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**LEGISLATION ON LEGAL CERTAINTY OF
SECURITIES HOLDING AND DISPOSITIONS**

**Member States Working Group
Discussion Paper**
of the Services of the Directorate-General Internal Market and Services

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INTRODUCTION

1. The present document is designed by the services of the Directorate General Internal Market and Services. Its aim is to provide participants of the Member States Working Group with information on the services' current approach in preparing a "Securities Law Directive" (SLD).

2. In 2004, the Commission set out a roadmap for future action with a view to enhancing the safety and efficiency of post-trading arrangements across Europe¹. It advocated, amongst other proposals, pursuing work in the field of legal barriers to a safe and efficient post-trading landscape. It mandated a group of legal experts, the Legal Certainty Group, to advise the Commission on whether legislation in the field of securities holding and dispositions should be improved, and if it should, how such improvement should be carried out. The Group presented its Advice to the Commission in August 2008². On the basis of this document and an open conference held on its outcome on 23 October 2008 in Brussels, the Commission services are preparing a legislative text in this respect. The present paper covers the entire scope of the future piece of legislation.

3. Additional background information to the questions below is comprehensively given in the 2008 Advice of the Legal Certainty Group. Therefore, this paper refers explicitly to that document. An electronic version of the 2008 Advice is available on-line, and a hardcopy can be obtained upon request.

1. GENERAL APPROACH AND SCOPE

4. Following the First and Second Giovannini Report, the Commission 2004 Communication and the publication of the Second Advice of the Legal Certainty Group, Commissioner McCreevy decided to start work on a legislative proposal. This was endorsed by the ECOFIN Council which concluded on 2 December 2008 in Brussels that it

"[...]

– *WELCOMES* the advice published by the Legal Certainty Group in August 2008, noting the number of references therein to the need for further legislation. The Council *AGREES* with the Legal Certainty Group assessment that EU legislation is needed in this area providing for a more harmonised legal framework for intermediated securities and a better protection of investors' rights enshrined in their securities;

– *INVITES* the Commission to present its response to the Legal Certainty Group advice as a matter of urgency including an outline of proposed legislative measures, accompanied by precise timelines for their effective submission to the

¹ "Clearing and Settlement in the European Union – the way forward", Communication from the Commission to the Council and the European Parliament, COM(2004) 312 final, 28.04.2004.

² "Second Advice of the Legal Certainty Group on Solutions to Legal Barriers related to Post-Trading within the EU, August 2008, http://ec.europa.eu/internal_market/financial-markets/clearing/certainty_en.htm.

European legislator, bearing in mind the benefits of maintaining global compatibility with other jurisdictions; [...]"

5. Following this mandate, the future Directive should regulate the legal framework governing

- the holding and disposition of securities held through securities accounts in its substantive law aspects (cf. section 2, paragraphs 9-57);
- the holding and disposition of securities held through securities accounts regarding conflict-of-laws (cf. section 3, paragraphs 58-68);
- the processing of rights flowing from securities held through securities accounts (cf. section 4, paragraphs 69-83);
- and, possibly, the access to central securities depositories by issuers of securities (cf. section 5, paragraphs 84-85).

6. In doing this, however, it should not harmonise the legal framework governing the question of whom an issuer has to recognise as the legal holder of its securities.

7. As regards the regulatory framework, the new legislation should ensure that all entities providing the securities account services, as far as they are not subject to MiFID or the Banking Directive, shall enter the scope of MiFID, cf. section 6, paragraphs 86-87).

8. In the opinion of the Commission services, the future legislation should take a functional and neutral approach as regards the legal concepts in place in the Member States. This aspect and the need for smooth interconnection with other areas of law (which are mainly governed by Member States' autonomous law, such as company, insolvency, tax law, etc.) advocate in favour of the act being a directive.

What are member States' views on these fundamental policy choices?

2. SUBSTANTIVE LAW ASPECT OF HOLDING AND DISPOSITION OF BOOK-ENTRY SECURITIES

9. In 2001 and 2003, two reports of a Commission expert group (the first and second "Giovannini Reports") stated that there is increased legal uncertainty in cross-border securities holding. At the source of these uncertainties were the differences in the legal concepts that applied to securities booked to securities accounts. This situation stemmed from the fact that the development of the law applicable to securities did not keep pace with market developments, namely the fact that securities holdings nowadays were evidenced by electronic book entries and the securities were held through a chain of account providers. Therefore, first, book entries on an account should be given identical legal significance throughout the EU. Second, conflict-of-laws rules regarding "proprietary issues" of intermediated securities should be harmonised.

10. Account holders hold securities with the assistance of account providers, which keep accounts in favour of the account holder to which the securities are credited. Account providers are considered entities like banks, brokers, central banks, central

securities depositories and similar. In some national holding arrangements, only one single account provider intervenes in the holding of securities, whereas, in other systems, it might be a multitude of them (in which case, reference is often made to a "holding chain"). However, the kernel of the practicalities of holding is regularly the relationship between one account holder and one account provider.

2.1. The minimum content of book-entry securities

11. The most relevant aspect of any future European legislation in the field of securities held through account providers would certainly relate to the requirements which need to be fulfilled in order to render the acquisition of securities or of a security interest in securities, legally effective. However, the certainty that an account holder acquires a legal position must be accompanied by the knowledge of *what exactly* he acquired. This is because account holders need to be sure to what extent the acquired position can be used, in particular: to participate in a corporation, to receive dividends or similar payments, to sell the securities, use them as collateral or realise their value in case a security provider does not fulfil his obligations, etc.

12. The legal design of the acquired position must provide clarity regarding these elements. To this extent, there is a clear need for harmonisation. Beyond this, it appears that the exact legal-conceptual nature (property [in its various occurrences throughout EU jurisdictions], trust, specifically designed right) of the acquired position is only of secondary importance to the acquirer. Consequently, harmonised European legislation might provide for a legal position of the acquiring account holder which comprises a set of legal attributes in the sense of a minimum content, without determining the exact legal characterisation of that position.

13. Principle: Starting from a functional point of view, the legal position of the acquirer should be shaped along the functional purposes of an acquisition of securities or interests in securities. Notably, account holders need to be sure (a) that the securities can be disposed of or used to provide a security interest; (b) that they can enjoy the rights flowing from the securities (dividends, voting rights) where they are themselves "investor", and, (c) whether and to what extent they can change the holding situation, if necessary.

