EACB position paper on the consultation of the European Commission concerning the Securities Law Directive (SLD)

21 January 2011

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General remarks

1. The proposals of the Commission concerning capital measures and other important events correspond more or less to the legal and operational status quo. We therefore disagree with the statements made by the Commission under 1.2 in the consultation paper. It is neither true that the cross border holding and disposition of securities is not effective, nor that investors are hampered to exercise the rights attached to securities they own. The Commission services mention the receipt of dividends as an example in the consultation paper. In reality dividend payments are credited without further motivation and free of charge to the account of the investor. Every owner of a security can exercise the rights attached to it also in case of a foreign issuer. The only exception are general meetings. The rationale for the different situation concerning general meetings is not caused by the way securities are held in custody, but rather

    - by a missing standardization of the communication flows between the issuer and the chain of intermediaries in form of ISO- or SWIFT-formats;
    - by the foreign language used by issuers for their communications in the cross-border context;
    - by the fact that issuers very often start the communication processes too late in the run-up of a general meeting, especially in the cross-border context.

    The principles published by the Commission for consultation are not going to dismantle the mentioned obstacles, because the issuers – even though originally responsible for informing their security-holders – are not the main target of a possible regulation. We therefore do not believe that the envisaged legislation will improve the cross-border recognition of rights attached to securities.

2. We would like to draw the EU Commission's attention to the market standards on corporate actions and the market standards on general meetings. The future SLD should provide sufficient legal basis for those market standards. The difficulties in the cross-border exercise of rights flowing from securities held through securities accounts are most often of a purely operational nature and not of legal nature. Initiatives like Target2-Securities and the harmonization of settlement cycles will further contribute to the removal of barriers.

1 – Objectives

Q1: Do you agree that the envisaged legislation should cover the objectives described above? If not, please explain why. Are any aspects missing (please consider also the following pages for a detailed description of the content of the proposal)?

3. We do agree with the consultation paper that the European Commission should consider the holding and disposition of account-held securities when developing a proposed directive.

4. From our perspective it needs to be made clear that there are two different types of investor rights:

    - the rights of an investor *on the securities*, for example the right to sell or pledge the security, and

- the rights of an investor *flowing from the securities*, for example the right to receive dividends or to exercise voting rights.

Consequently, it needs to be distinguished within the EU wide regulation as concerns Private International Law:

- *rights on the securities* shall be governed by the law to be determined by a rule yet to be found. The Commission proposes the law of the location of the account providers office in which the custody account of the ultimate account holder is kept. We think that it should be at least discussed whether the rules of the Hague Securities Convention, which is an international instrument for the unification of Private International Law that has been accepted by the Member States of the European Union and the European Union itself, are appropriate for the proposed substantive law.
- *rights flowing from the securities* shall be governed by the law governing the securities itself (being according to the rights attached to the securities the law set out in the terms and conditions of the securities, the law of the place of issuance of the securities, the law of the issuer).

The consultation paper does only deal with the first issue and it should be made clear that no change to the second issue is intended.

The clarification and protection of this practical difference needs to be set out as an objective. Even though dealt with in principle 14 but might be made clearer to avoid misunderstandings.

The consultation paper misses to make a fundamental differentiation that exists in the market, name the difference in the relationships between that of the

- the ultimate account holder (being the “true owner” of the securities and not itself an account provider) and its initial account provider (being the custodian with whom the ultimate account holder has its custody relationship), and that of the
- the initial account provider and its subsequent account provider or any subsequent account provider and its next subsequent account provider in the holding chain up to a CSD.

The fundamental difference is that only the ultimate account holder is entitled to exercise its *rights on the securities* and its *rights flowing from the securities*.

Consequently, it needs to be regulated on an EU wide basis that:

- only the ultimate account holder is entitled to exercise its rights and must have the direct right against the issuer to do so in all jurisdictions and that
- the account providers in the holding chain must not be entitled to do so without the ultimate account holder’s instruction.

The clarification and protection of these practical differences needs to be set out as an objective.

Q2: Would a Principle along the lines set out above adequately accommodate the functioning of so-called transparent holding systems?

Q3: If not: can you explain which aspect is not correctly addressed and what could be improved? Which are, if applicable, the repercussions on your business model?

5. In the case of splitting up of responsibilities vis-à-vis the account holder it should be clear who is responsible for which services and performances. The term "responsibility" seems to us adequate.

Q4: Do you know any specific difficulties of connecting transparent holding systems to non-transparent holding systems?

6. Our members active in so called "transparent" legal systems are very concerned about the outlines made by the Commission concerning non-discriminatory charges. Because each investor has an individual securities account, the costs are higher than in account provider systems. According to the Commission proposal the fees incurred by cross-border holdings of securities should be the same as the charges levied in respect of comparable domestic holdings of securities. The charges incurred by similar kinds of holding systems, however, should be the same. Comparing the charges of different holding systems is hardly possible.

3 – Account-held securities

Q5: Would a principle along the lines described above provide Member States with a framework allowing them to adequately define the legal position of account holders?

7. The principles described in the section "account-held securities" are based on an unclear terminology that might increase legal uncertainty. Many European directives and international conventions already contain detailed definitions of securities and we would appreciate if the SLD would be based on already existing nomenclatures rather than adding new terminologies. In this light we would suggest to use the definitions of the Geneva Securities Convention which uses the terms "securities" and "intermediated securities".

