

15 November 2017

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to share our views on the Consultation Paper issued by the European Commission on post-trade in a Capital Market Union published on 23 August 2017 with a deadline for a response by 15 November 2017.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 6511006398676.

The Global Foreign Exchange Division (GFXD) of the GFMA is submitting a separate consultation reply that focuses on foreign exchange.

Since we have been heavily involved in and have consented to both the main EPTF Report and the Detailed Analysis of the European Post Trade Landscape, our response does not cover all questions but rather focuses on some key points in the Executive Summary and on answers to questions 3, 4 and 5.

Please do not hesitate to contact Werner Frey, email werner.frey@afme.eu, should you wish to discuss any of the points.

Association for Financial Markets in Europe

London Office: 39th Floor, 25 Canada Square, London E14 5LQ, United Kingdom T: +44 (0)20 3828 2700

Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 788 3971

Frankfurt Office: Skyper Villa, Taunusanlage 1, 60329 Frankfurt am Main, Germany T: +49 (0)69 5050 60590

www.afme.eu

Executive Summary

With reference to the two sections of the consultation, AFME is of the view that **two interrelated parallel processes** are required to successfully promote the European Post Trade Reform to significantly contribute to the objectives of the CMU project *and* to the global competitiveness of European Capital Markets:

- the **swift dismantling of the EPTF Barriers** that on purpose have been narrowly defined to facilitate the implementation of the proposed solutions in the CMU context, and
- the **development and implementation of a longer-term strategy** for a comprehensive European Post Trade Reform.

In regard of the process of **dismantling the EPTF Barriers** (chapters 3.2. and 4 of the consultation document) AFME

- strongly supports the EPTF Report, its analysis and proposed solutions;
- advocates the inclusion of *all prioritised* EPTF Barriers in the CMU Action Plan;
- proposes to continue the close and *institutionalised* cooperation between the public and the private sector to monitor the dismantling of *all* EPTF Barriers;
- believes that the dismantling of the EPTF Barriers should start with no delay and therefore not made dependent e.g. on possible future benefits derived from technological developments such as DLT or the outcome of Brexit negotiations;
- suggests intensifying the *dialogue with Member States* in a bespoke and targeted manner as part of the aforementioned public-private partnership.

The second of the proposed parallel and interrelated processes, i.e. the **development and implementation of a longer-term strategy** for a comprehensive European Post Trade Reform, refers to the first section of the consultation (3.1.). In this context AFME

- stresses the importance of progress on the EPTF barriers
- emphasizes that progress on the EPTF barriers will facilitate longer-term strategic steps
- refers to the AFME Post-Trade White Paper¹
- proposes the setup of a strategy group by the European Commission, the mandate of which should inter alia include
 - the definition and the objectives of a comprehensive European Post Trade Reform;
 - an assessment of the likely impact of technological developments, based on an analysis to be performed of the conditions precedent, such as the legal and regulatory framework for such technological developments;
 - an assessment of the degree to which the successful dismantling of the EPTF Barriers achieves the defined objectives;
 - an analysis in regard of the timeliness of current post trade processes including their rationale;
 - high level proposals for achieving the defined objectives.

¹ <https://www.afme.eu/globalassets/downloads/briefing-notes/afme-post-trade-white-paper-2016.pdf>

In our view the following areas particularly require more in-depth work

- systemic risk /risk transmissions in the settlement space
- harmonisation of tax processes
- collateral management

Question 1: *Questions related to trends in European post trade services*

In our view, the Detailed Analysis of the European Post Trade Landscape (Annex 3 to the EPTF Report) provides comprehensive and detailed answers to the questions raised.

Question 2: *Questions related to DLT*

We concur with the opinion expressed by AMI-SeCo in its consultation response as its membership includes AFME members. Also, this opinion is in line with our views expressed in ESMA's DLT consultation 2016

<https://www.esma.europa.eu/press-news/consultations/consultation-distributed-ledger-technology-applied-securities-markets>

and in the EC fintech consultation 2017

<https://www.afme.eu/en/reports/consultation-responses/afme-response-to-european-commissions-consultation-on-fintech-a-more-competitive-and-innovative-european-financial-sector/>

In particular we would like to highlight that in our view

- DLT is one of several means to benefit post trade processes; on a case-by-case basis other fintech solutions may however be better alternatives;
- harmonisation and standardisation often are a pre-requisite to avoid continued (or renewed) fragmentation and to provide for a business case for related investments;
- DLT will benefit transparency in post trade processes;
- a regulatory level playing field is imperative.

Question 3: *Question related to systemic risk*

It is important to note that post trade services have proven safe and resilient even in times of crisis as in 2007/08. T2S and regulatory initiatives in the past decade have further improved safety in the post trade space.

