the EU, ISLA believes that Level 1 should establish broad principles only, empowering Level 2 to provide the necessary detail in technical standards. A specific example for ISLA regarding proportionality has been with regard to regulatory reporting under the SFTR. Despite industry efforts, the SFTR framework's disproportionate complexity burdens firms. Streamlining these detailed rules, without compromising data quality, would enhance consistency and usefulness for regulators.

4) Are there any barriers that could be addressed by turning (certain provisions of) the Alternative Investment Fund Managers Directive (AIFMD), Financial Collateral Directive (FCD), Markets in Financial Instruments Directive (MiFID), Undertakings for Collective Investment in Transferable Securities Directive (UCITSD), Settlement Finality Directive (SFD) into a Regulation? Please choose from 1 (strongly agree) to 5 (strongly disagree) or 'no opinion'. If you agree, please explain which barriers and how a Regulation could remove the barrier.

1 2 3 4 5 No opinion

Please explain [5000 Character Limit]

Whilst UCITS legislation has delivered a largely unified and successful investment vehicle for both institutional and retail investors, we believe there is scope to further facilitate the participation of UCITS assets in securities lending, to benefit from additional returns whilst also strengthening the competitiveness of the UCITS brand as a global standard. This includes inconsistent interpretation across Member States, on the acceptability of a pledge (security interest over collateral) mechanism for transferring securities as collateral under a securities lending transaction with UCITS. Pledge-type mechanisms should explicitly be considered as an acceptable form of collateral arrangement in a future UCITS review. Firstly, ISLA would like to highlight the Peer Review on the ESMA Guidelines on ETF's and other UCITS issues, released in July 2018. As part of the 'Follow Up Actions with NCA's' in point (90), it states that: *'In the context of collateral management, there may be an inconsistency between the [2014] Guidelines and Art. 22(7) of the UCITS Directive which was introduced by the UCITS V Directive. While the Guidelines refer to 'title transfer' and 'other types of collateral arrangement' (such as pledging arrangements) to be permissible for collateral received by the UCITS for its EPM, the text of Art. 22(7) stipulates that the assets held in custody by the depositary are allowed to be reused only where the transaction is covered by high-quality and liquid collateral received by the UCITS under a title transfer arrangement.'* This can be found in Article 22 (7)d of Directive 2014/91/EU, amending Directive 2009/65/EC (UCITS v). Advice, in relation to Guidelines for competent authorities and UCITS management companies, released in August 2014 stated: *'Guideline 43, subparagraph (g) offers guidance with respect to title transfer arrangements; however, this has led to uncertainty among market participants as to the nature of "other types of collateral arrangements" which would be suitable. In particular we note recent developments in securities lending via security pledge rather than title transfer. As some security borrowers might have a preference for pledge structures, an absence of guidance with respect to use of pledge structures may be resulting in UCITS investors being disadvantaged in their securities lending activity. Additional ESMA guidance on the use of pledge structures by UCITS could also facilitate UCITS participation in CCP-cleared securities lending.' As local NCAs' legislations are based on UCITS V Article 22(7) and the 2014 ESMA Guidelines, UCITS will be at a significant disadvantage to other lender types, if they are only able to accept collateral under a Title Transfer arrangement, making them less competitive. UCITS V, Article 22(7), which was updated from the UCITS IV, makes clear that a depositary cannot reuse for its own account the assets of a UCITS that it is holding in custody. However, it further states that it can, however, reuse the assets so long as it meets certain requirements'.*

'Title Transfer' and 'Pledging' are only mentioned in UCITS V Art.22 'Obligations Regarding a depositary'.

'Title Transfer' is only referenced in Section 43 (g) of the ESMA 2014 revised Guidelines and 'Pledge' is only mentioned in Section 43 (i):

'g) Where there is a title transfer, the collateral received should be held by the depositary of the UCITS. For other types of collateral arrangement, the collateral can be held by a third-party custodian which is subject to prudential supervision, and which is unrelated to the provider of the collateral.