8. Moreover it is of paramount importance not to give right to any "account holder" of the chain of intermediaries. In giving rights on securities to all the account-holders of the intermediaries chain, this paragraph gives these rights to each member of the chain even to the account provider who is indeed a mere intermediary. The securities holder must not be dependent on his account provider or another intermediary in the intermediary chain asserting rights for him. This could happen if, under national law, it is not the ultimate account holder who is entitled to the rights, but rather his account provider or a CSD. For reasons of investor protection and investor confidence in the system of account-held securities, we consider it necessary that the investors themselves hold all rights. The ultimate account holder must at all times be able to directly exercise these rights in each member state and must be recognized as investor of securities, if he chooses to identify himself as such. An account provider within the holding chain that is also an account holder must be recognized neither as investor of securities nor as being entitled to exercise investor's rights.

9. We have the following specific comments on principle 1: This principle talks about rights to disposition and rights to instruction, right to receive information etc. these may be combined under the name rights of disposition. The minimal content of these rights should be regulated by EU law, as described in the consultation paper.

   These rights should otherwise be regulated by national law under the heading "obligations of account providers", as these rights of disposition are stemming form the account provider's obligations as custodians of securities as regulated by law.

10. We have the following specific comments on principles 3 and 4: It needs to be decided by conflict-of-law rules, what the "national law" in these principles is. The problem with these principles is that they mix up different forms of rights and their different sources:

    (a) The *rights on securities* are national in nature and either "property rights" or "equitable interest" or others. The directive cannot and does not purport to harmonise the content of these rights but it must be harmonized as a minimum standard:

        - that these rights can and must be exercised directly **only by the ultimate account holder**. Another account holder my exercise these right only upon instruction of the ultimate account holder **but must not be regarded by national legislation as the "shareholder"** or in any other way as holder of these rights.

    (b) The *rights flowing from securities* (voting rights, dividends, interest payment, etc) are national in nature. The directive cannot and does not purport to harmonise the content of these rights, but it must be harmonized as a minimum standard:

        - that the law governing the securities creates the *rights flowing from securities*, which is e.g. the law chose by the issuer in the terms and conditions of the securities, or failing that the laws of the place of issuance.
        - that these rights can and must be exercised directly **only by the ultimate account holder**. Another account holder my exercise these right only upon instruction of the ultimate account holder **but must not be regarded by national legislation as the "shareholder"** or in any other way as holder of these rights.

    The ultimate account holder must have direct access to courts or administrative procedures to enforce its rights and any other account provider must not be obliged to do so by national law, due to the fact that national law does not recognize the ultimate account holder as beneficial owner of these rights.

    (c) The right to receive information or to transmit instructions. These rights are typically regulated in nation laws regarding the provision of custody services. These rights should remain subject to the laws of the member state in which the account provider provides its services/the account is held.

Q6: If not, which legal aspects that belong, in your opinion, to an adequate legal position of each account holder could not be realised by the national law under an EU framework as described above? What are the practical problems that might occur in your opinion, if Member States were bound by a framework as described above? Which are, if applicable, the repercussions on your business model?

11. The following remarks should be taken into account:

- It is of crucial importance to clearly distinguish entities that can be account holders and account providers at the same time (like intermediary banks) and entities that can only be account holders (like retail clients).
- The acknowledgement that only a single person has ownership rights on the securities, without defining the exact legal nature of the ownership rights and without prejudice to the trust contract, for the purpose of protection against the intermediary's insolvency;
- The introduction of methods of acquisition and disposition with title transfer and without title transfer, conform the Financial Collateral Directive.

Q7: The Geneva Securities Convention (www.unidroit.org/english/conventions/2009intermediatedsecurities/main.htm) provides for a global harmonised instrument regarding the substantive law (= content of the law) of holding and disposition of securities, covering the same scope as those parts of the present outline dealing this subject. Most EU Member States and the EU itself have participated in the negotiations of this Convention. Both the present approach and the Convention are compatible with each other.

If applicable, does your business model comprise securities holdings or transactions involving non-EU account holders or account providers?
Is it, in your opinion, important to achieve global compatibility regarding the substantive law of securities dispositions, or would EU-wide compatibility suffice?

12. The envisaged EU-legislation and the international convention for the harmonization of substantive law should be consistent. It has to be avoided that international efforts are in contradiction with EU regulations. Our member institutions provide account holding in EU- and non-EU securities and they work with EU and non-EU account providers. A global compatibility is therefore of crucial importance.

4 – Methods for acquisition and disposition

Q8: Would a principle along the lines described above allow for a framework which effectively avoids that more securities are credited to account holders than had been originally issued by the issuer?

13. From our perspective the suggested principles will not prevent that more securities are credited or debited to securities accounts than initially issued. According to the presented model the problem of excesses and shortfalls arises inevitably through the divergence between the effective times of crediting and debiting to an account.

14. It is a reasonable approach to indicate certain methods for acquisition and disposition. We welcome this approach of harmonization. However the member states should not be obliged to implement each outlined method. A European directive should rather specify particular methods for how the acquisition and disposition of securities can be accomplished. In this way national legislators will be able to follow their respective legal tradition and will reach at the same time a European harmonization as de facto the same prerequisites have to be met.

