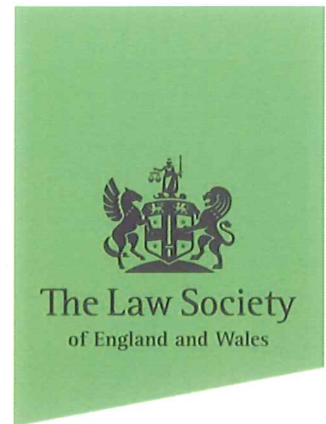

Ms. Kay Swinburne
European Parliament
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B-1047 Brussels

By email: kay.swinburne@europarl.europa.eu

Dear Ms. Swinburne

Proposed Regulation on Central Securities Depositaries

I am writing to you on behalf of the CREST Working Party of the Company Law Committee of the Law Society of England and Wales and the City of London Law Society Company Law Committee.

The Law Society of England and Wales is the representative body of over 140,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This letter has been approved on behalf of the Law Society by members of the Company Law Committee. The committee is made up of senior and specialist corporate lawyers.

The City of London Law Society (CLLS) represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees and in this case the response has been likewise approved by the CLLS Company Law Committee.

This letter is only concerned with the company law aspects of key parts of the proposed Regulation. We are concerned in particular that more thought needs to be given to the effect the proposed Regulation will have on the relationship between companies and shareholders and the rights of shareholders. The Regulation should not prejudice the rights of shareholders and one of its aims is to protect those rights. Recital 37 states "In order to protect the rights of shareholders, the rights of issuers to choose a CSD should not prevent the application of the national corporate laws under which the securities are constituted and which govern the relation between issuers and their shareholders".

If you have any queries relating to our proposals or would like to discuss them further, please contact me or Carol Shutkever (whose email is carol.shutkever@herbertsmith.com).

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1. Articles 3 and 4

1. These articles require companies whose securities are traded on a regulated market to arrange for the securities to be in book-entry form. Member States where a company is established must ensure that companies meet this obligation and must ensure the regulated markets they supervise ensure securities traded on those markets are recorded in book-entry form in a CSD before the trade date.

2. **Protection of shareholders' position:** In some Member States, including the UK and Ireland, there are numerous individual shareholders (and a much smaller number of corporate shareholders) who hold their shares in certificated form and shareholders may convert their shares from certificated form to dematerialised form and vice versa from time to time. Typically, shares held by institutions are held in dematerialised form. In many cases, shares held by individuals or small companies are only traded rarely and, when that happens, a shareholder can dematerialise their shares to be held in book-entry form. We do not believe that allowing shares which are not traded to continue to be held in certificated form would be damaging to the functioning of the market or the aims of the Regulation. We think it would be disproportionately costly for the Regulation to require all existing certificated shares to be dematerialised, rather than requiring certificated shares to be recorded in a book-entry form in a CSD prior to the intended settlement date if they are traded. The proposal would either impose significant costs on private shareholders individually (who are mostly small holders) or involve significant costs for issuers and/or registrars or depositaries. It would also be disproportionate to deprive existing shareholders of their current rights, in particular their right to be recorded on the share register, which gives them a direct relationship with the company (rather than rights that have to be exercised through an intermediary).

3. These issues would be dealt with by deleting Article 3(1) and just retaining Article 3(2). We believe Article 3(2) offers sufficient protection and meets the Regulation's objectives in relation to securities trading and settlement. Alternatively there could be a transitional provision to protect existing certificated holders, such as a new Article 3(3) as follows:

> ***Article 3***
>
> 4. *Paragraphs 1 and 2 shall not require a transferable security which is admitted to trading on a regulated market at the date this Regulation enters into force and which is not, at such date, represented in book-entry form to be so represented unless that transferable security is traded on a regulated market or is transferred following a financial collateral arrangement as defined in point (a) of Article 2 of Directive 2002/47/EC, in which case that transferable security shall be recorded in book-entry form in a CSD prior to the intended settlement date[1], unless it has then already been so recorded.*

5. **Intended settlement date:** At present, Article 3(2) refers to securities being recorded in book-entry form in a CSD prior to the trade date. We believe this should, instead, be prior to the intended settlement date. A requirement for securities to be in book-entry form in a CSD before the trade date would, in practice, affect the ability to trade shares (and expose shareholders to the risk of price movements against them), particularly for smaller shareholders who are likely not to hold their shares in this way.