*i) Non-cash collateral received should not be sold, re-invested, or <u>pledged</u>**.**'*

Additionally, as part of the Peer review on the Guidelines on ETFs and other UCITS issues conducted in July 2018, it was noted in ESMA's report at time of release, that '*One NCA [DE] confirmed that under its current legal framework as well as its internal and external guidance, other collateral arrangements than title transfer arrangements, such as pledging arrangements, are permissible.'* Germany has since, in 2021, removed this provision, as although the guidelines mention 'other types of collateral arrangement', 'pledged collateral' is not explicitly referenced. This clearly demonstrates interpretational challenges around the Guidelines. ISLA believes it would be helpful to include defined terminology and provide examples for 'other types of collateral arrangements' such as Pledge within the Level 1.

Allowing UCITS to accept collateral by way of pledge, increases the attractiveness of UCITS as a source for borrowing, without reducing the levels of investor protection and without introducing additional risk to underlying investors. The GMSLA 2018 Security Interest over collateral 'Pledge' document, is widely used across the market and recognised by ESMA in other pieces of legislation, such as SFTR.

5) Are there areas that would benefit from simplification in the interplay between different EU regulatory frameworks (e.g. between asset management framework and MiFID)? Please choose from
1 (strongly agree) to 5 (strongly disagree) or 'no opinion'. If you agree, please explain and provide suggestions for simplification. Also if possible present estimates of the resulting cost savings.

1 2 3 4 5 No opinion

Please explain [5000 Character Limit]

The EU's regulatory architecture has grown organically over decades, often in response to financial crises or specific market failures. While the goal is a "Single Rulebook," the reality is frequently one of fragmentation, overlaps, and inconsistencies for example, in reporting obligations. A critical overlap exists in **MiFIR** and **SFTR reporting** for SFTs involving EU central banks. SFTR explicitly exempts these, under Article 2(3) but MiFIR's Delegated Regulation (EU) 2017/590, Article 2(5) includes them, creating a direct conflict. This inconsistency generates legal ambiguity, operational inefficiencies, and costs. MiFIR's inherent design is unsuitable for capturing SFT characteristics, leading to inaccurate and largely unhelpful reporting data. ISLA would request that ESMA amend Article 2(5) of the Delegated Regulation to exclude all SFTs from MiFIR reporting and that all SFT transactions are reported via SFTR.

In terms of asset management conflicts, as described in our response to Question 4, we encourage ESMA and the Commission to acknowledge the use of Security Interest over Collateral 'Pledge' within the UCITS framework. This is because the EU's Uncleared Margin Rules under EMIR, have already introduced the concept of UCITS being able to accept collateral in other ways that are not via Title Transfer. This concept should be brought across in the context of UCITS engaging in securities lending transactions to ensure alignment.

UCITS which enter into uncleared OTC derivatives are subject to an obligation under EMIR to exchange collateral to mitigate the risks of one of the counterparties defaulting on their obligations. The exchange of collateral must comply with detailed requirements set out in Commission Delegated Regulation (EU) 2016/2251 (the Margin RTS). All UCITS are required under the Margin RTS to exchange variation margin (VM), which protects counterparties against exposures related to the current market value of their OTC derivatives. UCITS which have larger derivatives portfolios (i.e., UCITS which have an aggregate month-end average notional amount of uncleared OTC derivatives of 8 billion EUR or more) are also required to exchange initial margin (IM), which protects counterparties against potential losses that could stem from movements in the market value of the OTC derivatives occurring between the last exchange of VM before the default of a counterparty and the time that the OTC derivatives are replaced or the corresponding risk is hedged.

The Margin RTS does not explicitly require counterparties to use title-transfer collateral arrangements or security interest collateral arrangements, such as pledges to meet the requirements to exchange VM or IM, however, both types of collateral arrangements can be used to meet the requirements in the Margin RTS relating to VM and both are used in practice.

In contrast, it is commonly accepted in the market that title-transfer collateral arrangements cannot meet the more stringent requirements in the Margin RTS for IM. In particular, the Margin RTS requires that IM must be protected from the default or insolvency of the collecting counterparty. This cannot be achieved using a title-transfer collateral arrangement as the collateral becomes part of the proprietary assets of the collecting counterparty and, therefore, would not be protected from the default or insolvency of the collecting counterparty. Therefore, in practice, UCITS which are subject to the obligation to exchange IM must use security interest collateral arrangements such as pledges to comply with the IM requirements in the Margin RTS.