15. According to the outlines principles for the acquisition and disposition of account-held securities only one method is provided, namely the crediting and debiting of an account. The other four methods refer to the acquisition and disposition of collateral security rights. Consequently, the question of implementation leeway for national legislators arises only in this regard. However, this implementation leeway should also exist here and Member States should be under no obligation "to offer" all methods for creating security interests. They should not have to introduce methods that do not correspond to their respective legal tradition. In that respect, we explicitly welcome the regulation in principle 4, paragraph 5.

16. We encourage the European Commission to scrutinize the compatibility of the principles on methods for acquisition and disposition outlined in the consultation paper with the respective paragraphs in the Geneva Securities Convention, namely Art. 12, 1,a and Art. 12, 3.

17. As outlined in principle 4, paragraph 3, sentence 2 credits to a securities account the effectiveness of which is subject to a condition must be identifiable as such in the account. From our perspective such identification leads to considerable technical difficulties. The question is whether the identification is for internal purposes only – on the basis of which the custodian controls the delivery of the transaction – or for external purpose as well towards the client. From our perspective an internal identification is sufficient with the optional possibility of providing the respective information also to the client. We would therefore suggest to change the obligation of identification to an option that can be provided upon request. This would be a good compromise allowing to meet the requirements of the Commission concerning a technical identification system and an enhanced transparency. At the same time European co-operative banks would not be obliged to undertake considerable adaptations to their IT landscape.

    The sentence could be rephrased in the following way: "*Credits to a securities account the effectiveness of which is subject to a condition must be identifiable as such for the account provider and information must be given by the account provider to the account holder upon request.*"

18. In most jurisdictions contractual settlement is possible. This means that the account of the accountholder is credited already although the settlement process is not finished. The accountholder is not able to dispose these credited positions until the settlement process is finished. We do not see any reason why this contractual settlement should not be possible in the future.

Q9: If not, how could a harmonized EU-framework better guarantee that account providers do not create excess securities by over-crediting client accounts (keeping in mind that all account providers are either banks or MiFID regulated entities)? Please distinguish between regulating the account providers' behavior and issues relating to the effectiveness of excess credits made.

19. It is of crucial importance that member states should not be obliged to integrate all five methods into their national legislations. Where securities have been transferred, either with or without title transfer, the transferor may not use these securities again. Only the transferee should have the possibility to reuse the securities. More detailed national legislation and regulation is necessary, namely to provide for the accountability obligations related to the credit and debit of securities to securities accounts. The envisaged legislation should establish different mechanisms of supervision in order to achieve the integrity of each position in securities and book-entry securities, regardless the size and the presence of cross-border elements in the account provider's chain.

20. The proposed mechanisms contained in 4.1 sub paragraph 4 might not be sufficient insofar as neither of the measures "reversal of erroneous credits" and "provision of additional securities" can be promptly executed.

    A prompt reversal of the erroneous credit is not possible e.g. when the account on which the erroneous credit has been credited is no longer sufficiently covered or has been closed in the meantime or when it is impossible to promptly identify the erroneous credit.

    To promptly provide additional securities of the relevant description is impossible e.g. when the securities are not available in the market or when the account provider cannot afford to pay the purchase price.

    Any case where neither of these two mechanisms can be executed would lead to a continuation of a situation where fictitious account held securities (as they are not covered by a corresponding number of securities held by the account provider) can be transferred to other accounts, even against payment.

21. While the solution presented by the Commission in this consultation of an "ex-post rule" (principle 4 paragraphs 2 and 4) appears to be a conceivable option, in our estimation, however, it is not sufficient. From our perspective, appropriate legal and organisational regulations should already ensure ex ante that the number of securities credited by the account provider to its account holders in their securities accounts corresponds to the number the account provider holds with an upper tier account provider or of which it has custody itself, or – with the corresponding proprietary holdings of the account provider – exceeds that number.

    An obligation of the account provider to maintain sufficient holdings as cover does mitigate the risk that more "securities" are posted in the intermediary chain than were issued by the issuer. If excess securities nevertheless arise, these must immediately be eliminated by a *pro rata* reduction in the holdings. Even the merely temporary existence of an excess holding – in the extreme case on the record date – cannot be accepted.

Q10: Is the principle relating to the passing on of costs of a buy-in appropriate? If not, in which way should it be changed and why? What would be the repercussions on your business model?

22. The principle of passing on costs of a buy-in does not seem appropriate although practically reduced by paragraph 4, last sub-paragraph, as far as we understand its wording. The rule should be more clearly expressed. Over- or under-crediting will in most cases be the fault of an account provider, either directly or through the fault of his custodian.

    Only in cases where the relevant account provider can prove that the situation was not caused by faulty behavior on his part, should the costs of a buy-in be passed on proportionally to all holders of securities of that description. This rule should by analogy also apply to the compensation for damages in cases where the account provider has to apply the third mechanism (proportionate reduction) when he can prove that the situation was not caused by faulty behavior on his part.