6. **Direct issuance:** If Article 3(1) is to be retained, we suggest that the words "subsequent to a direct issuance of the securities into a dematerialised form" in line 4 of Article 3(1) be replaced by the words "or by being in dematerialised form". This is because, in some Member States including

[1] We make no comment for collateral arrangements, which are outside the scope of this letter, but further wording may be needed for such arrangements.

the UK, shares may be issued in certificated form and then subsequently converted into dematerialised form (and so may not have been directly issued in dematerialised form). In particular, when a private company in the UK applies for the admission of its shares to trading for the first time, its existing shares will all be in certificated form before admission.

7. **Markets covered:** We do not understand why Article 3(1) refers only to regulated markets, whilst Article 3 (2) refers to regulated markets, MTFs and OTFs. If Article 3(1) is to remain, we think they should be consistent. We would prefer to limit the Regulation to regulated markets. If the references to OTFs and MTFs are kept, the Regulation should not impose obligations on companies where their securities are traded on a market or an OTF or MTF without their consent.

8. **Off-market trades:** We suggest further provision is added to make it clear that off-market trades (e.g. a private transaction between shareholders) are not subject to the requirements. We suggest either the following words are added after "Directive 2002/47/EC" in Article 3(1), "the securities the subject of such a trade or transfer" instead of "those securities" or, alternatively, the new wording suggested for Article 3 as a whole below is used.

9. **Timing of entry into force:** The timing of entry into force of Article 3 needs to be clarified. In the introductory comments for the draft Directive (paragraph 3.3.2) there is a reference to a transitional period through to January 2018 for Article 3. However, in Article 70 there is only a reference to Article 3(1) applying from January 2020. There needs to be a sufficiently long transitional period in relation to Article 3(2) as well.

10. **Scope of companies within requirement:** It is not clear whether the reference to a "company" in Article 3(1) is only to a company incorporated in an EU Member State or whether it is intended to include any company, wherever incorporated, which has securities admitted to trading on a market in the EU. Article 4(1) would suggest that only companies established in a Member State are covered by Article 3(1) but it is not clear. It is not clear which companies Article 3(2) applies to because it says that it applies to the "securities" referred to in Article 3(1) but Article 3(1) does not apply to the same markets as Article 3(2). The scope of the requirement needs to be put beyond doubt. Whilst it would appear logical to impose the same settlement requirements on all companies whose securities are traded on markets established within the EU, the EU may consider it beyond the scope of its powers to impose such obligations on companies which are established in non-Member States, given the interaction between the trading requirement and the company law of those non-Member States.

11. **Member State jurisdiction:** Article 4(2) puts the obligation to ensure compliance with Article 3(2) on authorities of the Member State where the relevant market is located. However, the validity of a transfer of the ownership of shares is a matter for the law in which the relevant company is established (for other transferable securities it may be a matter for the law of the instrument or agreement that constitutes the securities). A Member State should be required to impose the relevant obligations on both companies and markets established in that Member State.

Suggested new wording for Articles 3 and 4

12. Suggested wording that would deal with all of the points referred to above in relation to Articles 3 and 4 (on the basis that the Regulation does not apply to trading on an OTF) is as follows:

Article 3 *(replacing Article 3(1) and (2))*

Where transferable securities within the scope of this Regulation[2] *are traded on a regulated market or multilateral trading facility (MTF) [or are transferred following a financial collateral arrangement as defined in point (a) of Article 2 of the Directive 2002/47/EC]*[3] *such securities may only be traded and settled on such market or MTF if they are recorded in book-entry form in a CSD before the intended settlement date*[4]*.*

Article 4 *(replacing Article 4(1) and (2))*

The authorities of the Member State where the company that issues transferable securities is established and the authorities competent for the supervision of the regulated markets and MTFs on which the relevant transferable securities are traded shall ensure that Article 3 is applied to such companies and markets.

2. Article 46

Article 46 deals with governing law and sets out how "any question with respect to proprietary aspects in relation to financial instruments held by a CSD" is to be governed. We do not think that the current wording of Article 46 meets the Regulation's objective as set out in the Recitals. Recital 36 provides "In order to enhance legal certainty especially in a cross-border context, it is important to establish clear rules on the law applicable to ownership aspects in relation to the securities that are maintained by a CSD in its accounts. Following the approach taken by the existing conflict of laws rules, the applicable law should be the law of the place where the accounts of a CSD are maintained". Recital 37 provides "In order to protect the rights of shareholders, the right of issuers to choose a CSD should not prevent the application of the national corporate laws under which the securities are constituted and which govern the relationship between issuers and their shareholders".