The UCITS Directive permits UCITS to use both OTC derivatives and securities lending arrangements for efficient portfolio management ("EPM"). ISLA proposes that there should be consistency between both types of EPM techniques as to the permissible ways in which UCITS can accept collateral. Given that UCITS are permitted to accept collateral subject to security interest arrangements such as pledges, to meet their obligations under the Margin RTS for uncleared OTC derivatives and, as a practical matter, have to accept collateral under such arrangements if they are subject to the requirement to exchange IM, it should also be possible for UCITS to accept collateral under security interest collateral arrangements (such as pledges) where this relates to their securities lending activities.

7) Do you have other recommendations on possible streamlining and simplification of EU law, national law or supervisory practices and going beyond cross-border provision?

Yes / no / no opinion
If yes, please list your recommendation and suggested solutions. Please rank them as high, medium or low priority.

Please explain [5000 Character Limit]

Outside of core financial market regulation, the withholding tax landscape across Europe can act as a significant barrier to entry for investment, and further reduce competitiveness. We commend Commissioner Mairead McGuinness, in her 2024 letter to Mario Draghi, where she highlights as a priority, greater harmonisation within the single market to iron out divergent national rules, mentioning barriers linked to differing taxation frameworks. The recently agreed FASTER Directive aims to make the administrative withholding tax procedures better fit for cross-border investment and combat the possibilities of abuse of taxation rules. However, without a clear and consistent definition of 'beneficial ownership' of securities, and a consistent interpretation of OECD guidelines, this can create obstacles for investors when allocating their investments across international markets, thereby potentially limiting the growth of EU capital markets. Furthermore divergent anti-abuse legislation across EU member states, including retrospective changes of guidance and lack of clear and unambiguous regulation can result in investors withdrawing their supply of securities available for lending from the market altogether. ISLA would recommend that as part of the implementation of the EU FASTER Directive, the Commission should promote clear, unambiguous and forward-looking legislation, including a harmonised EU-wide definition of beneficial ownership, taking into account widely accepted international standards, such as the OECD guidelines and ensure consistency of interpretation between Member States. Achieving consistent terminology, particularly a unified definition of 'beneficial owner' throughout Europe, is a key step to preventing transactions that undermine market integrity.

8) Does the EU trade, post-trade, asset management or funds framework apply disproportionate burdens or restrictions on the use of new technologies and innovation in these sectors? Please choose from 1 (strongly agree) to 5 (strongly disagree) or 'no opinion'. Please explain and provide examples.

1 2 3 4 5 No opinion

Please explain [5000 Character Limit]

Capital markets in Europe are now more accessible than ever, and a lot of this can be attributed to technology advancements that have considerably reduced the cost of trading, especially for the individual retail investors. Support for development of new infrastructures in the Post Trade space such as Distributed Ledger Technology can further: (i) reduce settlement times, with the potential for 'real time' settlement finality, eliminating the delays caused by traditional intermediaries (ii) reduce operational costs by streamlining the often manual elements of the settlement process (iii) enhance transparency and auditability by creating a secure record of all activity reducing risk and potential fraud (iv) improve governance by providing a clear picture of ownership and transaction history with access to consistent and good quality data to help mitigate counterparty risk.
To encourage greater use of digital infrastructure, ISLA believes that the use of digital assets, such as tokenised traditional financial assets, could make the EU more competitive and even more accessible. Digital assets can make a significant positive impact on liquidity, as they allow for fractionalisation, meaning that market participants can gain ownership of assets in smaller digital units, which facilitates participation from a much wider range of investors, including those with less capital. New asset classes can also create additional avenues for funding and collateral purposes by removing geographical and operational barriers associated with traditional collateral management, leading to a more frictionless market. The regulatory environment to facilitate movement of tokenised assets as well as the infrastructure, including custody solutions and trading platforms is still evolving, and ISLA would support further developments as well as further consultation with industry.
For technology to thrive, it is imperative that financial markets adopt not just the technology, but also a unified and therefore frictionless standard. To further this outcome, ISLA has been working alongside the International Swaps & Derivatives Association (ISDA) and the International Capital Markets Association (ICMA) to develop the FINOS Common Domain Model (CDM). The CDM creates a single data standard that can be used to represent securities lending, repo and derivative transactions through common data points, transaction lifecycle events and product definitions. This common standard approach will support legal, KYC and static information that underpin market operations and therefore improve post-trade activities. The improved data clarity realised by this approach not only improves market efficiency but also has been proven to significantly reduce costs, for both the market and regulators. In its April 2022 Machine Readable Executable Reporting feasibility study, the European Commission highlighted the benefits to both market participants and the supervisory community of a CDM. Combining this concept with the reality that regulatory compliance represents one of the largest operating costs, there are obvious benefits to adoption of these technologies and standards, further improving the attractiveness of operating in the EU.
ISLA would recommend a primary focus on developing a sturdy legislative framework to embolden participation in the market for digital assets including through MiCA, MiFID II and a review of the DLT Pilot Regime for Market Infrastructures based on DLT, to create harmonisation and remove uncertainty for businesses by outlining clear and concise definitions and use cases. ISLA requests support for the uptake of the Common Domain Model (CDM) for SFTs, bonds and derivatives markets