23. We would like to get a further explanation on the proposed buy-in procedure, especially in which part of the chain such a method should be opportune. Relating to principle 4.4b we want to stress that a lower level account provider in the intermediary chain cannot be responsible and liable for the loss or shortage of securities as a result of an error and/or fraud/bankruptcy of a custodian upstream in the chain. This could introduce systemic risk because such an incident will contaminate the whole chain, because of the introduction of intra chain exposure.

5 – Legal effectiveness of acquisitions and dispositions

Q11: Would a principle along the lines described above provide Member States with a framework allowing them to determine legal effectiveness and ineffectiveness to an extent sufficient to safeguard basic domestic legal concepts, like e.g. the transfer of property?

24. From a systematic perspective, it must first be stated that the principles presented in paragraph 5 must absolutely be coordinated with the Settlement Finality Directive (98/26/EC) because the latter has similar provisions.

25. A condition can be an appropriate measure under national law in order to ensure a linkage of the separately considered elements “acquisition” and “disposition”. Due to the fundamental role of the issue for the integrity of the system it should not only be possible to stipulate such a condition contractually, but there should also be a juridical requirement in the legislative text.

26. From our perspective it is absolutely necessary to have the possibility of making a credit to a securities account under the condition that the intermediaries have a sufficient coverage of securities. In particular, such conditional crediting would ensure that the acquisition by the account holder only becomes effective after the debiting of another securities account became effective. In this way long positions would be avoided. Such a condition would not in any way hamper transactions in a cross-border environment.

Q12: If not, please specify how and to what extent national legal concepts would be incompatible. Please specify the practical problems linked to these Background, and, if applicable, the repercussions on your business model.

27. The intent of introducing a legal concept of acquisition and disposition of securities that dissolves the link between acquisition on the one hand and disposition on the other hand makes it impossible to to ensure that the number of securities which become manifest in credits to securities always correspond to the number of the securities issued by the issuer.

6 – Effectiveness in insolvency

Q13: Would a principle along the lines described above provide for a framework allowing effective protection of client securities in case of insolvency of an account provider?

Q13bis: If not, which measures needed for effective protection could not be taken by Member States under the proposed framework?

28. Our basic assumption is that derivatives are not in scope of the SLD-initiative because they are not capable of being credited to a securities account. Client securities are currently well protected under the national concepts of ownership, co-ownership and trust. That protection fails effectiveness when account providers improperly credit securities to securities accounts, for example where more securities are credited to securities accounts than the account provider holds upper-tier or where the exact rights of the account holder on the securities are not clear (ownership or security). We welcome the proposed rules on integrity and a clear definition of a "securities account" (which includes an account provider, an account holder and securities) in the context of protection against the intermediary's insolvency.

29. We strongly disagree with a reasoning where securities are considered as claims against the intermediary, such as in the second paragraph of 6.2, which discusses the situation of the "creditors of the insolvent entity". The investor's protection against the intermediaries' bankruptcy currently results from:

    - **In rem rights** of investors on the securities (ownership or equitable interest) and
    - **Segregation** of proprietary assets from client's assets in the account provider's books.

    The reasoning in terms of protection of "creditor of the insolvent entity" is difficult to understand in such circumstances.

7 – Reversal

Q14: Is the list of cases allowing for reversal complete? Are cases listed which appear to be inappropriate? Are cases missing? What are, if applicable, the repercussions on your business model?

30. According to the proposed legislation each posting, including an erroneous posting, is initially effective but can be undone by a reversal. While in certain

instances a reversal may serve as an appropriate reaction to an erroneous posting, it is not sufficient as the sole remedy for erroneous postings.

31. We would like to highlight the following example. In case of an erroneous posting for technical reasons – which results in more securities being posted to securities accounts than were initially issued by an issuer – an institution would have to accept with a reversal that long positions exist until the date of the reversal. This can have a significant impact – particularly at the time of a general meeting (record date or dividend payment) – on the issuer which – should these postings be given preliminary effect – would have to grant the rights attached the security to non entitled security holders as well. Even an ipso iure reduction of the holdings could not be regarded as a suitable solution.

Q15: Should national law define the extent to which general consent to reversal can be given in standard account documentation? What are, if applicable, the repercussions on your business model in case your jurisdiction would take a restrictive approach to this question and limit the possibility of general consent to reversal?

32. A consent by the account holder to the reversal through the account provider's general terms and conditions is preferable to the statutory rule proposed in paragraph 3.

33. Case 7.1.1 (a) of the consultation paper appears to be inappropriate. If both parties agree to a reversal, this reversal is possible. There is no need for a provision in this respect. Case 7.1.1 (a) could be an open door to general ex ante approvals of reversal for any reasons.

    Currently, reversal is contractually allowed in many custody agreements for reasons set out in the agreement, such as non receipt of payment of the securities credited to the account holder's securities account. Reversal without any other reason than simple consent is never sufficient in current market practice.

8 – Protection of acquirers against reversal

Q16: Do you agree with the 'test of innocence' as proposed ('knew or ought to have known')? Do you know of any practical obstacle that could flow from its application in your jurisdiction? What would be the negative consequences in that case?

34. The confidence of an account holder in the amounts credited to her/his securities account with the respective legal rights attached to them is of crucial importance for the functioning of an account-held securities system. Even though an account holder is already protected by the rules governing the legal legitimacy of a cancellation, it is nevertheless helpful to have an increased protection as recommended in principle 8.

