EuropeanIssuers

aisbl - ivzw
Rue Belliard 4-6
B-1040 BRUSSELS

Tel : +32 (0)2 289 25 70
Fax : +32 (0)2 502 15 60

info@europeanissuers.eu
www.europeanissuers.eu

KEY CONCERNS

FOR CAPITAL MARKETS AND COMPANIES

ON THE REGULATION

OF CENTRAL SECURITIES DEPOSITARIES (CSDs)

9 July 2012

A. GENERAL COMMENTS

EuropeanIssuers is the representative association for publicly traded companies in Europe, seeking well functioning European financial markets that appropriately serves the interests of their users.

The companies represented by EuropeanIssuers, and by its national associations members, play an essential role regarding the development of, and the support to, the real economy.

Within this framework, one must keep in mind that any Regulation regarding the functioning of post-trade financial market infrastructures not only affects the operations of CSDs or other similar structures but it will also be of utmost importance, and impact, to the European companies as users of such infrastructures.

Indeed, it is our belief that the performance of equity markets must be judged by reference to the benefits achieved by the companies which are quoted on those markets and which are a crucial end user of such markets and infrastructures.

With this in mind, EuropeanIssuers welcomes the Proposal for a Regulation on improving securities settlement in the European Union and on CSDs (from now on the "Proposal" or the "Regulation"), as it is our understanding that the Proposal improves settlement and reduces the risk of reversals, namely by the harmonisation of settlement cycles.

The adoption of a common regulatory framework for CSDs aims to ensure that securities clearing and settlement systems are safe, secure and reliable, do not add risks and help reducing infrastructure services costs rendered to Issuers.

However, some major lines of concern remain:

B. KEY CONCERNS

1. Free Choice Regarding Location

CSD Regulation must ensure that Issuers have the right to choose any CSD established in the EU for recording their securities and receiving CSDs services, and that that right is subject to consistent and timely implementation across Europe.

2. Integrity of the Issuance

CSD Regulation must ensure that the amount of issued securities always corresponds exactly to the amount of securities that are entered into the holding system.

3. Primacy of applicable corporate law

All questions related to the creation of the securities, to the rights and obligations it expresses, to the relation between the securities holder and the issuer, and to the question of who qualifies as securities holder must be governed by the law of the country under which the security has been created.

4. Settlement Security

CSD Regulation must ensure that settlement is as risk free as possible, to remove the possibility of reversals. CSDs, as core market infrastructures, should not be directly exposed to any banking risk.

5. Free Choice Regarding Form

CSD Regulation must not prejudice the right of investors to hold securities in certificated form.

6. No Increase in Costs

After implementation, the CSD Regulation must be followed by consistent ex-post review and systematic assessment, to determine if it worked as intended and, specially, to identify inadvertent or adverse consequences for Issuers, namely related with any kind of costs increase.

7. Shareholders Transparency

The European capital market needs the Shareholder Identification (identification of the end investor as the person who directly invests own money in a security) principle acknowledged EU wide.

8. Common Harmonised Legal Framework

In order to ensure and enhance the safety, efficiency and competitiveness of post-trade financial market infrastructures, the CSD regulation must be consistent with global standards already in place or in course of preparation.

C. COMMENTS

1. Free Choice Regarding Location

EuropeanIssuers welcomes the proposed measure giving issuers the right to record their securities in any CSD authorized in the EU (article 47).

However, it is crucial for issuers and investors that the choice of the CSD should leave the operation of the applicable corporate law unaffected.

In case of shares, for example, the issuance of securities is governed by the *lex societatis* of the company's home jurisdiction, irrespective of the location of the CSD.

The same holds true with respect to the law governing the holding patterns or the rights flowing from the shares, which is equally the *lex societatis* of the home jurisdiction.

The Regulation should make this clear.

2. Integrity of the Issuance

It is of utmost importance for Issuers, including for corporate governance reasons, that the amount of issued securities always corresponds exactly to the amount of securities that are entered into the holding system, hence preventing inflation of securities, which would be prejudicial to investors and confidence in financial markets

A fundamental responsibility of the CSD is thus to reconcile the securities held in its books (either via custody of a book entry system) with that of the issuer, and following also the reconciliation of securities on all levels down the chain to the end investor.