14. Complement 1: The above described rights are generally conferred upon the account holder as soon as it "full title" in securities. However, there are types of dispositions where the parties agree that the receiving account holder shall not acquire the full set of rights, for example in case of a security interest under which the acquirer shall not have the right to receive dividends flowing from the securities. The general understanding under the functional approach being that that only the method of acquisition (for example: crediting) needs to be harmonised, it is clear that the legal nature of the disposition (pledge, mortgage, charge, usufruct, etc.) can equally be left to Member States' law. Consequently, Member States' law must have an influence on the content of an acquired position. In particular, in the context of security interests and other limited interests, the law must be in a position to restrict the security taker's right to dispose of the securities and to restrict the right to exercise rights flowing from the securities.

15. Complement 2: Similarly, on the basis of the functional approach, the national law must be able to attribute additional features to the legal position described above. For example, where the applicable law qualifies the right of an account holder in book-entry

securities as a property right, the legal position (a) can be called "property", (b) must cover the minimum content described above, and, (c) can additionally have legal attributes that property in this jurisdiction normally has, as long as these attributes do not contradict the minimum features or differ from any other rule of the future directive.

Rule 1

1. Member States shall ensure that book-entry securities³ confer upon the account holder⁴ at least the following rights:
 - (a) the right to exercise and receive the rights attached to the securities⁵, as far as the account holder is not acting in a capacity of account provider⁶ for a third person;
 - (b) the right to effect a disposition⁷ under [the methods provided for by the directive];
 - (c) the right to instruct the account provider to arrange for holding the securities with another account provider or otherwise than with an account provider, as far as permitted under the applicable legal framework.
2. In case of acquisition⁸ of a security interest or other limited interest in book-entry securities the Member States may restrict the above set of rights.
3. Member States may attribute additional characteristics to book-entry securities and characterise the legal nature of book-entry securities as far as the characteristics or the legal nature do not contravene the rights cited in paragraph 1 or any provision of this Directive.

Would Member States agree that the variety of legal approaches applied in the EU and the need for smooth interconnection with other areas of law require a functional approach?

³ 'Book-entry securities' would mean the legal position which is conferred upon an account holder in respect of securities standing to the credit of the account holder's securities account.

⁴ 'Account holder' would mean a person in whose name an account provider maintains a securities account, whether that person is acting for its own account or for others, including in the capacity of account provider.

⁵ 'Securities' would mean financial instruments or financial assets, other than cash, which are capable of being credited to a securities account, as listed in Annex I Section C of Directive 2004/39/EC.

⁶ 'Account provider' would mean a person who,

- maintains securities accounts for account holders and is authorised in accordance with Article 5 of Directive 2004/39/EC to provide services listed in Annex I Section A indent (9) of Directive 2004/39/EC or is a Central Securities Depository as defined in Article [...] of [EMIL] and, in either case, is acting in that capacity;
- if not subject to the law of a Member State, in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity.

⁷ 'Disposition' would mean

- to relinquish book-entry securities (disposal), in particular for the purpose of a sale,
- to create security interests or other limited interests in a book-entry securities in favour of another person, or
- to relinquish security interests or other limited interests in book-entry securities.

⁸ 'Acquisition' would mean the receiving of book-entry securities or of a security interest or other limited interest therein.

2.2. Acquisition and disposition of book-entry securities

16. Principle: From a functional perspective, different methods are used throughout EU jurisdictions to realise acquisitions and dispositions.

- Book-entry methods
 - crediting of an account;
 - debiting of an account;
 - earmarking of securities in an account or of a securities account;
 - removing of an earmarking.
- Non-book-entry methods
 - conclusion of a control agreement;
 - conclusion of an agreement with and in favour of the account provider.

17. The future Directive should create a set of commonly accepted methods that prevail EU-wide over any other method. From a functional point of view all six methods above appear suitable. However, there might be a doubt about the commonly accepted use of control agreements, as they do not have the same visibility as book-entry methods which might lead to situations where account statements show securities which already had been disposed of earlier (the same argument does not apply to the sixth method listed above, as in that case the beneficiary of the security interest is at the same time the guardian of the encumbered asset and therefore does not need protection).

18. Complement 1: An important question is how to implement the standard of harmonised methods across jurisdictions. One method would be to abolish all other methods which exist under national law. However, a less intrusive technique appears to be preferable. Notably, the assurance that harmonised methods always prevail over non-harmonised methods should be sufficient to achieve the targeted effect. A clear statement to this effect should be inserted directly together with the list of harmonised methods, whereas the details could be left to a rule on priorities (*cf. infra*).

19. Complement 2: As Member States shall continue to be in a position to characterise the legal position from a legal-conceptual point of view, it is necessary that they retain the same power as regards the legal concept underlying disposition and acquisition (e.g., "transfer of property" or "assignment", etc.). Again, the legal characterisation must not pre-empt the effect of rules harmonised under the Directive, in particular the rules on effectiveness of acquisition and account holder protection against reversal.

20. Complement 3: National law, for various reasons, addresses regularly cases (such as for instance "heritage") where the law effects an automatic transfer of rights between persons. It appears to be harmful to enter into the area of these well developed special regimes. Consequently, acquisitions and dispositions operated by mandatory operation of law would need to be carved out.

What are Member States' views on the possible inclusion of control agreements as one of the harmonised (and prevailing) methods?

Rule 2

1. Member States shall provide for acquisitions and dispositions of book-entry securities and limited interests therein to be effected by at least one of the following methods:

- (a) crediting⁹ an account;
- (b) debiting¹⁰ an account;
- (c) earmarking¹¹ book-entry securities in an account, or earmarking a securities account¹²;
- (d) removing of such earmarking;
- (e) concluding a control agreement¹³;
- (f) concluding an agreement with and in favour of an account provider.

2. The above methods shall prevail over any other method permitted by the law of a Member State.

3. Member States may characterise the legal nature of dispositions over book-entry securities effected under the above methods as far as the legal nature does not contravene other rules of the Directive.

4. Acquisitions and dispositions arising by mandatory operation of the law of a Member State are effective and have the legal attributes, in particular rank, attributed by that law.

⁹ 'Crediting' would mean the adding of book-entry securities to a securities account.

¹⁰ 'Debiting' would mean the subtracting of book-entry securities from a securities account.

¹¹ 'Earmarking' would mean an entry in a securities account made in favour of a person, including the account provider, other than the account holder in relation to book-entry securities, which, under the account agreement, a control agreement, the rules of a securities settlement system or the applicable law, has either or both of the following effects:

- that the account provider is not permitted to comply with any instructions given by the account holder in relation to the book-entry securities as to which the entry is made without the consent of that person;
- that the relevant account provider is obliged to comply with any instructions given by that person in relation to the book-entry securities as to which the entry is made in such circumstances and as to such matters as may be provided by the account agreement, a control agreement or the rules of a securities settlement system, without any further consent of the account holder.