to reduce the regulatory burden and cost for regulators in the EU, whilst promoting a level of standardisation across markets for lifecycle events, thus improving interoperability and communication across the EU capital markets.

9) Would more EU level supervision contribute to the aim of simplification and burden reduction?

Please choose from 1 (strongly agree) to 5 (strongly disagree) or 'no opinion' and explain.

1 2 3 4 5 No opinion

Please explain [5000 Character Limit]

The question of whether greater EU-level supervision, specifically by bodies like ESMA, would contribute to simplification is complex. While increased centralisation of supervisory powers holds promise for streamlining certain aspects of regulation, the fundamental complexity of the EU's legislative process itself remains a significant factor.
The primary concern is not in regards to more central supervision but rather more **consistent interpretation and application of rules across all Member States**. This is currently a significant pain point for firms operating cross-border, as National Competent Authorities (NCAs) can interpret the same EU directives differently, leading to "gold-plating" and a fragmented regulatory landscape. Providing a truly single rulebook in practice is therefore key to simplifying compliance for firms.

For firms operating across multiple EU countries, reporting to a single EU-level supervisor (or through a highly coordinated system managed by ESMA) could replace the need to report to numerous NCAs, significantly reducing duplicative efforts and associated IT costs. ESMA itself has recently emphasised its efforts to simplify and reduce reporting burdens, for instance, by seeking to remove duplicative reporting obligations under MiFIR by reusing already reported transaction data.

However, it's crucial to acknowledge that increased EU-level supervision will not fully address the burden, primarily due to the inherent complexity of the **EU's legislative process.** The EU's multi-layered legislative process, involving the Commission, Parliament, and Council, often results in highly detailed and prescriptive Level 1 regulations. While Level 2 measures (delegated acts, technical standards) are intended to provide flexibility, the initial Level 1 texts can be so granular that they constrain ESMA's ability to simplify or apply proportionality effectively. The comprehensive and multi-stakeholder nature of EU legislation can make it a slow and cumbersome process to amend or adapt rules to rapidly evolving markets or emerging risks.

3. Post-trading

Issues with respect to post trading identified to date fall into three main areas:

• barriers to cross-border settlement
• barriers to the application of new technology and new market practices
• unharmonised and inefficient market practices and application of law, as well as disproportionate compliance costs.

This consultation aims to further specify the above barriers, as well as understand current market practices and costs borne by market participants, be they fees or other compliance costs. This section seeks feedback on possible measures, legislative or non-legislative, to achieve more integrated, modern post-trading infrastructures. Respondents are asked to provide concrete examples to support answers provided, and, where possible, quantitative and qualitative information.

3.1.3. Settlement services in the EU

23) How could settlement in T2S be further enhanced in order to build a deeper and more integrated market in the EU and facilitate cross-CSD settlement? [5000 Character Limit]

ISLA believes that there a number of challenges that need to be resolved in the EU post trade landscape outside of developing T2S however, enhancing settlement in T2S to build a deeper and more integrated EU market and facilitate cross-CSD settlement requires a multi-faceted approach, focusing on optimising existing frameworks, leveraging securities lending, and embracing digital transformation.