This must be done at the highest level in the holding chain by the CSD which must ensure that the aggregate number of securities held in the accounts opened by custodians for a given issue corresponds to the total number of securities issued by the relevant listed company and recorded in that CSD

However, a CSD cannot carry out this task adequately if it is allowed to fulfil only one of the core-functions (art. 2.1(a)) that are the notary services and the central maintenance service (Annex, section A), as both are indissociable.

Indeed, reconciliation takes place by comparing the account recording the total issue with the accounts opened by CSDs participants in CSDs books. Intrinsic to the public-utility function is also the settlement function, which is about ensuring that delivery of title in securities by the seller is concomitant with payment by the buyer, thus preventing systemic risk.

Therefore, EuropeanIssuers considers that any entity that fulfils at least one of the 3 core services of section A of the Annex must apply for a CSD licence and must be in a position to provide all three core services defined in the Regulation.

3. Primacy of applicable corporate law

EuropeanIssuers opposes altering the existing conflict of law rule, which would hamper the free operation of the applicable corporate law, which, under all national legal systems, governs the relationship between shareholders and the issuing company, including shares ownership regimes

Article 46.1 provides that "any question with respect to proprietary aspects in relation to financial instruments held by a CSD shall be governed by the law of the country where the account is maintained".

Under this proposed regulation, where the account is used for settlement in a S.S.S, the applicable law shall be the one governing that S.S.S (article 46.2). Where the account is not maintained in a S.S.S., that account shall be presumed to be maintained at the place where the CSD has its habitual residence (article 46.3).

These provisions subject ownership regimes to the law governing the account agreement and would affect the operation of the applicable corporate law. Only that corporate law creates the bundle of rights and obligations which are expressed in the term "share" in a company. This creation law must not be affected by the secondary law of the transfer of this position. The question of who is an owner of a "share" cannot be determined in a way contrary to the primary law of its creation. Thus, shares ownership regimes, including determination of the person entitled to exercise the rights attached to the shares, are defined by the *lex societatis* and the issuance contract and should be left outside the scope of the envisioned Regulation.

In addition, under most national ownership regimes, it is not at the level of the CSDs but at the level of the relevant intermediary that shares are held on behalf of the owner.

It should therefore be made clear that all questions related to the creation of the securities, to the rights and obligations expressed in a "security", to the relation between the securities holder and the issuer and to the question who qualifies as securities holder are governed by the law of the country where the Issuer has been incorporated and is normally seated.

In addition, reference in articles 46.1 to 46.3 to "the account" may be misleading as it may allude either to the CSD in its central market role ("issuer CSD) or to CSD holding securities with another CSD on behalf of clients and acting as a custodian ("investor" CSD) in direct competition with custodians.

Hence, the existing conflict of law rules of the Settlement Finality Directive, which have never generated substantial uncertainty, should be maintained and the reference to proprietary aspects removed.

4. Settlement security

As per our previous paper on the CSD Regulation (attached) EuropeanIssuers welcomes the provisions harmonising settlement cycles and reinforcing settlement discipline (notwithstanding later detailed comments upon publication of settlement discipline measures that are to be defined by the European Securities and Markets Authority in due time).

It is crucial that the CSD Regulation result in a post-trade environment where systemic risk is mitigated and efficiency, effectiveness, transparency and systemic stability are enhanced.

In this regard, article 37.3 of the Proposal deserves further observation, and discussion, as the provisions on the cash settlement appear to leave the participants a choice between the settlement in central bank money or in commercial bank money.

Giving the current strong interconnection of central and commercial bank money in most European payment systems, all aspects related with the appropriate balance between the use of central and commercial bank money need to be very carefully analyzed and stated with complete clarity (also, considering the change in context provided by the entry into force of the ECB's T2S project).

Namely, where a CSD is allowed to offer banking services, this should be done in such a way that would ensure that even in the case of a credit event affecting the banking entity, the settlement of securities transactions and the integrity of the issuance are preserved.

And, indeed, international recommendations provide that if central money is not used, steps must be taken to protect members of the central securities depository from potential losses and liquidity pressures arising from the failure of a commercial bank.

5. Free Choice Regarding Form

CSD Regulation must not prejudice the right of investors to hold securities in certificated form.