¹² 'Securities account' would mean an agreement between an account provider and an account holder establishing, amongst other, procedures allowing for the evidencing of securities holdings of that account holder with that account provider.

¹³ 'Control agreement' would mean an agreement in relation to book-entry securities between an account holder, the account provider and another person or, if so provided by the applicable law, between an account holder and the account provider or between an account holder and another person of which the account provider receives notice, which includes either or both of the following provisions:

- that the account provider is not permitted to comply with any instructions given by the account holder in relation to the book-entry securities to which the agreement relates without the consent of that other person;
- that the account provider is obliged to comply with any instructions given by that other person in relation to the book-entry securities to which the agreement relates in such circumstances and as to such matters as may be provided by the agreement, without any further consent of the account holder.

2.3. Effectiveness of acquisitions and dispositions

21. Furthermore, certainty requires the assurance that, from a specific point in time, acquisitions and dispositions can no longer be “undone” and are “good against” third parties.

22. Principle: Under future EU legislation, acquisitions and dispositions shall be effective once they are established under one of the harmonised methods set out above, establishing at the same time the effectiveness between account holder and account provider and the effectiveness *vis-à-vis* third persons. No other requirements than those set by the harmonised methods shall be required, e.g. registration of a security interest in a register, notarisational, etc.

23. Complement 1: It seems appropriate to reaffirm in the context of this rule that the applicable corporate law rules on who is regarded as holder of securities, is not influenced by the present rule. The main example for this caveat is the existence of a separate shareholder register which is operationally and legally different from the holding structure for securities: the national corporate law can prescribe that the acquirer of securities can only exercise rights flowing from the securities, e.g. voting rights, as soon and as long as it figures in the register of shareholders.

24. Complement 2: In some Member States, so-called conditional credits are used, in particular in the case of so called "conditional settlement" where a credit appears in the clients account whereas the securities have not yet been credited to the account provider's account at the upper level. The condition is to make sure that the credit can be reversed in case the securities are not received from the upper level.

25. Complement 3: Control agreements and agreements with and in favour of the account provider are not accompanied by a visible manifestation in the account. Consequently, the effectiveness and ineffectiveness acquisitions and dispositions effected under these methods needs to follow separate rules. As both methods consist basically of the conclusion of an agreement, it should be left to the applicable law to state under which conditions such agreement is ineffective. However, it might be necessary to address additionally the case of the account provider in whose favour such an agreement has concluded, in case it subsequently "gives up" its position by allowing the securities to be debited or earmarked in favour of a third person without reserving its position.

Rule 3

1. Member States shall not require any steps further than those set out in Article [...] to render an acquisition or disposition effective between the account holder and the account provider and against third parties.
2. Effectiveness in the above sense does not determine whom an issuer has to recognise as legal holder of its securities.
3. [Member States may stipulate that the effectiveness can be made subject to a condition agreed upon between account holder and account provider.
- 4.] Member States may provide for reasons which trigger ineffectiveness of acquisitions and dispositions effected under a control agreement or an agreement with and in favour of the account provider and regulate the consequences of such ineffectiveness.

What are Member States' views on the possibility to make the effectiveness subject to a condition agreed upon between the account provider and account holder?

2.4. Effectiveness in insolvency

26. The most important aspect is the protection of account holders' securities in the event of the insolvency of the account provider.

27. Principle: The future legislation must make crystal clear that the insolvency administrator of the insolvent account providers does not have access to the securities or interests therein established by one of the harmonised methods. This protection is probably already granted by the above rule. However, because of the overarching importance of this aspect, and in order to remove doubts regarding the question whether the insolvency administrator is a "third party", the insolvency situation should be addressed in an additional, separate rule.

28. Complement: National insolvency law often contains rules targeted at the protection of the creditors of the insolvent entity. In particular, there are rules for the recapture of assets transferred by the debtor to the detriment of his creditors in a suspect period prior to the commencement of the insolvency proceedings, especially in cases of alleged or actual fraud. It is not the aim of the Securities Law Directive to harmonise or to affect these rules. In addition, the Directive does not intend to interfere with rules on ranking of claims and methods of enforcement in insolvency. As there is a wide range of such rules, there needs to be a rather general statement of this principle, ideally accompanied by rule examples.

Rule 4

1. Acquisitions and dispositions that have become effective under Article [...] are equally effective against the insolvency administrator¹⁴ and creditors in any insolvency proceeding¹⁵.
2. Paragraph 1 does not affect the application of any substantive or procedural rule of law applicable by virtue of an insolvency proceeding, such as any rule relating to:
 - (a) the ranking of categories of claims;
 - (b) the avoidance of a transaction as a preference or a transfer in fraud of creditors; or
 - (c) the enforcement of rights to property that is under the control or supervision of the insolvency administrator.

Would Member States see a need for the first paragraph of the rule above, given that the substance is implied in the general rule on effectiveness (Rule 3), or belong both to the same principle and should be merged?

2.5. Reversal of acquisitions and dispositions

29. However, there is agreement that totally comprehensive effectiveness of acquisition and disposition of book-entry securities is unpractical. Therefore once an effective book-entry position is established, there needs to be clarity on the conditions under which it can be subsequently “undone” and what the legal consequences in such a case would be.

30. Principle: The future harmonised legislation should therefore provide for reasons allowing for "invalidity" or "reversal". The set of reasons should be very restricted, in order to guarantee maximum certainty regarding the validity of an acquisition. There are a number of cases of possible reversal which are all borrowed from general principles of law and which should be maintained for the area of book-entry securities.

31. First, the obvious exception is that the account holder agrees that a crediting is reversed.

32. Second, it must be possible to reverse a crediting which the account holder did not want to obtain, either because it objected explicitly or because it did not give general or special authorisation to credit securities to its account.

33. Third, where an unauthorised debit violates the rights of the account holder or a third person which had a security interest in the book-entry securities, reversal of the debiting (= re-crediting) must be possible.

¹⁴ 'Insolvency administrator would mean any person or body appointed by the administrative or judicial authorities whose task is to administer an insolvency proceeding.

¹⁵ 'Insolvency proceeding' would mean any winding up proceeding or reorganisation measure as defined in Article 2 (1)(j) and (k) of Directive 2002/47/EC.

34. Fourth, where an earmarking of book-entry securities in favour of a third party was not authorised by the account holder, it must be possible to reverse the earmarking (= delete it).

35. Fifth, where a valid earmarking is removed without the consent of its beneficiary (in particular: secured party), the removal can be reversed (= re-earmark).