1. **Scope unclear and too wide:** We are concerned that the scope of Article 46 is unclear and that, unless the scope is clarified, there is a risk that it will unintentionally override other laws, including company law. The uncertainty arises because it is not clear which "proprietary aspects" in relation to the relevant securities are subject to Article 46. For example:

(a) If A is an individual for whom a CSD holds securities, is the intention that the law determined in accordance with Article 46 should apply to determine who has a proprietary interest in the shares if A dies intestate or with a will governed by the law of a jurisdiction different from the law of the country where the account is maintained or if A divorces their spouse and the relevant court determines how A's property should be divided?

(b) If A is a company which becomes insolvent does the law determined under Article 46 determine who is entitled to the securities?

(c) If A is a partnership established under an agreement governed by a different law and there is a dispute as to ownership of the securities among the partners is that to be determined in accordance with the law determined under Article 46?

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[2] See the comments above about whether the scope of the requirement is to be limited to companies incorporated in a Member State.

[3] We make no comment on collateral arrangements which are outside the scope of this letter.

[4] We make no comment on collateral arrangements but further wording may be needed for such arrangements.

(d) If A is an individual or a company that is acting as a trustee of a trust governed by English law and holds the securities shown in the CSD account for B (the sole beneficiary of the trust), is B's entitlement to a proprietary interest in the securities to be determined in accordance with the law determined under Article 46 (which may not recognise the trust concept)?

We assume that Article 46 should only apply in a narrower set of circumstances (e.g. if there is a dispute between CSD account holders as to which account holder is entitled to a security) and that it is intended to deal with rights in rem (i.e. rights to the securities recorded by the CSD) and not rights in personam (a right against the CSD). We have suggested revised drafting below to make this clearer. The effect of Article 46 will be to determine what law governs a dispute about a proprietary interest in a security recorded in book-entry form by a CSD. A decision will bind the whole world (not just the parties to the dispute). A person who succeeds in a dispute will be able to require the CSD to show that person as the person for whose account the CSD records the security and as the person from whom the CSD must take instructions (e.g. to transfer the security to a third party). If the CSD becomes insolvent the applicable law will determine whether the CSD holds the security for a particular person.

2. **Securities covered:** We believe the intention is that Article 46(1) should apply to all securities maintained by a CSD in its account. Recital 36 refers to "securities that are maintained by a CSD in its accounts". However, Recital 36 says it is important to establish clear rules on the law applicable to ownership aspects in relation to such securities and the applicable law should be the law of the place where the accounts of the CSD are maintained. This suggests Article 46 should apply to all securities **recorded** (our emphasis) by a CSD. However, Article 46(1) refers to financial instruments **held** by a CSD – which may be thought to restrict the relevant instruments to those in which the CSD itself has a proprietary interest. We have suggested revised drafting below to make it clearer that Article 46 applies to all securities recorded by a CSD.

3. **Protection of company law:** Recital 37 says that, in order to protect the rights of shareholders, the right of issuers to choose a CSD should not prevent the application of the national corporate laws under which the securities are constituted and which govern the relation between issuers and their shareholders. This Recital is reflected in Article 47(1), but not in Article 46. We think it also needs to be included either as a general principle in the Regulation or, at least, in Article 46. This would make it clearer that the Regulation is not intended to displace corporate law provisions e.g. as to who a company recognises as a shareholder. In some Member States, including Germany and the UK, the person recorded by a CSD for book-entry purposes may not be the same person as the company recognises as its shareholder.

4. **CSD agreements:** We assume that CSDs may enter into agreements both with issuers of securities and with those who have accounts with them. We assume it is intended that Article 46 should override any governing law clause in such agreements. We think it would be helpful for the Regulation to require CSDs to include the Article 46 provisions in any such agreements. We have suggested wording below.

5. **Settlement Systems:** Article 46(2) deals with a case where an account is used for settlement in a securities settlement system. We assume Article 46(1) is intended to be subject to Article 46(2) – our suggested redraft makes this clearer. Article 46(2) also says that the applicable law in such a case is the "one governing that securities settlement system". We are not clear if that is to be determined by the person running the securities settlement system in accordance with the agreements that allow participants to use that system, or in some other way. We have suggested revised drafting. It is not clear what is meant by "Where the account is used for settlement in a securities settlement system". For Article 46(2) to apply we assume the account must be being used for that purpose when the dispute as to ownership arises (and that it would not be enough for the account to have been used in that way previously). We have suggested revised drafting. A

similar point arises in relation to the words "Where the account is not used for settlement in a securities system" in Article 46(3). We suggest that CSDs should be required to record this information.

