Our position

Trilogue recommendations

Central Securities Depository Regulation (CSDR)

Markets in Financial Instruments Regulation (MiFIR)

Alternative Investment Fund Managers Directive (AIFMD)

American Chamber of Commerce to the European Union
Speaking for American business in Europe

Avenue des Arts/Kunstlaan 53, 1000 Brussels, Belgium • **T** +32 2 513 68 92
info@amchameu.eu • amchameu.eu • European Transparency Register: 5265780509-97

Executive summary

The EU co-legislators are currently negotiating the review of Central Securities Depository Regulation (CSDR), Markets in Financial Instruments Regulation (MiFIR) and Alternative Investment Fund Managers Directive (AIFMD). These files are essential for functioning of the European Capital Markets Union (CMU). Despite many positive aspects, businesses have identified areas for refinement that would further ensure strong and attractive European capital markets. Amongst others, co-legislators should focus on:

- Narrowing of the mandatory buy-in (MBI) provisions and digitising post-trade processes with regard to the CSDR.
- Creating a consolidated tape and calibrating transparency regimes within the MiFIR.
- Ensuring that liquidity risk management is the primary responsibility of the investment manager and opting for qualitative reporting with regard to the AIFMD.

Introduction

In today's context of global tensions, in particular the Russian aggression in Ukraine, period of high inflation rates and recent energy price issues, the creation of a strong and complete CMU is more important than ever. The CMU could become an effective solution for many of the challenges the EU is currently facing. It is also key to support the economic recovery and to channel private funds into investments in the green and digital transitions and to build an inclusive and resilient economy.

Currently, key files of the CMU package are being negotiated in trilogues – in particular, the review of the CSDR, MiFIR and AIFMD. Despite positive developments, there are numerous aspects for refinement in order to achieve a fully functioning CMU.

CSDR

A well-functioning and calibrated settlement discipline regime is a critical pre-condition for the development of safe and efficient capital markets in Europe. Appropriate calibration of, and articulation between, the penalties and buy-in provisions are crucial to the success of such a settlement discipline regime. The co-legislators have already made improvements to the initial Commission proposal regarding the narrowing of the mandatory buy-in (MBI) provisions[1].

MBIs and cash penalties

In the Council's General Approach **(GA)**, the provisions relating to cash penalties and MBIs have been clearly decoupled into two distinct articles. This allows them to be treated and activated separately, in a manner that reflects their different disciplining function in the market. In this regard, the **cash**

[1] MBIs, even if implemented as a last resort, could have severe adverse effects on the efficiency and liquidity of markets – in alignment with the ECB's opinion of 22nd July 2022 that recommends discarding MBIs altogether.

penalties regime should be prioritised as the most effective and transparent tool to encourage settlement efficiency.

The Council's GA and European Parliament (EP) appropriately consider that **MBIs should only be implemented as a last resort measure.** This would require the Commission to consult the European Systemic Risk Board (ESRB) and request a cost-benefit analysis from the European Securities and Markets Authority (ESMA) before being able to adopt MBIs through an Implementing Act (IA). It also encourages the Commission to further assess the effectiveness and proportionality of the penalty mechanism before adopting its IA without considering the IA settlement efficiency in the EU vs other third-countries like the US (which has an inherently less fragmented post-trading landscape that skews proper analysis).

The EP's position requires that the IA further takes account of whether or not a particular market is already subject to appropriate contractual provisions which provide a right for receiving participants to trigger a buy-in. This is consistent with the master agreements such as the Global Master Securities Lending Agreement (GMSLA) (for securities lending) and the Global Master Repurchase Agreement (GMRA) (for repos) which already contain buy-in provisions.

Moreover, the Council GA and the EP's position have granted ESMA the ability to recommend to the Commission to amend or repeal its IA where it considers that MBIs application is no longer justified, necessary, appropriate or proportionate.