Rule 5

Member States shall ensure that book entries can be reversed under the following circumstances:

- (a) in the case of crediting with the consent of the account holder;
- (b) in the case of erroneous crediting without the consent of the account holder;
- (c) in the case of debiting which was not authorised by the account holder, or a third person who has acquired an interest in the relevant book-entry securities;
- (d) in case of earmarking which was not authorised by the account holder;
- (e) in case of removal of an earmarking which was not authorised by the person in whose favour it was made.

Would Member States agree that reversal should be possible only under these well defined exceptions?

2.6. Protection of acquirers against reversal

36. A comprehensive legal system on acquisition and disposition of securities requires a rule of so-called "good faith acquisition". In the book-entry environment, the absence of such a rule may have very serious systemic consequences. An attempt to unwind a sequence of acquisitions because one of these acquisitions had been invalid could cause serious strain to participants and, possibly, to systems. In most jurisdictions, there are rules in place protecting the parties involved in such a situation against the risk of unwinding a sequence of acquisitions. Such a rule is commonly termed "good-faith purchaser" rule and Member States' rules resemble each other as regards their general reasoning, while differing considerably as regards exact legal requirements and consequences.

37. An account holder's ability to rely on a credit in his account (with limited exceptions) is the linchpin for a regime of enhanced cross-border legal certainty in the present context. Therefore, a harmonised protection rule is of utmost importance and only a high degree of uniformity can significantly eliminate the threat of unexpected reversal of book entries. For this reason, legislation should be based on a purely functional provision without allusions to traditional legal concepts and employ neutral terminology order to avoid misinterpretation.

Rule 6

Member States shall ensure that

- (a) an account holder should be protected against reversal¹⁶ of a crediting;
- (b) a person in whose favour an earmarking has been made should be protected against reversal of this earmarking

unless it knew or ought to have known that the crediting or earmarking should not have been made.

Would Member States concur with the approach to grant wide protection against reversal under the above described conditions?

2.7. Priority

38. Principle: As a further issue, harmonisation of rules on priority of interests appears to be necessary. Priority conflicts between several market participants with respect to the same book-entry securities can, and do in practice, arise. The laws of Member States address this question in different manners. Future harmonised legislation will have to provide appropriate rules, striking a balance between the various dispositions on the basis of the following criteria: first, the chronological order in which competing rights or interests are established, second, the different nature of the methods used, third, an agreement by the parties to alter the order of priority, and, fourth, policy considerations that give absolute protection of certain claims.

39. The chronological order is a classical means of determining an order of priority with respect to rights and interests created in the same assets. Generally, rights and interests created earlier in time prevail over others created subsequently.

40. Complement 1: Interests created by means of specific methods should have a “better” priority although they have been established later in time as compared to other interests created with respect to the same securities but by different methods. The future Directive is generally built on the assumption that book-entries to an account should have constitutive effect as regards acquisition and disposition of securities and that the use of book-entry securities generally increases transparency. Against this background, interests created by book-entries should be attributed a priority rank that is more favourable than the priority rank granted to interests created under non-book-entry methods. This idea, however, can logically only apply to earmarking, as crediting and debiting are not within the scope of the priority provisions.

41. Complement 2: The principle of contractual freedom of the parties allows for the order of priority to be changed by them. However, such agreement may not affect the rights of third parties.

42. Complement 3: On the basis of policy considerations, national law often attributes a certain rank to certain claims (for example the tax or social security authorities might have a super-priority over the assets of a debtor). The present proposal is not intended to change priority or rank which is attributed to a non-consensual interest.

¹⁶ ‘Reversal’ would mean that a book entry is undone by a converse act.

Rule 7

1. Member States shall ensure that
 - (a) interests in the same book-entry securities which are acquired by earmarking rank amongst themselves in chronological order;
 - (b) interests in the same book-entry securities which are acquired by control agreement or an agreement with and in favour of the account provider rank amongst themselves in chronological order;
 - (c) interests in book-entry securities which are acquired by earmarking have priority over interests acquired in the same book-entry securities by means of a control agreement or an agreement with and in favour of the account provider.
2. Parties can deviate from the above rules by agreement. Such agreement cannot affect the rights of third parties.
3. Non-consensual security interests or other limited interests should have the priority attributed by that law.

Would Member States agree with the preferred treatment of designating entries over non-book-entry methods?

2.8. Account holder protection and integrity of the issue

43. There needs to be a rule ensuring (a) that account providers have at all times a number of securities of a given description available which fully covers their account holders' relevant holdings, and (b) that there is no "inflation" of the number of securities as against the number originally issued. To this end, a mechanism should be in place designed to avoid imbalances in the holdings on the level of each account provider. Different legislations use different means to avoid and rectify imbalances that adversely affect the integrity of the issue. None of these national rules gives rise to particular legal concerns when examined in a purely domestic context. However, their diversity amongst EU jurisdictions is a problem in itself. Generally speaking, it must be the first aim of each and every account provider and the holding chain as a whole to avoid imbalances between the amount of securities validly credited and the amount issued, since any imbalance persists at least for some time raising operational and legal uncertainty, e.g. as regards the payment of dividends and the exercise of voting rights. However, no jurisdiction could categorically deny the theoretical possibility that an imbalance occurs, for instance because of error or even fraud. Cross-border scenarios are probably particularly predisposed for a failure of mechanisms which aim at avoiding imbalances because it may happen that rules that apply (effectively) on the acquirer's side differ from the rules applicable on the alienator's side (which equally work well) – however, in combination both mechanism are ineffective. Consequently, there needs to be a set of repair mechanisms able to rectify imbalances once they have occurred.

44. Principle 1 ("One-to-one match"): The Directive should set the account provider's unconditional obligation to maintain a number of book-entry securities that corresponds to the aggregate number of book-entry securities credited to the accounts of its account holders *plus* the book-entry securities held by the account provider for its own account, if applicable. Articles 13 of the MiFID and 16 of the MiFID Implementing Directive contain a similar obligation which is, however, less concrete. An additional option to reinforce this principle and decrease the danger of the occurrence of an imbalance on a

functional basis would consist in the introduction of a harmonised framework for regular reconciliation of securities holdings, for example on a daily basis, and possibly in the context of MiFID.

45. Principle 2 ("Repair mechanisms"): Reversal (cf. above) is probably the easiest and most effective means to repair imbalances. However, reliability and safety of the system allow reversal only under certain circumstances (*cf. supra*). Additionally, even if the requirements for reversal are met, the securities might have been disposed of in the meantime; as a consequence, the reversal would be excluded on the grounds of the good faith purchaser rule. Consequently, as the condition to maintain or re-establish the balance is unconditional, the account provider should be obliged to acquire the necessary number of securities on the market ("buy-in"). Subsequently, these securities are applied to make up for the deficit and cancel out the imbalance. The requirement to buy in securities should not be subject to contractual agreement among parties. It needs to be discussed whether the buy-in principle can sensibly and should apply in the event of insolvency of the account provider.