35. We are concerned that in the context of the "good faith acquisition" the SLD should adequately take into consideration the fact that to the extent account held securities are not covered by a corresponding number of securities of the same description held by the account provider they do not constitute a credit as defined by the SLD but only a fictitious position.

a) For this reason “good faith acquisition” regarding such positions is not possible.

b) For this reason the account provider is bound to correct such positions by applying mechanisms to restore compliance:

i. Mechanism (a) (reverse erroneous credit) will usually be in line with the principle of “good faith acquisition”, as the account holder will not be able to pass the “test of innocence”;
ii. Mechanism (b) (providing of additional securities) does not conflict with the “good faith principle”, as the securities are only acquired after the fictitious credit has already been made;
iii. However in cases where due to inapplicability of mechanisms (a) and (b)the subsidiary mechanism of “proportionate reduction” (see Q 9) needs to be applied the account provider will be ordered to correct such positions even against the principle of “good faith acquisition”. This should be explicitly stated by the SLD in the context of the “good faith acquisition” principle.

9 – Priority

Q17: Will a principle along the lines set out above, under which the applicable law would need to afford an inferior priority to interests created under a control agreement, be appropriate and justified against the background that control agreements are not 'visible' in the relevant securities account? If not, please explain why.

36. The priority of interests in securities should fundamentally be based on the time of their creation. A distinction based on the identifiability of the interest instead is not appropriate.

37. As outlined in the Geneva Securities Convention, interests that have been created in a certain manner should always be granted priority over other interests. This regulation serves to promote the application of the convention internationally. The grantees, which substantiate security interests based on the convention’s rules, enjoy priority over other holders of security interests. Should such considerations also play a role in the harmonisation within Europe, then a similar regulating mechanism in the SLD could be applied. However, in order to avoid negative effects on international harmonisation, it would be desirable that a provision - if any - with regard to interests always enjoying priority contained in an European Directive corresponds with the provision in the Geneva Securities Convention.

38. We are against a legislation under which “visible” interests have priority over “invisible” interests. Principle 9, paragraph 1 subparagraph (c) cannot function as a basis for a possible EU Directive. We are in favour of deleting it completely and to amend principle 9, paragraph 1, in the following way:

“*interests in the same account-held securities rank amongst themselves in chronological order*”.

39. In addition, it is of high importance that the priority rules of the SLD do not conflict with the regulations in the Financial Collateral Directive (FCD). To the extent that interests were created under this provision and are to be characterized as financial collateral, such interests must – regardless of the selected manner of

creation – have priority over corresponding creations of an interest outside the scope of the FCD. In contrast, several creations of interest subject to the FCD are subject to the aforementioned priority rules inter se. For transparency reasons and the smooth functioning of collateral management systems after the SLD is implemented, an appropriate editorial clarification in the SLD would be very important.

Q18: Have you encountered difficulties regarding the priority/rank of an interest created under a mechanism comparable to a control agreement in the context of a priority contest, or, more generally, in an insolvency proceeding? If yes, please specify.

Q19: Would there be negative practical consequences for your business model flowing from a Principle along the lines set out above? If yes, please specify.

40. Yes, by rendering a general terms and conditions lien junior to a retroactive earmarking, the accommodation of loans would be hampered. Prior to entering an earmark in favor of the grantee of a bank's account holder, the bank would always need to review whether to create an earmarking interest to itself in its own favor or leave the matter with its – then subordinated – general terms and conditions lien. In addition, account providers might see in the future the necessity of creating earmark interests solely in order to maintain prior claims over the securities concerned. Such a development would lead to considerable higher costs and would cause a loss of flexibility, both to the detriment of the account holder.

10 – Protection of account holders in case of insolvency of account provider

Q20: Would a Principle along the lines described above pave the way for the national legal frameworks to effectively protect client securities in case of the insolvency of an account provider?

41. Yes, a principle where the securities credited to securities accounts are not available in case of an insolvency of an intermediary would protect the securities of clients.

42. However, this is not sufficient. Securities inflation, opacity as to the account holders rights and opacity as to the account provider's identity need to be avoided in order to make this rule effective.

Q21: If not: Which mechanisms should be available which could not be implemented under a framework designed along the lines described above. Please specify.

43. Available mechanisms in case of an insolvency of an account provider could be:

- monetary damages for all account holder pro rata as insolvency claim;
- harmonized time period for an insolvency receiver to determine if the insolvent estate holds enough securities to satisfy all claims from account holders;
- harmonized rule if the disposition/transfer of securities should be barred until the insolvency receiver had time to determine if the insolvent estate holds enough securities and if not what the

consequence for those account holders should be, who do not transfer the securities to another account provider.

Q22 Should the sharing of a loss in securities holdings (occurring, for example, as a consequence of fraud by the account provider) be left to national law? Would you prefer a harmonized rule, following the pro rata principle or any other mechanism?

11 – Instructions

Q23: Would a Principle along the lines described above provide for a framework allowing the national law to effectively apply restrictions on whose instructions to follow for purposes of investor protection, notably in connection with the envisaged Principle contained under section 4 (Paragraph 2)? If not, please explain why.