We also **welcome the extension in the GA of the exemption from the application of MBIs** to securities repurchase or lending agreements 'and other types of transactions' that render the buy-in process ineffective. The EP approach to simply exclude 'securities financing transactions' (SFTs) would achieve a similar, albeit cleaner, outcome.

Post-trade processes

The ongoing **digitisation of post-trade processes** – notably via the increased use of Distributed Ledger Technology (DLT) – will provide a long-term solution to legacy challenges, including settlement efficiency as well as enabling a reduction of the settlement cycle. In particular, associations representing the securities lending, derivatives and repo markets, the International Securities Lending Association (ISLA), International Swaps and Derivatives Association (ISDA) and International Capital Market Association (ICMA), are working together to create a Common Domain Model (CDM). CDM is a consensus-driven domain model which consumes transactional data points, passes them through functions defined within the CDM and finally expresses each lifecycle event to either a counterpart, supporting system or a supervisory body. This encoding of industry practice will benefit many aspects of a transaction including:

- Product representation, event representation and outcome from regular events such as billing and margining, to less frequent complex corporate actions.
- Legal documentation impacting a transaction, such as the ISDA/GMSLA/GMRA agreement.
- Process sequencing and outcome: reference data and translation into or from other data models such as the Financial products Markup Language (FpML).

There are numerous benefits stemming from the adoption of CDM, which provides yet another reason not to rush into imposing MBIs. Among others, it can sit within Distributed Ledger architectures to deliver a significant reduction in trade reconciliation breaks both internally and externally, which will in turn support a step change improvement in settlement failure rates.

MiFIR

Looking at the trilogue negotiations regarding the MiFIR and the Markets in Financial Instruments Directive II (MiFIR/D) review, there are two main areas for refinement:

- **Creation of a consolidated tape** – the creation of a real-time pre-trade tape for equities and a separate tape for bonds would create more open and integrated capital markets.

- **Transparency regimes** – Appropriately calibration would encourage a diversity of trading mechanisms to better handle adverse market conditions.

Consolidated tape

European capital markets can make a big leap forward in their integration – and their global competitiveness – with an ambitious framework towards the creation of a consolidated tape. Such a framework moves fragmented national capital markets towards a European single market with all the size and efficiency benefits for investors.

In particular, **a Consolidated Tape for equities and bonds** has the potential to significantly increase transparency by providing investors with a single and cohesive view of trading across the market. **The position agreed upon in the EP regarding the consolidated tape is a positive development.** On the other hand, the complex compromise reached by the Council would result in only limited additional transparency and not benefit smaller and retail investors.

In more detail, the policymakers should include the following aspects in the final compromise:

- **Separate tapes by asset classes** – This allows for the tape to take into account the different market structures of these asset classes.

- **A real-time pre-trade consolidated tape for equities** – A pre-trade real-time tape would help to overcome market fragmentation, while providing a true picture of pan-EU liquidity, enhancing transparency and execution outcomes for end investors.

- **An ETF consolidated tape** – To support the growth of the EU ETF market.

Transparency regimes

The MiFIR/D framework should continue to support a wide diversity of trading mechanisms and recognise that a 'one-size-fits-all' market structure does not work well for all financial instruments and under all circumstances. In particular, policymakers should continue to consider the need for **appropriately calibrated transparency regimes**, based on trade size and market liquidity. This will preserve the ability of liquidity providers to meet the needs of all investors.

Generally, we see the **Council's position as a step in the right direction** – in particular:

- Separating the deferrals regime for bonds and derivatives, and extending maximum lengths – allowing up to four weeks price and volume for bonds and up to two months for derivatives (as opposed to two weeks in the Commission proposal).

- Removing non-equity pre-trade transparency for RFQ and voice trading systems as well as deleting the pre-trade transparency regime for non-equity SIs.