46. Complement: It is important to specify by what means the account provider accomplishes the duty to cover the aggregate number securities standing to the credit of the accounts of its clients. The future Directive should prescribe that securities must be held "in kind". This means that it would be insufficient to organise sufficient coverage by keeping cash reserves, participating in whatever kind of insurance arrangement, etc. The account holder must have at its disposal securities in any of the three possible "aggregate states": either in an account with another account provider; or directly in the register of the issuer/registrar; or, physically as certificates.

What are Member States' views on the need for both, a rule on strict one-to-one match and a repair mechanism?

Rule 8

1. Member States shall ensure that an account provider has to maintain, for each description of securities, a number of securities or book-entry securities that corresponds to the aggregate number of book-entry securities of the same description¹⁷ standing to the credit of the accounts of its account holders or, if applicable, held for its own account.
2. In the event that an insufficient number is maintained, Member States shall ensure that the account provider applies either or both of the following mechanisms in order to re-establish the maintaining of a sufficient number:
 - (a) the reversal of erroneous bookings, subject to Article 8;
 - (b) the provision of additional securities.
3. An account provider may comply with the obligation of paragraph 1 by
 - (a) holding book-entry securities as an account holder with another account provider;
 - (b) procuring that securities are held on the register of the issuer; or
 - (c) possession of certificates or other documents of title.

2.9. Protection of account holders and issuers in case of insolvency

47. The main occurrence of failure of the above "one-to-one match" principle and repair mechanisms is the insolvency of the account provider. In such event, there need to be a mandatory mechanism that eliminates the imbalance between the aggregate number of securities credited to accounts and the number of securities issued, in order to protect issuers and prevent systemic instability.

48. Principle 1: In case the account provider holds securities for its own account, these securities shall be attributed to its account holders.

49. Principle 2: As soon as there is no possibility left to *increase* the number of securities held by the insolvent account provider for its account holders, the only possible solution is to *diminish* the number of securities credited to the accounts of the account provider's clients. For reasons of account holder protection and stability of the system, any arbitrary allocation of the loss to one or the other account holder should be avoided and by consequence such loss should be shared (mutualisation of loss). Mutualisation of the loss appears to be the right solution for two reasons: first, it would be very difficult to argue for the loss to be born by individual account holders. Even in the event where it is possible to identify one or more account providers that are "closer" to the facts that actually caused the loss (for example: those account holders that received credits on their accounts at the time the loss occurred) they would become victim of the account provider's mistake or misbehaviour in a rather arbitrary manner. Second, individualisation of losses bears the risk of producing further failures by other market

¹⁷ 'Securities of the same description' would mean securities issued by the same issuer and being of the same class of shares or stock; or in the case of securities other than shares or stock, being of the same currency and denomination and treated as forming part of the same issue.

participants with the potential of a chain reaction. In stress situations such a chain reaction needs to be avoided, therefore losses need to be cushioned.

Rule 9

1. Member States shall ensure that in the event of insolvency of the account provider securities or book-entry securities held by the account provider for its own account shall be attributed to its account holders, as far as the number of securities held by the account provider for its account holders is insufficient.

2. A remaining shortage of book-entry securities on the accounts of the account holders of the insolvent account provider shall be shared amongst the account holders. The relevant rules of a securities settlement system¹⁸ can apply in accordance with the law that governs that system.

To what extent could an obligation to buy-in (even) in case of insolvency be an appropriate remedy against shortfalls?

2.10. Duty to act only on account holders instruction

50. Principle: As crediting, debiting and earmarking are capable of immediately affecting market participants' legal positions towards book-entry securities, the Directive must make sure that the account provider follows only the instruction of the account holder.

51. Complement: However, there are various well reasoned exceptions: in particular, the account provider and the account holder could contractually agree on another person being authorised to give instructions, for example in case of a family member being mandated to make any disposition; or, the national law might provide for the power to instruct the account provider in the context of tutelage or similar. Additionally, the right to instruct might also depend on whether a security interest over the relevant book-entry securities had been established, and similar cases.

Would Member States agree with this approach?

¹⁸ 'Securities settlement system' means a system as defined in Article 2(a) of Directive 98/26/EC for the processing of transfer orders referred to under the second indent of Article 2(i) of Directive 98/26/EC.

Rule 10

1. An account provider is neither bound nor entitled to give effect to any instructions in relation to book-entry securities of an account holder given by any person other than that account holder.
2. Paragraph 1 is subject to:
 - (a) the provisions of any agreement between account holder and account provider;
 - (b) the rights of any person (including the account provider) who has acquired an interest in the relevant book-entry securities;
 - (c) any judgement, award, order or decision of a court or other judicial or administrative authority of competent jurisdiction;
 - (d) any applicable rule of the law of the Member State;
 - (e) if the account provider is the operator of a securities settlement system, the rules of that system.

2.11. Attachment of book-entry securities

52. There are two scenarios which need special attention when it comes to attaching book-entry securities, as opposed to attaching other interest or chattel: on one hand the prohibition of "upper-tier attachment", and, on the other hand, the attachment of segregated client accounts. Whilst both mechanisms relate to "attachments" they deal in fact with two different issues.

53. Principle 1 "prohibition of upper-tier attachment": This term is commonly used to refer to the risk that a securities account with an account provider at a higher tier in the holding pattern may be subject to a legal claim (typically through court proceedings) to freeze or attach the account in order to enforce a claim against a person alleged to hold an interest through an account provider at a lower tier. This phenomenon occurs in the following forms:

- In holding arrangements where legal relationships exist only between the account holder and its own direct account provider the account holder has no rights against any higher-tier account provider. Hence, there is nothing to attach at the higher-tier account provider level. The taking up of an "upper-tier prohibition rule" in such a legal context is thus merely stating the obvious and serves as a clarification.
- In holding arrangements where the investor is considered to be the direct owner of the securities all the way down the holding chain, upper-tier attachment is conceivable. Two scenarios must be distinguished:
 - first, the investor, as legal owner of the securities, can only be identified as such by his own direct account provider, the higher-tier account provider being unable to do so; in this case higher-tier identification is not possible. Consequently, the upper-tier prohibition rule is important and adds actual legal value.
 - second, the investor, as legal owner of the securities is identified or identifiable at the direct *and* at the higher-tier account provider level; in

this case, higher-tier identification is possible and a legal and a policy issue arise. The following key elements are of importance:

- where the investor has a direct account relationship with the higher-tier account provider, its direct account provider acting merely as an “account operator”, there is no issue of upper-tier attachment because there is only one securities account (maintained by the upper-tier entity and administered by the account operator);
- where the direct account provider of the account holder holds itself an account with a higher-tier account provider which is subdivided in as many sub accounts as there are direct investors and the identity of the investors is disclosed to the higher tier account provider one may conceive an “upper-tier attachment”. This depends, however, in particular on, first, the identification of the decisive record (direct account provider/higher-tier account provider) of the investor’s rights, and, second, a solid information transfer system between the direct and the higher tier account provider to ensure that they receive the same information in real time.