44. The principle uses indistinctly the terms “intermediary” and “account provider”. We suppose that those terms are synonymous and mean “account provider”.

45. Limitations to these elements of the principle should be clear. In this respect, sub-paragraphs (a) and (b) seem related to the methods of acquisitions and dispositions. In our view the link should be made clearer so to avoid that the future article on instructions becomes a mean to deviate from the provisions of the future article on Methods for Security Financial Collateral Arrangements (methods for acquisition and disposition).

46. A rule should be added so to provide that, failing the end investor’s instruction, an upper-tier intermediary (or intermediary of the upper-tier intermediary) may not provide instructions related to the rights flowing from those securities. If an end investor does not exercise rights, those rights should expire and not be exercised by intermediaries.

12 – Attachment by creditors of the account holder

Q24: Would a Principle along the lines described above provide Member States with a framework allowing them, in combination with the envisaged Principle on shared functions, to effectively reflect operational practice regarding attachments in your jurisdiction? If not, please explain why.

47. The principle could be misunderstood. It should be clear that creditors can only attach account held securities that an accountholder who is at the same time account provider does not hold in his function as an account provider. In other word: This principle says, that an attachment of securities held by an accountholder in its function as account provider is not allowed.

Q25: Have you ever encountered, in your business practice, attempts to attach securities at a tier of the holding chain which did not maintain the decisive record? If yes, please specify.

48. No, our member institutions have not encountered attempts to attach securities at a tier of the holding chain, which did not maintain the decisive record. Nonetheless we consider the proposed “prohibition of upper-tier attachment” to be useful and support such a regulation.

13 – Attachment by creditors of the account provider

Q26: Would the proposed framework for protecting client accounts be sufficient? Should the presumption that accounts opened by an account provider with another intermediary generally contain client securities become a general rule? If not, please explain why.

49. We consider the proposed principle 13 as important to the functioning of a securities depository system.

14 – Determination of the applicable law

Q27: Would a Principle along the lines described above allow for a consistent conflict-of-laws regime? If not: Which part of the proposal causes practical difficulties that could be addressed better?

50. The Commission recommends supplementing a directive on the substantive law relating to account-held securities with rules of Private International Law. This recommendation is to be endorsed.

51. Under the Commission's recommendations, the connecting factor for the matters specified in paragraph 3 should be the place at which the securities account is maintained. Since according to the proposed substantive law rules for the matters specified in paragraph 3 the booking to the securities account of the ultimate investor should be decisive, it is logical for the conflict of laws rules to be connected to the place of the securities account, i.e., the place of this booking to a securities account.

52. However, it must be noted that a transfer of account-held securities affects two ultimate account holders and hence two securities accounts, where the securities accounts may be maintained in different countries. Because the acquisition and disposition of securities in the future directive are governed as two acquisition and disposition fact situations legally independent from each other, the facts constituting the disposition may accordingly be evaluated under a different legal system (nexus to the "seller's" securities account) from the facts constituting the acquisition (nexus to the place of the acquirer's securities account).

53. We would like to make reference to the second sentence of Principle 14.1: "Where an account provider has branches located in jurisdictions different from the head offices' jurisdiction, the account is maintained by the branch which handles the relationship with the account holder in relation to the securities account, otherwise by the head office." The two underlined terms are unclear to us. A possible interpretation is that:

    - If the account provider is located (through a branch or headquarter) in a Member State of the EU, the applicable law is the law of the Member State where the account provider is located;
    - "Otherwise", i.e. if the account provider has no presence in the EU, the applicable law is the law of the headquarter.

    We strongly disagree with such an interpretation. Since we do not see any benefits of this second sentence, we propose to delete it from the future legislation.

Q28: Would the mechanism of communicating to the client, whether the head offices or a branch (and if a branch, which one) is handling the relationship with the client, add to ex ante clarity? Is it reasonable to hold the account provider responsible for the correctness of this information? If applicable, would any negative repercussions on your business model occur?

54. We are not in favor of a harmonization of communication to clients. This would lead to a whole range of uncertainties. It should be left to the account providers how to communicate.

55. Legal uncertainties will arise for international account providers with branches in various countries. For instance, if the account provider and the account holder, or additional other third parties are assuming that the securities account is being maintained at a certain location identified by the account provider in its communication, but a court comes to the conclusion, based on the facts, that a completely different location, and hence a different legal system, is controlling.

56. This would be particularly significant for interests created on the securities posted in the securities account and their legal basis. It remains unclear why this approach was chosen by the Commission. For the vast majority of account holders and account providers the communication of the place of the branch maintaining the securities account is of no interest because only domestic offices come into question anyway. The costs nevertheless affect all account providers.

Q29: The Hague Securities Convention provides for a global harmonised instrument regarding the conflict-of-law rule of holding and disposition of securities, covering the same scope as the proposal outlined above and the three EU Directives. Most EU Member States and the EU itself have participated in the negotiations of this Convention. The proposed principle 14 differs from the Convention as regards the basic legal mechanism for the identification of the applicable law. However, the scope of principle 14 is the same than the scope of the Convention: property law, collateral, effectiveness, priority. Do you agree that this will facilitate the resolution of conflicts with third country jurisdictions? If not, please explain why.