Optimise the CSDR framework - Europe has a robust, yet fragmented, securities settlement framework under the Central Securities Depositories Regulation (CSDR). For ISLA, securities lending and borrowing plays a vital role in reducing settlement fails in core equity and bond markets. Securities lending and borrowing is seen as the obvious solution to secure settlement efficiency. ESMA has acknowledged that 'securities borrowing is usually the easier way to prevent or resolve a settlement fail caused by the lack of securities'. Therefore, supporting and empowering securities lending directly contributes to better settlement outcomes within T2S. While an accelerated settlement cycle (e.g., T+1) is a significant step towards modernising capital markets and enhancing attractiveness to invest in Europe, ISLA cautions against additional or progressive penalties under CSDR without clear evidence of their effectiveness. Such penalties could exacerbate liquidity concerns, impose substantial administrative burdens, and potentially discourage participation by smaller market participants. ISLA has been directly involved in discussions with policy makers and regulators surrounding the implementation of T+1, and is broadly supportive of the move. ISLA is working with the EU industry T+1 taskforce and in particular its SFT workstream, to produce a set of recommendations for the Commission to utilise. ISLA would recommend that the Commission liaise directly with the independent Chair, Giovanni Sabatini to seek feedback on the industry's SFT technical workstreams findings, as these are near finalised.

One point to raise specifically in relation to T2S, is that there is a lack of harmonisation between T2S and non T2S markets. Regarding settlement cut-off times, T2S has successfully harmonised DvP and FoP cut offs, however in non-T2S markets, variations remain. Seamless settlement across markets requires harmonisation and non-T2S markets should be encouraged to adopt similar features. ISLA would highlight that any current fragmentation between T2S participants themselves also needs to be resolved, for example with corporate action processing. In the 15th T2S Harmonisation Progress Report from the ECB in January 2025, they stated 'Even though 24 national and international FMIs have connected to T2S, not all of them have adopted the necessary standards to harmonise their individual markets with the requirements of the platform. The ECB monitors connected markets adoption of various post-trade standards as part of its annual review process and according to its latest assessment in January 2025, there is still room for improvement in many markets. The ECB notes in its report that corporate actions market practices are the most lacking in terms of required standards adoption, with 18 markets in need of further harmonisation. These market practice differences will further complicate the implementation of T+1.'

25) Are there any national market practices, laws, rules/regulations, or operational requirements which hinder the participation in T2S or cross-CSD settlement? Yes / No
Please provide details. [5000 Character Limit]

ISLA is supportive of the AMI-SeCo SEG's report on remaining trade barriers to post trade integration. The main post-trade barriers in the European Union, generally recognised across various industry and regulatory bodies, revolve around the continued fragmentation which hinders the creation of a truly integrated and efficient single capital market. One of the main barriers to entry that falls outside of trade processing, is around the divergent national tax regimes. Complex and varying national tax rules, particularly those related to withholding tax, create significant administrative burdens and costs for cross-border investors, discouraging efficient capital flow. Inconsistencies in legal definitions for key concepts (e.g., beneficial ownership) across national legal systems complicate compliance and can create legal risks for cross-border transactions.

26) What can be done to ensure progress and take-up by T2S participants of already agreed harmonised standards and market practices (e.g. market standards for corporate actions, SCoRE corporate actions standards, T2S corporate action standards, other T2S harmonisation standards, other relevant global or European market standards and market practices)? [5000 Character Limit]

ISLA believes that enforcement of T2S practices should be discussed via specific industry T2S governance groups and doesn't necessarily require legislative action. However, ISLA supports NCA's taking a more active role in promoting the adoption of standards more broadly. As described in responses to previous questions, ISLA has been working alongside the International Swaps & Derivatives Association (ISDA) and the International Capital Markets Association (ICMA) to develop the FINOS Common Domain Model (CDM). The CDM creates a single data standard that can be used to represent securities lending, repo and derivative transactions through common data points, transaction lifecycle events and product definitions. This common standard approach will support legal, KYC and static information that underpin market operations and therefore improve post-trade activities. The improved data clarity realised by this approach not only improves market efficiency but also has been proven to significantly reduce costs, for both the market and regulators. More information regarding the CDM can be found here.