EuropeanIssuers does not see for what reason all transferable securities that are admitted to trading on regulated markets should be issued in book-entry form. While, this does facilitate settlement, many investors purchase securities as part of a long-term investment and they prefer to hold securities in certificated form.

Hence, EuropeanIssuers sees the compulsory dematerialisation as a considerable market change for Issuers and Investors in many Member States and therefore proposes that a grand-fathering clause be added to this, pursuant to which for a period of 5 years after entry into force of the Regulation, transferable securities will only be immobilised or dematerialised in the case where they are presented for that purpose to a CSD.

6. **No Increase in Costs**

EuropeanIssuers considers that the CSD Regulation must work as a stimulus for innovation and efficiency for the post-trade industry, but also as a trigger for wider choice, lower prices and reduced costs for Issuers.

Therefore, we expect CSD Regulation to provide for reduction of costs for Issuers as the result of effective wider possibility of choice and competition between CSDs, and also between CSDs and issuer agents as regards registration of ownership. But we are also concerned about the possibility of prices increasing by the post-trading industry imposing new implementation costs on Issuers.

Thus, the CSD Regulation's entry into force must not give room or justification for any increase of costs, directly and indirectly, in more or less tangible ways, which, by increasing the costs for Issuers will translate into increasing the cost of raising capital for listed companies using the capital markets, which is a sensitive matter.

For this reason, after implementation, the CSD Regulation must be followed by consistent ex-post review and systematic assessment, including interactive and dynamic effects, and the measurement of impacts on Issuers, to determine if it worked as intended and, specially, to identify inadvertent or adverse consequences for Issuers, namely related with any kind of costs increase, further emphasizing what creates value for end-users and avoiding and eradicating any troublesome for quoted companies.

7. Shareholders Transparency

EuropeanIssuers believe that the CSD Regulation creates an opportunity for ensuring that issuers have easier access to their ultimate investors (end investors, i.e. **the person who directly invests own money in a security),** irrespective of the nature and number of the intermediate layers of depository systems between the issuer and the ultimate investor thereby also facilitating that the flow of information between issuers and ultimate investors.

Central to issuers' concern is allowing not only the ultimate investor to receive and to exercise the rights flowing from securities, but also for the issuer to communicate with and ensure that the ultimate investor has actually been identified and received adequate information. Hence, recognition of the ultimate investors' rights should be complemented by an EU-wide acknowledgement of the shareholder identification principle, in order to ensure more effective disclosure by the intermediary, wherever the latter is located, of the clients it represents.

Acknowledging EU-wide the shareholder identification principle would in essence achieve minimum harmonization: what this proposal means is removing obstacles to the free operation of the applicable corporate law, which, under all national legal systems, governs the relationship between shareholders and the issuing company, including the shareholder identification procedure.

Under this proposal, the Italian shareholder of a company seated in France will be subject to the French identification procedure and the Italian specific rule will not apply. The latter will only be enforced vis-à-vis shareholders of Italian seated companies, irrespective of their residence.

By contrast, full harmonisation (e.g. setting an EU wide uniform rule) is neither feasible nor necessary.

8. Common Harmonised Legal Framework

The CSD Regulation will only be of merit if it improves services and outcomes for end users, namely the Issuers.

EuropeanIssuers also believes that the CSD Regulation must translate into practical and real future developments like the significant increase of interoperability among CSDs or improved access to liquidity, while fully respecting a level playing field for all users.

With that in mind, and in order to ensure and enhance the safety, efficiency and competitiveness of post-trade financial market infrastructures, the CSD Regulation must be consistent with global standards already in place or in course of preparation.

The development of this new regulatory framework must be seen in the context of other ongoing work, specially, the CPSS/IOSCO *Principles for Financial Market Infrastructures*, the ECB TARGET2-Securities (T2S) project (under which the settlement process of most CSDs will be outsourced to a single IT platform), and other official European initiatives related with the functioning and development of the European capital market (*e.g.*, the ones related with the follow up of the Giovannini's working group).

For this purpose, we request the European Commission services to produce and update a comparison of all relevant sets of rules, including their respective expected results and impact.

Without access to this information, it is unlikely that the end users will be able to participate in the debate.