57. We agree that the outlined principle will facilitate the resolution of conflicts with third country jurisdictions.

58. It remains unclear to us why the Commission did not refer to the already internationally coordinated approach of Article 4.1 of the Hague Securities Convention. According to this rule the parties themselves may in the first instance agree on the location at which the securities account is maintained, which is dispositive for the nexus under private international law.

15 – Cross-border recognition of rights attached to securities

Q30: Would a general non-discrimination rule along the lines set out above be useful? Have you encountered problems regarding the cross-border exercise of rights attached to securities?

Q31: If applicable, would a Principle along these lines have (positive or negative) repercussions on your business model? Please specify.

59. Despite higher costs such general non-discrimination rule would indeed be beneficial and should be made clearer by stating expressly that each ultimate account holder must have the right to identify itself as investor and "true owner" of a security and thereby having a direct right to enforce its rights under the securities in any member state. Consequently national law cannot deny an ultimate account holder the direct exercise of its rights under the securities by considering an account holder within the holding chain as "investor" for domestic legal purposes.

16 – Passing on information

Q32: Is the duty to pass on information adequately kept to the necessary minimum? Is it sufficient? If applicable, would there be any (positive or negative) repercussion of such a Principle on your business model? Please specify.

60. It is correct and appropriate to restrict the forwarding obligation to information that could have a significant impact on the account holder's legal position and which is necessary to protect his interests.

61. The account providers should be permitted to refrain from notifying the account holder if the information is not received by the account provider in a timely manner or the measures to be taken by the account holder are economically unacceptable because the costs incurred are disproportionate to the possible claims of the account holder. In these narrowly limited cases the account holder has no interest in receiving the information and therefore there is no necessity for passing it on. Otherwise, unnecessary costs would be generated, which would preferably have to be borne by the issuer and/or the account holder.

62. A corresponding rule charging the costs to the issuer is absolutely necessary because the issuer's original obligations are at stake here. Such a rule could not be confronted with the reproach of setting existing structures in stone precisely because no specific fee model should be provided. On the contrary, if the SLD were to establish a new obligation for intermediaries which made the issuer's primary obligation obsolete, the result would hardly be a situation which would allow a competitive allocation of costs. This is because one party will be obligated to act while the other parties – even if this action is taking place in their interest – have no incentive to bear the costs of the former, not even in part. In addition to this, the structures in the intermediary chain are standardised, only the issuer's interfaces to the investor/intermediary chain are not. Hence, imposing the obligations (and also costs) on the intermediaries alone, would proof counterproductive from this perspective because it is precisely the issuers which would need an incentive to deliver the original information in a brief, standardised, electronic form and in English.

Q33: How do you see the role of market-led standardisation regarding the passing on of information? What are your views on a regulatory mechanism for streamlining standardisation procedures?

63. Functioning market standards for information regarding the implementation of capital measures and other important events have been established, at least in the intermediary chain. The Joint Working Group General Meetings and the Joint Working Group Corporate Actions have both achieved an outstanding set of

standards, which have been endorsed by all constituencies. Gap analyses are in the course of being realised. We strongly encourage the EU Commission to follow those gap analyses, which will identify the legal barriers to the implementation of the Market Standards.

64. We would like to highlight a specific case with respect to the intersection between issuers and the intermediary chain. Especially in the interests of an efficient execution of general meetings, an obligation placed on the issuer regarding standardised information in ISO or SWIFT formats would be just as desirable as their obligation to provide timely information in a language standard in the financial markets (English).

17 – Facilitation of the ultimate account holder's position

Q34: If you are an investor, do you think that a Principle along the lines described would make easier any cross-border exercise of rights attached to securities, provided that technical standardisation progresses simultaneously? If not, please explain why.

65. A distinction should be made between the so called material rights (e.g. rights on dividend an interest) and participatory rights (in particular voting rights). It is often operationally very difficult and/or expensive or even impossible to exercise voting rights in securities hold through international links. We agree that a (contractual) opt out at least for participatory rights must be possible (we refer to 17.2 Background last paragraph on page 30). However it could be stated more explicitly.

Q35: If you are an account provider, would you tend towards the opinion that your clients can exercise the rights attached to their cross-border holdings as efficiently as their domestic holdings? What would be the technical difficulties you would face in implementing mechanisms allowing for the fulfillment of the duties outlined above? What would be the cost involved?

66. Generally, the cross-border exercise of rights works sufficiently well. With the exception of general meetings, rights can be exercised cross-border just as they are domestically for capital measures and other important events.

67. In our opinion, difficulties arise only with respect to the cross-border exercise of voting rights at general meetings. These votes can often not be cast because information about the general meeting reaches the ultimate account holder too late and it is written in a language that she/he does not understand. These difficulties could be avoided if the issuer were obligated to provide information on the general meeting:

    - in a timely manner,
    - standardised in an ISO or SWIFT format (maximum of two pages) and
    - in a language that is also commonly used in a cross-border context (English).

18 – Non-discriminatory charges

Q36: If you are account holder, have you encountered differing prices for the domestic and the cross-border exercise of rights attached to securities? If yes, please specify.

Q37: If you are an account provider: do you price cross-border exercise of rights differently from domestic exercise? If yes: on what grounds are different pricing models necessary?