27) Do you comply with the abovementioned standards and market practices (e.g. market standards for corporate actions, SCoRE corporate actions standards, T2S corporate action standards, other T2S harmonisation standards, other relevant global or European market standards and market practices)?

If not, which ones do you not comply with. Please explain why.

[Yes/No]

On behalf of the members of ISLA, we broadly support the standards and market practices mentioned above and continuously engage with our member firms to establish and maintain our own specific market best practices, particularly on issues such as partial settlement and bilateral claims resulting from CSDR penalties. The ISLA Best Practice Handbook can be found here.

3.1.4. Legal certainty

39) Are there barriers for investors to obtain legal certainty on their rights and powers (e.g. ownership rights, rights in relation to corporate events)and for intermediaries to have legal certainty on their duties in relation to financial instruments, cash or cash equivalent, issued in/maintained in/settled by a CSD?
Yes/No]
[5000 Character Limit]

ISLA believes that a critical barrier is the absence of clear and consistent definitions for example of 'beneficial ownership' and 'shareholder' across EU Member States. This ambiguity directly impacts the ability of investors to determine their precise legal rights and powers associated with ownership of those securities, particularly in markets such as ours, where legal title is transferred between the lender and the borrower of securities. These terms are outlined in the Global Master Securities Lending Agreement of which ISLA supports and maintains.

There is often a misalignment from national regulators between who is deemed to be the economic owner, the legal owner, and the owner for tax purposes in the context of securities lending transactions and the absence of a consistent and clearly articulated definition of the term 'beneficial ownership' can make it difficult to determine how relief procedures should be applied in practice.

Further, in the context of the EU's Shareholders' Rights Directive, the effectiveness of provisions aimed at facilitating shareholder engagement (e.g., identification of shareholders, exercise of voting rights, timely information flow) is severely hampered while there is no common understanding of who the 'shareholder' actually is throughout the complex chain of intermediaries and especially in the context of securities lending. The SRD II review that has applied since 2020, was an important step towards improving the legal framework, however the lack of a shareholder definition that relies on domestic corporate and securities laws of the country of issuance means that the party identified as the shareholder can differ between EU Member States, which is especially problematic from a cross border perspective.

ISLA requests that policy makers consider clear, unambiguous, prospective and operationally achievable legislation in these areas. There is an increasing risk that uncertainty, stemming from unpredictable and fragmented approaches as well as unclear definitions by EU policy makers, may jeopardise the overall role of securities lending in capital markets and the liquidity of securities.

3.3. Barriers and other aspects under the FCD

88) Do you see legal uncertainty related to the recognition of tokenised financial instruments as collateral under the FCD? If yes, please describe these uncertainties. Yes/ No
Please Explain [5000 Character Limit]

Legal uncertainty is the key barrier against widespread adoption of DLT by investors and institutions in publicly traded securities. While the FCD broadly covers "financial instruments" and "cash," the unique characteristics of tokenised assets and Distributed Ledger Technology (DLT) create several ambiguities:

Legal Qualification of Tokenised Assets: It is not always clear how a tokenised asset, which is a digital representation, fits into the existing legal definitions of "financial instruments" (e.g., shares, bonds) or "cash" as understood by the FCD. The legal nature of a token itself (e.g., whether it represents direct ownership, a claim, or a mere record) can vary and affect its eligibility.
Definition of "Account" and Location: The FCD's conflict-of-laws rules often refer to the "law of the country in which the relevant account is maintained." DLT networks, by their decentralised nature, typically do not involve traditional intermediary accounts or a single physical location, making it challenging to determine the applicable law for collateral arrangements.
Perfection and Enforcement of Security Interests: Traditional collateral law often relies on concepts like "possession" or entries in centralised registers for perfecting (making legally effective against third parties) and enforcing security interests. Adapting these concepts to the DLT environment, where assets are digitally transferred on a distributed ledger, requires legal clarification to ensure enforceability, especially in insolvency proceedings.
Interoperability and Standards: The lack of a unified legal and technical standard for tokenised assets across different DLT platforms and jurisdictions can create fragmentation and further legal uncertainty, hindering cross-border DLT-based collateral arrangements.

