

**European Financial
Markets Lawyers Group**

- THE VICE-CHAIRMAN -

European Commission
Mr. Jörgen Holmquist
Director General
DG Internal Market and Services
Rue de la Loi 200
B-1049 BRUXELLES

23 June 2010

Dear Sirs,

**Projected EU legislation on Legal Certainty of Securities Holdings and Dispositions
(Securities Law Directive).**

The European Financial Markets Lawyers Group (EFMLG) is a group of senior legal experts in the field of wholesale, corporate and investment banking, who have their professional careers in the major credit institutions of the EU, and meet regularly to review and discuss issues that have an impact on EU financial market integration. Among its tasks, the EFMLG monitors and discusses from a legal perspective any changes and prospective changes in the legislative framework and its application affecting the business of such credit institutions. You may wish to read more about the EFMLG in its website: www.efmlg.org.

The EFMLG has closely monitored the elaboration of Unidroit's Geneva Convention¹, two of its members have participated in the "Legal Certainty Group" dealing with Barrier 13 of the 2nd Giovannini Report, and, it recently considered, after having liaised with the Commission Services, the 2010 Commission's first, second and fourth Discussion Papers on legislation on legal certainty of securities holdings and dispositions prepared for the Member States Working Group dealing with the draft Securities Law Directive (SLD). This letter is the result of our exchange of views regarding such Discussion Papers.

First, you may recall that the EFMLG wrote in 2008 to the Commission² calling for an EU solution before the Unidroit draft Convention was finalised, so that the "global approach" would be consistent with the EU approach, rather than vice versa. Regrettably, Unidroit's Geneva

¹ Convention on Substantive Rules Regarding Intermediated Securities, dated 9 October 2009.

² Dated 4 February 2008, see www.efmlg.org/documents.htm.

Convention was finalised in a second diplomatic conference in October 2009, well before the EU could finalise its concept. Fortunately, we have been informed that there is a general consensus within the EU that no EU Member State will ratify the Geneva Convention³ before a proper legal regime is found in Europe for this difficult matter by way of a SLD. Indeed, the EFMLG believes that the Geneva Convention is the result of hard fought global compromises, and that the harmonisation achieved in its text is minimal due to the repeated references throughout its text to States' declarations, applicable securities law, national insolvency law, and intra-state regional "non-convention law". Furthermore, the Geneva Convention requires to be read together with its official commentary in order to properly understand its provisions. We believe that the EU could and should do better in achieving a higher degree of harmonisation and legal clarity, in particular if there is the will to overcome Barrier 13 of the 2nd Giovannini Report.

Second, the EFMLG would like to convey its concern that the project for a SLD contained in the first and second Discussion Papers may not achieve a sufficient degree of legal harmonisation within the EU to allow a cross-border primary and secondary market for book-entry securities. The fact that the project, as contained in the second Discussion Paper, makes 15 cross-references⁴ to national laws, in a text of 18 articles/rules, is indicative of the minimalist approach taken by the Commission. In the subsequent rounds of SLD preparatory discussions, or in its final legislative proposal, the Commission should endeavour to reduce the number of cross-references to national law in order to increase the level of legal certainty.

Third, the draft SLD only contemplates "holdings" and "dispositions" of securities. It does not contemplate the "issuance" or "creation" of securities in dematerialised form. For as long as the latter are not legislated on, this crucial omission means for the issuers of securities that it is impossible to issue on a cross-border basis, placing the securities in several jurisdictions simultaneously. Many EU Member States have already legislated on the manner of issuing dematerialised securities, in a non-consistent manner⁵. The economic size of the secondary market is in some segments of the capital markets already EU-wide, but the legal framework impedes a cross-border primary market (i.e. issuing fungible securities simultaneously in two or more EU markets), thus keeping alive the legal barriers contemplated in the Giovannini reports. Whilst the possibility of addressing issuance in another projected piece of EU legislation (whether in the European Market Infrastructures Regulation (EMIR) or in another piece), has been hinted at by the Commission when the issue has been informally raised, so far the EU regulation of securities issuance is unclear; furthermore, from a purely systematic perspective of

³ As of the date of this letter, only Bangladesh has ratified the Geneva Convention. Three ratifications are needed for the Convention to enter into force among its signatories.

⁴ Projected articles/rules (second Discussion Paper) 1(f)(r)(s), 3.1(c), 3.3, 4.2, 4.3, 4.4, 5.3, 5.4, 7.3, 9.3, 10.4, 12.2(d), and 13.2.

⁵ An important example being the Member States whose legislation allows only for collective issuance of securities (i.e. non-individualised securities, where investors acquire a percentage), against the other EU Member States whose legislation maintains a regime of individualised securities.

EU law, it would make more sense to address securities issuance in a more comprehensive single legal act addressing the regulation of the whole cycle of securities, i.e. issuance, trading and amortization, which could be the SLD. The most important link between securities legislation and securities infrastructure is perhaps the “notary function” played by central securities depositories (CSDs); this function could also be well addressed in the SLD, whilst leaving the overall regulation of CSDs to another piece of EU legislation.