54. Principle 2 ("protection of segregated client accounts"): The goal of a rule on prohibition of the attachment of segregated client accounts by creditors of the account provider is to enhance investor protection and to allow for an efficient functioning of holding through securities accounts in structures using multiple tiers and omnibus accounts.

55. Articles 13(7) and 13(8) of the MiFID and Article 16(1)(d) of the MiFID Implementing Directive require that credit institutions and investment firms “must take the necessary steps to ensure that any client financial instruments deposited with a third party (...) are identifiable separately from the financial instruments belonging to the investment firm and from financial instruments belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection”. This segregation rule is designed to safeguard client securities in case of insolvency of the account provider and to prevent the use by the account provider of client securities for own account.

56. A problem arises because, although the MiFID provides for a segregation requirement, it does not draw any legal consequences from such requirement. Therefore, the idea is to provide that creditors of an account provider may not attach accounts which are identified as “client accounts” with a higher-tier account provider.

57. It is worth noting that in some countries there is a rebuttable presumption that an account that an account provider has with an upper-tier account provider *always* contains clients' assets, which is probably the strongest protection possible. Such national rule should be maintained and respected by the future Directive.

Would Member States think that the rule on upper-tier attachment should be more explicit on systems where attachment at the upper level seems practical?

Would Member States be in favour of introducing a client-account presumption entailing effects on the legal attribution of the securities?

Rule 11

1. Member States shall ensure that creditors of an account holder may attach book-entry securities only at the level of the account provider of that account holder.
2. Creditors of an account provider may not attach securities credited to accounts opened in the name of that account provider with a second account provider, as far as these accounts are identified as containing securities belonging to the first account provider's customers. Where the law of a Member State provides for a presumption that accounts opened by an account provider with a second account provider contain clients assets, the presumption applies.

3. CONFLICT-OF-LAWS OF HOLDING AND DISPOSITION OF BOOK-ENTRY SECURITIES

58. Many dispositions in securities involve a cross-border element. Therefore, more than one jurisdiction may be relevant to these dispositions. As already mentioned, not only the legal concepts applying to securities held through account providers vary considerably, but similarly the conflict-of-laws rules do not conform to each other. Three directives address the issue, amongst other questions, notably Article 9(1) of the Financial Collateral Directive, Article 9(2) of the Settlement Finality Directive, and Article 24 of the Winding-Up Directive.

59. The current situation raises three questions: First, the conflict-of-laws rules as contained in the three directives are based on slightly different criteria. The future Directive shall bring the three rules in line with each other so as to ensure consistency and predictability.

60. Second, these rules exclusively apply to the relatively limited scope of the directives, notably to those organisations covered by their personal scope. The future Directive should apply to all account holders and account providers. Consequently, a uniform conflict-of-laws rule for all market participants should be introduced.

61. Third, starting the discussion on the basis of Article 9(1) of the Financial Collateral Directive, which is the most recent one, there is a risk that in some (admittedly rare) cases the interpretation of where securities accounts are "located" could diverge. That means, before settling on a uniform conflict-of-laws rule for the entire environment, the rule itself needed to be clarified as regards the so called "connecting factor". This should happen on the basis of the following guidelines.

62. Principle 1: The connecting factor of the conflict-of-laws rule should be based on the factual criterion similar to the criterion used in the three directives, i.e. where a securities account is 'maintained'. However, more guidance is needed for proper interpretation of this criterion. In this respect, regard has to be given to the reasonable perspective of the account holder, which expects that the law of the country is applicable where the branch is located by which it is serviced. In deciding which branch is servicing the client, the question of through which branch the account was opened, which branch handles the commercial relationship with the account holder, and which branch administers payments or corporate actions relating to the securities credited to the securities account, and similar aspects, will have to be taken into account. However, the

place of the location of supporting technology or of call or mailing centres shall be disregarded.

63. Principle 2: In addition to additional clarification of the connecting factor, ex-ante legal certainty requires the account holder to exactly know which law governs its account. The account provider should always be in a position to tell where an account is maintained and serviced. This certainty should be transferred to the account holder by communicating the relevant location. The account provider shall be responsible for the correct fulfilment of this duty and the competent authority shall be in a position to intervene where the communication does not reflect the location where the account is actually serviced.

64. Complement 1: There needs to be a clarification that the approach is entirely fact based. Consequently the communication must not be able to alter the underlying analysis of where the account is actually maintained and serviced. In the scenario where a judge might look at the question, he will always base its analysis on the factual elements described above. In case the factual analysis and the communication differ, the factual analysis prevails.

65. Complement 2: There need to be an exclusion of "renvoi", in order to avoid that the law identified under the rule refers to yet another law.

66. Complement 3: There is agreement that the conflict-of-laws rule should roughly cover what is dealt with in the substantive law part regarding holding and disposition. However, there are additional elements which need to be covered by the conflict of laws rule, notably those that are closely connected to the matter but are, in the substantive law part, left to Member States' autonomous legislation. For instance, the characterisation of the legal nature of the rights arising from crediting securities accounts would need to be included. Furthermore, there are aspects addressed in the substantive part which should not be governed by the conflict of laws rule, for instance the loss sharing mechanism in case of insolvency. Consequently, a detailed list of issues setting out the scope of the conflict-of-laws rule needs to be included in a separate paragraph.

67. Complement 4: There needs to be a clarification that all securities booked to a securities account are covered by the conflict-of-laws rule, regardless the legal nature that national law attributes to them. This aspect is particularly important where national law characterises certain book-entry securities in a cross-border context as being of contractual or similar nature.

68. Complement 5: There might be additional benefit in harmonising the way by which the location is communicated to the account holder, for example in a separate document, on the account statement, or even as part of the account number. The Commission Services envisage to deal with this rather technical issue in the framework of secondary legislation once the conflict-of-laws rule has been adopted in principle.

Would Member States have additional thoughts on how the existing *acquis communautaire* could be developed further into a conflict-of-laws rule covering the entire environment of securities holding and disposition?