On the other hand, **shortening post-trade deferrals for fixed income** risks worsening market liquidity and prices for European investors when dealing with illiquid or large in scale transactions. Associated costs will be particularly felt for instruments where risk taking intermediation is a more important part of liquidity provision.

AIFMD

The investment management industry plays a crucial role in meeting the political aims of the CMU. It helps pensioners and savers invest for a better future and channels money into the economy supporting corporates, including SMEs. Europe has developed the global gold standard brands of investment funds with the UCITS and AIFMD regulatory frameworks.

To strengthen these frameworks, the policymakers should ensure that **qualitative reporting to NCAs is outlined in the level 1 text**, in particular focusing on human resources rather than quantitative information such as assets under management, and **liquidity risk management remains the primary responsibility of the investment manager.** In more detail, we have identified three main areas for refinement in light of the trilogues.

Delegation

The delegation framework needs structural changes that recognise the fundamentally robust nature of the EU regime and notably the benefits of the global practice of delegation. The EU's fund model has an ability to access the best global expertise for investment activities across the world through delegation of portfolio management activities. These delegation practices are already underpinned by strong oversight, effective governance and a strict application of the EU rulebook for activities both in and outside of the EU.

The positions reached both by the Council and EP make beneficial changes compared to the original Commission proposal – notably removing the ESMA notification regime and instead outlining qualitative NCA reporting requirements in the level 1 text.

The EP focuses on the human resources for oversight and supervision of delegation, giving national authorities a more holistic understanding of delegation practices, rather than the Council's more quantitative focus on assets under management. The **reporting framework outlined by the EP would be more effective than the Council version as qualitative reporting allows for more effective supervision from NCAs**.

Furthermore, EP amendments mandating the reporting RTS to focus on standardisation and **reducing duplication and inconsistencies** in reporting frameworks are a positive development. It is key to bear in mind existing provisions for substance and the effective oversight and control of delegation. Management Companies (ManCos) already provide their national supervisors with extensive information on substance and quality of oversight. Any targeted revisions should focus on streamlining and reinforcing current practices.

Financial stability

The global success of Europe's investment fund industry is built on robust and effective regulation and supervision – the resilience of the investment fund sector during the March 2020 period of COVID-induced market volatility can be attributed, in part, to the effectiveness of Europe's funds regime.

We agree with the EP position restating that primary responsibility lies with the manager for overall liquidity and risk management of funds – in particular, when it comes to (de)activation of liquidity management tools (LMTs). We do not envisage a scenario where an NCA or ESMA would be better positioned or informed than an investment manager to take a decision regarding the (de)activation of an LMT. Extending existing provisions in this regard would lead not only to significant operational and governance challenges, but to the emergence of undue moral hazard by shifting responsibility for the prudent management of an investment fund's liquidity profile disproportionately to a regulatory authority.

Fees and costs

The review should be limited to the targeted issues covered in the Commission's proposal. The proposal by the EP is not an ideal avenue to introduce broad changes on fees and costs. The Commission's Retail Investment Strategy expected in May, is the appropriate place for this discussion.

Conclusion

The ongoing reviews to CSDR, MiFIR & AIFMD are positive developments as Europe seeks to ensure the creation of an effective and secure framework for financial actors. However, in order to achieve a well-functioning CMU, further refinements are needed. Amongst others, the policymakers should prioritise the cash penalties regime as the most effective and transparent tool to encourage settlement efficiency. With regard to MiFIR, the creation of a real-time pre-trade tape for equities and a separate tape for bonds would better integrated capital markets and appropriately calibrated transparency regimes would encourage a diversity of trading mechanisms.

In addition, for further strengthening of UCITS and AIFMD regulatory frameworks for investment funds, it is important to ensure that liquidity risk management is the primary responsibility of the investment manager and opt for qualitative reporting, which allows for more effective supervision, over the quantitative approaches. With the these modifications and a stronger partnership with the private sector, the proposals have the potential to benefit both businesses and the public interest alike.