Fourth, in addition to the above, and in view of the important role and responsibilities that the SLD will impose on securities account providers, the EFMLG believes that the function of securities account providers may need to be legally reserved to either official entities or licensed and supervised institutions (e.g. regulated CSDs, credit institutions, investment companies, central banks). However, substantive rights over securities credited to an account should be legally protected in the SLD anyway, for the benefit of account holders and legal certainty, irrespective of whether the account providers have been officially authorised and are supervised. This observation may plead towards regulating the legal status of account providers in a parallel but separate piece of EU legislation, stating an administrative regime for such function as distinct from a substantive private law such as the one of the projected SLD.

Fifth, the EFMLG is concerned about the regime foreseen in the projected SLD regarding the “inflation of securities”, i.e. the shortage of securities when an account provider has credited securities of which it has an insufficient number, in the event of insolvency of the account provider. The projected Articles 10 and 11, as contained in the second Discussion Paper, impose on account holders the cost of such shortage. The EFMLG would see as a correct incentive for integrity purposes the imposition of such costs on the account provider, which seems more in line with basic principles of justice. The EFMLG understands nevertheless that the Commission is currently working in the direction suggested by the EFMLG, and would encourage the Commission to stick to this line.

Sixth, the projected Article 14 contains a conflict of laws rule. Article 9(2) of the Settlement Finality Directive⁶ also contains a conflict of law rule applicable to securities settlement systems. Article 9 of the Financial Collateral Directive⁷ contains another conflict of law rule applying to book-entry securities. The EFMLG would see improvements in legal certainty by consolidating in one single provision the several conflict of laws rules that exist and are now projected, regarding rights on securities, and placing this consolidated text in the basic EU text on private international law, i.e. the Rome I Council Regulation⁸ which has the benefit of direct applicability

⁶ Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems.

⁷ Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

⁸ Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (ROME I).

and already also contains conflict of laws rules for securities and financial instruments, that may require adaptation.

Seventh; with regard to the facilitation of the exercise of the rights flowing from the securities by the ultimate account holder, the EFMLG supports the view, well expressed by several organisations that have commented the SLD project, that the SLD should contain basic principles but the implementation of them should better be left to contract among account holders and account providers, so that the diversity of possible business arrangements is preserved. A final view on this should perhaps be taken after there is some experience of the regime established by the 2007 Shareholders' Rights Directive, whose implementation by EU Member States will be mostly effective in shareholders' assemblies this year.

Eight; the EFMLG considers that within the projected text of draft provisions for the SLD there are some inconsistencies, i.e. rules that contain some firm principle but which are disapplied or modified by subsequent provisions, probably the result of compromise, which may lead to different interpretations and implementation by national authorities. The projected Article 6 (Effectiveness in insolvency) contains a rule in its paragraph 1 that is disapplied in paragraph 2. The projected Article 7 (Reversal of acquisitions and dispositions) contains one rule in its paragraph 1 that is subject to different rules under paragraphs 2 and 3, and is furthermore overruled by the projected Article 8 (Protection of acquirers against reversals). The EFMLG would recommend improving legal clarity and consistency in these projected provisions.

Finally, the EFMLG believes that it is of paramount importance to ensure maximum harmonisation in the national implementation of the SLD, even a *single rulebook* approach. To this end, the European Securities and Markets Authority should be entrusted with the task of following up such national implementation.

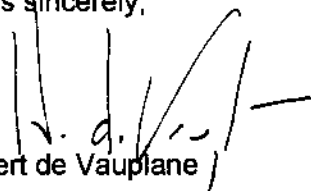
The EFMLG is fully supportive of efforts to achieve a greater harmonisation of substantive securities laws for both primary and secondary markets. It considers that the EU should find proper solutions with priority given to the regime foreseen in the Unidroit Geneva Convention. It also sees merit in the "functional" approach taken by the Commission.

Whilst today national laws on book-entry securities in the EU Member States are clear and unproblematic, the problem is the substantial diversity among such laws, which acts as a barrier to an EU-wide market. The task to be achieved by EU legislation is to reduce or abolish such a legislative barrier, but without detriment to the current level of legal clarity and certainty. Regarding this task the Commission, as holder of the legislative initiative, needs to make choices rather than compromises and cross-references to national laws, since the latter approach will maintain legal diversity in the implementation phase and thus fail to achieve the desired results. One possibility that the Commission may wish to consider, if the task of making national laws convergent to a single approach is found politically difficult, would be to prepare for an optional regime, established by way of regulation, without modifying national legislation,

whereby those issuers wishing to operate on a cross-border EU-wide basis could decide to have their securities governed by the optional regime, operating as a single rulebook.

The EFMLG is ready to assist further should the Commission so wish.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'H. de Vauplane', with a long horizontal stroke extending to the right.

Hubert de Vauplane

Vice-Chairman