We therefore perceive the following areas as being most prone to systemic risk

- a technical failure of a major (I)CSD for an extended period of time rendering timely settlement impossible
- an insolvency of a major CCP caused by a simultaneous insolvency of an extraordinary number of participants
- a knock-on effect of operational and/or IT failures, e.g. caused by cyber-crime.

Consequently, solutions to address such systemic risk concerns include

- back-up / contingency systems in place at FMIs
- elimination of uncertainty as to the legal soundness of risk mitigating techniques used by intermediaries and of CCPs' default management procedures, e.g. as proposed by the EPTF
- cyber-crime prevention measures.

We dispute the analysis contained in paragraph 3.1.3 that suggests that securities lending and collateral management are inherently sources of risk, and of operational risk. Securities lending and collateral management are services that are used by market participants to manage their resources of securities and cash so to facilitate the settlement of their obligations on intended settlement date, and to manage their exposure to counterparty risk. Accordingly, securities lending and collateral management contribute to the reduction both of bilateral counterparty risk, and of systemic risk. As with all financial service activities, there are, of course, risks, including operational risks, associated with such activities. We believe that progress in tackling the EPTF barriers, as well as further work on the analysis contained in Annex 3 of the EPTF report (such as the discussion of default procedures of clients of CSD participants that is contained on page 75 of Annex 3), will help tackle the underlying sources of risk.

Question 4: The international dimension and competition in post-trade

In our view there are two complementary dimensions:

- the impact of international principles and rules on European post trade such as internationally agreed principles for financial markets infrastructure, in particular the principles set out by CPMI / IOSCO, that are a very useful tool to reduce risk and increase efficiency at a global level and coherence of regulatory regimes, in particular in areas where trading activities are of a global nature such as in OTC derivatives and related clearing;
- solutions developed in Europe that should be adopted globally such as the T+2 settlement cycle and the European market standards for corporate actions processing that have been condensed by ISSA in principles to be implemented globally.

A condition precedent to further international operational and legal harmonisation and standardisation is in our view the successful completion of European post trade reform.

In our assessment, the overall level of competition in the post trade space has significantly increased over the last decade. The consolidation in the custody industry is proof of such increased competition.

T2S at the FMI level and the dismantling of EPTF Barriers will have a positive effect on competition and further consolidation in post trade, of which investors will be the beneficiaries.

Question 5: Future strategy for European post-trade services

The AFME Post Trade Division issued in June 2016 The White Paper 2016² that describes in chapter 3 the targeted future state of the post-trading landscape in Europe in detail.

We propose the setup of a strategy group by the European Commission, the mandate of which should inter alia include

- the definition and the objectives of a comprehensive European Post Trade Reform;
- an assessment of the likely impact of technological developments, based on an analysis to be performed of the conditions precedent, such as the legal and regulatory framework for such technological developments;
- an assessment of the degree to which the successful dismantling of the EPTF Barriers achieves the defined objectives;
- an analysis in regard of the timeliness of current post trade processes including their rationale;
- high level proposals for achieving the defined objectives.

In addition to the proposed strategy group, bespoke expert groups may be required to deal with individual topics.

Questions 6 to 12: related to EPTF Barriers

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

We confirm our support of the prioritisation of the EPTF Barriers as outlined in the Executive Summary of the EPTF Report.

We note that there is currently work in progress related to the withholding tax barrier and to the barrier related to legal uncertainty in proprietary rights in intermediated securities and third-party effects of assignment of claims

We note in particular that the work on the withholding tax barrier is based on a non-binding Code of Conduct. We are concerned that the Code of Conduct may not cover the full set of suggestions set out in the EPTF report, and that the non-binding nature of the Code may lead to different degrees of implementation across different member states. Given the importance of the barrier, we urge the that Commission and Member States be ambitious in codifying and implementing the EPTS suggestions, including such suggestions as the harmonisation of the fiscal status of market claims.

We confirm that all EPTF Watch-list Barriers deserve close attention in the future. This is especially the case for Watch-list Barrier 4 on insufficient collateral mobility. We believe

² <https://www.afme.eu/globalassets/downloads/briefing-notes/afme-post-trade-white-paper-2016.pdf>

that this Barrier will become much more significant as market conditions change (with the progressive tightening of monetary policy, and as unconventional monetary policy actions stop), and as new regulatory measures take effect (such as the progressive implementation of margining requirements, and of new Basel liquidity requirements).

We deem a monitoring group set up by the European Commission with representatives from the public and the private sector highly important to maintain the momentum created by the work of the EPTF, increasing thus the chances of EPTF Barriers being successfully dismantled.