Rule 12

1. Member States shall ensure that any question with respect to any of the matters specified in paragraph 4 arising in relation to book-entry securities shall be governed by the law of the country where the relevant securities account is maintained. Where an account provider acts through branches, the account is maintained by the branch which services the client in relation to the securities account.
2. An account provider in the sense of the first indent of Article [...] is responsible for communicating to the account holder the branch which services the account holder in writing. The communication itself does not alter the determination of the applicable law under paragraph 1.
3. The reference to the law of the country is a reference to its domestic law, disregarding any rule under which, in deciding the relevant question, reference should be made to the law of another country.
4. The matters referred to in paragraph 1 are:
 - (a) the legal nature of book-entry securities;
 - (b) the legal nature and the requirements of an acquisition or disposition of book-entry securities as well as its effects between the parties and against third parties;
 - (c) whether a disposition of book-entry securities extends to entitlements to dividends or other distributions, or redemption, sale or other proceeds;
 - (d) the effectiveness of an acquisition or disposition and whether it can be invalidated, reversed or otherwise be undone;
 - (e) whether a person's interest in book-entry securities extinguishes or has priority over another person's interest;
 - (f) the duties, if any, of an account provider to a person other than the account holder who asserts in competition with the account holder or another person an interest in book-entry securities;
 - (g) the requirements, if any, for the realisation of an interest in book-entry securities.
5. Paragraph 1 determines the applicable law regardless of the legal nature of the rights conferred upon the account holder upon crediting of book-entry securities to his securities account.
6. The Commission shall, in accordance with the procedure laid down in Article [...], adopt implementing measures specifying the formal requirements for any communication under paragraph 2.

4. EXERCISE OF RIGHTS FLOWING FROM SECURITIES

69. For investors¹⁹, the cross-border exercise of rights flowing from securities is often cumbersome, excessively expensive or even impossible. The reason is the *de facto* operational “separation” of the investor from the issuer which is often accompanied by legal incompatibilities as soon as a holding chain crosses jurisdictional borders. Notably, the law of one Member State applicable to the issuer of securities might not tie in smoothly with the law governing holding and settlement in the Member State where such securities are actually held. The Commission Services are of the opinion that cross-border clearing and settlement should allow for sufficient possibility for investors to exercise their rights. The future Directive should address this issue in three different rules:

4.1. Recognition of holding through securities accounts

70. Principle: Member States must ensure that a cross-border investor can exercise rights enshrined in his securities. In order to achieve this, they should recognise two aspects. First, ultimate account holders in a cross-border context often face difficulties in exercising their rights and should generally not be discriminated as against purely domestic holders of the same securities. Second, ultimate account holders sometimes are not identified, by the issuer law, as the legal holder of the securities. Instead, one of the account providers involved in the holding is identified as legal holder.

71. Member States should make sure that, regardless the nature of the difficulty, account providers must (a) facilitate the exercise of the rights by the ultimate account holder itself; (b) be ready to receive or exercise the rights for the ultimate account holders.

72. Complement: The above rules are only capable of creating duties for EU regulated account providers. As soon as a client of an EU account provider is outside the EU, the duties still apply. However, in case this non-EU entity is itself an account provider for a third party, it is not covered by the envisaged duties. In other words: the directive will be unable to guarantee the effective exercise of rights by clients of a non-EU account provider. This issue is particularly sensitive where a holding chain “exits and re-enters” the field of application of EU law and regulation. In order to promote the effective exercise of rights in such cases, an extended duty of the EU regulated account provider should be established.

¹⁹ The directive would not use the term “investor” and rather build on the expression of “ultimate account holder”. Though both terms envisage generally the same type of market participant (the one who bears the risk of the investment), there is an important difference: “investor” is an economical term, referring to who actually paid the price for the securities, regardless whether the investor is an account holder (or, in traditional terms, “owns” the securities) or whether an agent that does not provide securities account services to the investor acquires them in its own name. The latter situation of an “invisible” investor standing behind an agent or nominee should not be covered by the future directive. The national rules on agency and similar arrangements fully cover this context, in particular address the issue of rights and duties between the parties.

Rule 13

1. Member States shall ensure that the ultimate account holder²⁰ is able to receive and exercise the rights flowing from securities, regardless whether it is either itself identified by the applicable law as the legal holder²¹ of the securities, or its account provider or a third person is identified by the applicable law as the legal holder of the securities.
2. The ultimate account holder shall be able, in any case,
 - (a) to receive and exercise the rights flowing from the securities itself, with or without facilitation by its account provider as provided in [Rule 14], or
 - (b) to have these rights received or exercised by its account provider or a third person under its instruction, as provided in [Rule 15].
3. Where an account holder is not subject to the law of a Member State its account provider must take appropriate measures to ensure the effective exercise of rights flowing from securities which the account holder might hold for others.

Would Member States agree that the difficulty of cross-border action processing should be addressed from those two angles?

Would Member States agree with the concept of "ultimate account holder"

4.2. Facilitation of the exercise

73. Principle: Whether or not the ultimate account holder is identified by the applicable law as the legal holder of the shares, account providers should be obliged to assist in the effective exercise of rights. To this end, the must at least provide a certificate evidencing the holdings; or, arrange for the ultimate account holder to be able to act as a proxy where it is not the legal holder of the securities.

74. Complement 1: There need to be rules regarding the possibility to contract out from this obligation. The Commission should address these aspects in an implementing measure.

75. Complement 2: A certificate evidencing the holding can unfold its full benefit only if other market players, in particular issuers, recognise it as legally binding. The Commission should set out the technical details of such mechanism in an implementing act.

²⁰ "Ultimate account holder" refers to an account holder which is not acting in the capacity of account provider for another person.

²¹ "Legal holder" refers to the shareholder, bondholder or holder of other financial instruments, as defined by the law under which the relevant securities are constituted.

Rule 14

1. Member States shall require that the account provider facilitates the receipt or exercise by the ultimate account holder of the rights flowing from the securities against the issuer or a third party where the facilitation is necessary for the effective receipt or exercise or where it is requested by the ultimate account holder.
2. Such facilitation must at least consist in
 - (a) providing the ultimate account holder, regardless whether he is the legal holder of the securities or not, with a certificate confirming its holdings; or,
 - (b) arranging for the ultimate account holder being the representative of the legal holder with respect to the receipt or exercise of the relevant rights ("proxy"), where an account provider or a third person is the legal holder of securities, in which case Article 11 of Directive 2007/36/EC applies correspondingly.
3. The Commission shall adopt measures specifying
 - (a) the extent to which the obligations following paragraphs 1 and 2 can be made subject to a contractual agreement between the ultimate account holder and its account provider as well as the formal requirements to be met by such agreement;
 - (b) in respect of point (a) of paragraph 2, the content of the certificate to be provided, establishing a standard form to be used throughout the Community for that purpose, and the conditions under which issuers shall recognise such certificate.