89) Do the definitions and concepts in the FCD, including the notion of 'possession and control', 'accounts' and 'book-entry' result in barriers or legal uncertainty, e.g. due to the change in market practices, the use of DLT? Yes/ No
Please Explain [5000 Character Limit]

They are not consistent with how those concepts are understood in a DLT based settlement structure.

90) Is the list of collateral providers and collateral takers limiting the applicability of the FCD in a detrimental manner for DLT-based financial collateral arrangements? Yes/No
Please Explain [5000 Character Limit]

It is not the primary factor. Collateral providers and takers are inconsistently stated across different EU jurisdictions.

91) Do you think that collateral other than cash, financial instruments and credit claims should be made eligible under the FCD, in particular in light of DLT based financial collateral arrangements? If yes, please list what other forms of collateral should be considered as eligible and explain why. Yes/ No
Please Explain [5000 Character Limit]

Other forms of collateral for example are tokenised commodities. DLT allows for the fractionalisation and efficient transfer of ownership of physical commodities, overcoming historical challenges of physical delivery, storage, and fungibility in traditional collateral arrangements. Making these eligible under the FCD could unlock significant real-economy value as collateral, increasing the pool of available liquidity. Broadening eligible collateral types significantly increases the overall pool of assets that can be used for financial collateral arrangements, enhancing market liquidity and resilience.
It allows a wider range of assets to be efficiently mobilised for financing purposes, benefiting businesses who hold significant value in non-traditional financial instruments.

92) Do you see the need to change the current approach that only financial collateral arrangements should be protected where at least one of the parties is a public authority, central bank or financial institution? Yes / No

Please Explain [5000 Character Limit]

This concept has not been implemented equally in all EU Member States, as this wasn't a mandatory restriction, therefore some jurisdictions do offer protection to a wider range of parties. If any changes were made, it would need to be consistent across the EU.

93) Is the non-aligned definition of 'collateral security' and 'financial collateral' under the FCD creating barriers? Yes / No

Please Explain [5000 Character Limit]

These terms also relate to Insolvency laws across the EU, which are also unharmonised. In order to harmonise more broadly, ISLA would recommend that the insolvency laws need to be harmonised in tandem.

95) Have you encountered problems with the recognition/application of close-out netting provisions under the FCD (both national and cross-border) ? Yes / No

Please Explain [5000 Character Limit]

The Industry requires legal opinions to support their effectiveness in each jurisdiction, ISLA maintain the Global Master Securities Lending Agreement (GMSLA) and provide the legal opinions in each jurisdiction, which may also even be split down further into counterparty type.

96) As noted in the Commission report on the review of SFD and FCD (COM(2023)345 final), given the FCD deals primarily with financial collateral and only peripherally with netting (only as one of the methods that can be used to enforce collateral arrangements), do you consider that there is a need for further harmonisation of the treatment of contractual netting in general and close-out netting in particular? ? Yes / No

Please Explain [5000 Character Limit]

ISLA believes that there is a need for further harmonisation however, care needs to be exercised so that other directives such as the Insolvency Directive do not inadvertently create contradictory law to the FCD.

Tokenised securities will be tech neutral but, as a point of law they may be treated differently because of the way they are held or transferred. Legal certainty that transfers have taken place is required. i.e. transfer of title. The FCD is dependent on the same legal structure we have for the account based system and intermediated holding structure at CSD level for transfers of securities and settlements of transactions. However, DLT is a new and different structure, and so there needs to be certainty both at the SFD and FCD level that they determine and recognise when transfers take place.

All collateralised financial markets are totally dependent on the enforceability of collateral arrangements including close out netting, title transfer and security interest (Pledge) agreements. Even though there are inconsistencies and some legal uncertainties with the FCD, as it currently stands, there is nonetheless a level of certainty supported by legal opinions that allow the markets to operate efficiently. When we consider tokenised securities, for securities held or issued in this form, a completely different analysis is required as regards to netting, title transfer and security interest.