68. It is logic that the longer the intermediary chain (and for cross-borders that is still the case) the account holder has to pay a respective higher price. Account providers should be able to compensate higher costs by higher charges.

69. We are disappointed by the lack of detail and clarity in this principle. In the day to day business these charges are a contractual matter, and frequently form part of a bundled rate with other services offered simultaneously. This seems to be ignored in the outlines of the Commission.

19 – Holding in and through third countries

Q38: Have you encountered difficulties in using non-EU linkages as regards the exercise of rights attached to securities? If yes, please specify. If not, please explain why.

Q39: Admitting that non-EU account providers cannot be reached by the planned legislation, which steps could be undertaken on the side of EU account providers involved in the holding in order to improve the exercise of rights attached to securities through a holding chain involving non-EU account providers?

70. The account provider only has the ability to select its contractual partner to the best of its knowledge following a careful examination. As part of the intermediary chain an intermediary cannot intervene in the customer relationships beyond the next member of the chain. Substantive law in this area has evolved very differently over time across countries, which does not make dealing with cross-border matters any easier.

20 – Exercise by account provider on the basis of contract

Q40: Do you think that a general authorisation to exercise and receive rights given by the account holder to the account provider should be made subject to certain formal requirements? Please specify.

71. We see no need for a European regulation touching formal requirements for a general authorisation to receive or exercise rights. Besides, the account provider is obligated to provide a whole range of services under the custody agreement. All services going beyond the necessary passing on of information for the exercise of rights or the timely exercise of rights should be subject to the individual agreement between the account holder and account provider.

72. In this respect, we would like to emphasise that – based on the authorisation – intermediaries should have the right (but not the obligation) to represent the account holders in the exercise of their rights. Principle 20, which is formulated ambiguously in this respect, should therefore be amended as follows:

*"Where an ultimate account holder is able to exercise itself the rights flowing from securities but does not want to do so, its account provider **may** exercise these rights upon its authorisation and instruction …"*

21 – Account provider status

Q41: Should the status of account provider be subject to a specific authorisation? If not, please explain why.

73. We are not in favor of amending the MiFID by upgrading "safekeeping" from an ancillary to a full investment service. An amendment to the respective MiFID Annex I would have significant effects on the regulatory regime of the MiFID. Therefore, before the described step is considered, the related consequences should be carefully examined in order to maintain a consistent set of rules in the EU in the future as well.

74. The expansion would lead to considerable and wide-ranging consequences, not only for the account-held securities business, but also for already licensed investment services companies. Numerous MiFID requirements are tied exclusively to provision of investment services, to which safekeeping does not belong. For example, the requirement for the independence of the compliance function would be expanded considerably. However, extending the independence of the compliance function to include safekeeping would be disproportionate, in particular for smaller and medium-sized account providers.

75. The safekeeping and compliance function in these firms is currently handled by one department, without this having caused a conflict of interest. We consider it absolutely necessary that this organisational structure could be maintained in the future. It appears questionable whether the allowed exception to this under MiFID could provide further assistance here, because the requirements for it to be used are currently very high (see Art. 6 paragraph 3 Directive 2006/73/EC).

Q42: If yes, do you think that MIFID would be an appropriate instrument to cover the authorisation and supervision of account providers?

76. If the providing of accounts would be covered by the MIFID, the applicable requirements should be focused on what is necessary for account providers. For example not all KYC and categorization rules should become applicable.

77. From our point of view MiFID is not an appropriate instrument to cover the authorisation and supervision of account providers. Account providers´ activities differ from the typical activities of banks and firms who provide investment services. For example providing investment services requires conduct of business obligations. Some of these obligations are not suitable for activities like maintaining securities accounts (for instance Article 19 (5) of the MiFID). It seems problematic that an account provider should be obliged to assess whether the account maintaining service is appropriate to the client, because the client has to safekeep his property (financial instruments) on an account.

22 – Glossary

Q43: Do the terms used in this glossary facilitate the understanding of the further envisaged principles? If no, please explain why.

78. We would like to draw the EU Commissions special attention to the definition of "account provider", which now allows non-EU based and non-EU regulated account providers to qualify as account providers under the proposed SLD. We are in favour of the deletion of the second part of the definition of "account provider", which is currently in square brackets.

79. The definition of "account holder" is confusing as it can designate an account provider as well as the investor: this term is thus ambiguous and leads to legal uncertainty. Practically, the "rights" given to the "account holder" as defined in this glossary will benefit to the investor as well as to any account provider although both are not in the same legal position. As account provider and final account holder are defined separately, the term "account holder" is not useful: "account holder" is either an account provider or the final account holder. Thus the notion of account holder is redundant and leads to confusion.

80. The definition of "legal holder" should be made more precise, so to be in line with the definition of "shareholder" under the Shareholders Rights Directive.

81. It is unclear whether the "end investor" of the Market Standards for General Meetings and for Corporate Actions corresponds to the "ultimate account holder" or to the "legal holder". Our understanding is that neither of those terms always designates the end investor. It also means that the proposed SLD contains no definition of the end investor.

Q44: Would you add other definitions to this glossary?

82. Yes, a definition of end investor and use of that term throughout the articles of the proposed SLD on corporate actions processing so to align the SLD with the Market Standards on Corporate Actions and on General Meetings.

Contact:

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