Would Member States agree that facilitation should be in principle mandatory where it is necessary for the effective receipt or exercise of rights or where it is requested by the ultimate account holder?

4.3. Exercise under instruction by the ultimate account holder

76. Principle 1: Where an ultimate account holder is unable to exercise or receive the rights because it is not the legal holder of securities, its account provider shall be obliged to exercise or receive the rights under its authorisation and instruction.

77. Complement 1: As this obligation can go relatively far (would, for instance, an account provider be obliged to take legal shareholder action against the company on behalf of its clients?) there might be a justified need to be able to restrict the range of corporate rights to which this duty applies. The Commission should specify the extent to which account providers should be able to contract out from this obligation in secondary legislation.

78. Principle 2: Where an ultimate account holder does not want to exercise or receive the rights itself, the account provider should be obliged to exercise on the clients behalf only within the framework of the level of service contractually agreed between both parties.

79. Complement 2: The above principle bears the risk that ultimate account holders transfer the right to receive and exercise the rights in too extensive a manner. Therefore, the Commission should address in secondary legislation the limits of such transfer, in

particular the formal requirements to be met by a general transfer of the right to exercise and receive.

Rule 15

1. Member States shall oblige account providers to receive and exercise rights flowing from securities
 - (a) where the ultimate account holder is unable to exercise the rights itself because the account provider or a third person is the legal holder of the securities. The receipt or exercise shall be conditional upon authorisation and instruction by the ultimate account holder.
 - (b) 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 is obliged to exercise these rights upon its authorisation and instruction and in accordance with the contractually agreed level of services.
3. The Commission shall adopt measures specifying
 - (a) the extent to which the obligation following paragraph 1(a) can be made subject to a contractual agreement between the ultimate account holder and its account provider as well as the formal requirements to be met by such agreement;
 - (b) the formal requirements to be met by an agreement following paragraph 1(b) as far as it provides for general authorisation of the account provider to exercise the rights flowing from the securities.

Would Member States agree with the need to restrict the duty of account providers to exercise for the ultimate account holder?

4.4. Passing on information

80. The effective exercise of rights flowing from securities requires that the relevant information flows smoothly between the ultimate account holder and the issuer. To this end, the future directive should comprise a rule ensuring the information flow in both directions, downstream (issuer to ultimate account holder) and upstream.

81. Principle: Downstream information needs to be processed to the extent that it (a) is processed through the chain and does not originate from third persons (e.g. from the financial press, rating agencies, etc.), (b) that it is directly linked to the exercise of a right flowing from the relevant securities, and, (c) that it is directed to all legal holders of the relevant securities. Upstream information needs to be processed as far as it is provided by the ultimate account holder in the context of the exercise of rights flowing from securities.

82. Complement 1: The Commission should have the possibility, by way of secondary legislation, to address issues of technical standardisation where it appears necessary to ensure the efficient implementation of the duties described above.

83. Complement 2: The duty to process information is capable of increasing costs for the involved account providers. Member States follow different approaches on how this cost is to be shared between issuer, account providers and ultimate account holders. The Commission should address this issue in secondary legislation in order to ensure that the

implementation of the duties is not hampered by incompatible rules regarding the bearing of cost.

Rule 16

1. Member States shall ensure that information with respect to securities received from an account provider by an account holder is passed on to the ultimate account holder as far as information
 - (a) is necessary in order to exercise a right flowing from the securities which exists against the issuer; and
 - (b) is directed to all legal holders of securities of that description.
2. Information with respect to securities received by an account provider from its account holder must be passed on to the issuer of the securities or, if applicable, the following account provider, as far as pieces of information are provided by the ultimate account holder in the course of the exercise of a right flowing from the securities which exist against the issuer.
3. The Commission shall,
 - (a) in accordance with the procedure laid down in Article [...], adopt implementing measures in order to take account of technical developments in financial markets and to ensure the uniform application of paragraphs 1 and 2;
 - (b) in accordance with the procedure laid down in Article [...], establish rules regarding the sharing of the cost entailed by complying with the obligations laid down in this article.

Would Member States agree that the information flow needs to be regulated so as to permit the two preceding rules to result in a measurable improvement for investors?

5. ACCESS TO CENTRAL SECURITIES DEPOSITORIES

84. Giovannini Barrier 9 concerns hurdles to issuer that might wish to issue their securities into a CSD other than their (roughly speaking) "home" CSD. The Commission had mandated the Legal Certainty Group to provide for a first blueprint for legislation capable of dismantling this barrier and had included the issue in its public consultation. Since then, the Commission Services started working on an additional legislative instrument, covering market infrastructures and providing for mandatory clearing of certain types of financial instruments, while at the same time intending to discuss this proposal with Member States in a separate working group.

85. At present, it is unclear whether CSDs should be regulated in the context of this overarching market infrastructure legislation and whether the issue of Barrier 9 should be dealt with in the same instrument. The Commission services intend to discuss this issue with Member States at the occasion of a forthcoming meeting of the Working Group on Market Infrastructure Legislation.

6. REGULATORY FRAMEWORK FOR ACCOUNT PROVIDERS

86. Member States aim at increasing the safety and soundness of holding through account providers as these entities are in a position to play a central role in the safeguarding of the integrity of a securities issue and the protection of investors' holdings. Therefore, account provider's activity is regularly put under the scrutiny of a competent authority. Providing the service of maintaining securities accounts is an "ancillary service" under Annex I Section B of the MiFID. The provision of ancillary services *per se* does not require an authorisation. However, if provided by an investment firm, the rules of the MiFID apply, *cf.* Articles 5(I) and 6(1) of the MiFID. This means that if an account provider is not an investment firm in the sense of MiFID, its activity, though being an ancillary service, is not subject to the rules of the Directive; hence, at a Community level, there is a regulatory "gap" as there is no common rule on the question of whether or not such entities have to be subject to authorisation and regulation which might be filled by upcoming harmonised legislation.

87. The Commission Services suggest closing this regulatory gap by "elevating" the relevant "ancillary service" of MiFID to the status of "investment service". Given that CSDs are equally account providers in the sense of the SLD, they would need to be excluded from that change in the scenario where special authorisation and operating conditions were to be defined in the framework of the infrastructure legislation.

Would Member States agree with this approach?

Rule 17

Directive 2004/39/EC shall be amended as follows:

1) At the end of Section A of Annex I the following paragraph shall be inserted:

'(9) Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management, where not provided by a central securities depository under Article [X] of the [Infrastructure Legislation].'

2) In Section B of Annex I the first paragraph shall be deleted.

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