6. **Presumption as to where account is maintained:** Article 46(3) says an account shall be "presumed" to be maintained where the CSD has its habitual residence. It is not clear if this presumption is irrebuttable – or whether it can be rebutted by evidence to the contrary. We have suggested wording below to provide certainty on this.

Suggested new wording

Article 46

(1) Subject to (5), any question with respect to the following proprietary aspects in relation to transferable securities[5] recorded in book-entry form by a CSD shall be governed by the law of the country determined in accordance with (2) or (3) below:

(i) *the legal nature and effects against the CSD and third parties of the rights arising from a credit of transferable securities to an account maintained by the CSD;*

(ii) *the legal nature and effects against the CSD and third parties of a disposition of transferable securities from an account maintained by the CSD;*

(iii) *the CSD's duties, if any, to any person other than the account holder who asserts a proprietary interest in transferable securities in an account maintained by the CSD that is in competition with the interests of the account holder or any other person[6].*

(2) Where the account is used for settlement in a securities settlement system when the facts giving rise to any dispute occur, the applicable law shall be the one governing that securities settlement system as determined in accordance with the rules applicable to that securities settlement system.

(3) Where the account is not used for settlement in a securities settlement system when the facts giving rise to any dispute occur, that account shall be irrebuttably presumed to be maintained at the place where the CSD has its habitual residence as determined by Article 19 of Regulation (EC) No 593/2008 of the European Parliament and the Council.

(4) The application of the law of any country specified in this Article shall comprise the application of the rules of law in force in that country other than its rules of private international law.

(5) The provisions of this Article are without prejudice to the company law applicable to an issuer of transferable securities recorded in book-entry form by a CSD and to the holders of such transferable securities and the relationship between the issuer and such holders in relation to such transferable securities.

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[5] We have referred to transferable securities instead of financial instruments to be consistent with Article 3.

[6] We have not included wording relating to transferable securities collateral, as this letter is only concerned with company law aspects.

(6) *Any agreement entered into by a CSD with an issuer of transferable securities to be recorded in book-entry form by the CSD or by a CSD with an account holder shall include a provision that reflects the provisions of this Article.*

(7) *A CSD shall record whether or not an account is used for settlement in a securities settlement system and shall update that record promptly if there is any change.*

3. Article 47

Article 47 gives companies the right to arrange for their securities to be recorded in any CSD established in any Member State. It says it is "without prejudice to the corporate law under which the securities are constituted". We are concerned that the extent of the carve out is not clear and that the rights of shareholders may be prejudiced unless the position is clarified.

1. **Relationship with company law:** The company law of a Member State may confer a right or obligation on a company or a shareholder (e.g. a right to receive information or to participate in a share issue). In some cases, it may not be possible to exercise a right without co-operation from the CSD recording the relevant shares (e.g. because the CSD has to allow access to its records to allow a right of inspection or because the CSD must provide information to the company about those recorded on the record, for example to determine who can participate in a corporate action or meeting). Shareholders will only be protected if a CSD is required to meet the requirements imposed by company law. Some Member States such as the UK have company law requirements which must be followed by a CSD, which mean companies must use a CSD which meets those requirements.

We are also concerned that the reference to "corporate law" is not clear. In some Member States the relationship between a company and its shareholders is not only governed by a statute dealing with the incorporation of companies but may extend to other provisions too. It is likely that different Member States will have different ideas as to what is covered by their corporate law.

2. **Costs:** In some cases, there will be a cost to a CSD in meeting the relevant requirements. We do not think CSDs should be required to provide services to an issuer where they would have to incur additional material costs to meet the relevant requirements, unless the issuer agrees to meet those costs. As company law requirements may change from time to time, a CSD should be able to terminate a service which imposes additional material costs unless the issuer agrees to meet those costs.

Suggested new wording

Article 47

1. An issuer shall have the right to arrange for its securities to be recorded in any CSD established in any Member State provided that, in the case of shares, the arrangements between the company and the CSD are such that the company and its shareholders will be able to exercise their rights and meet their obligations required or permitted by the company law which applies to the company or to the relevant shares to the same extent they could if the CSD were established in the Member State where the company is incorporated or whose company law applies to the relevant shares.

2. Where an issuer submits a request for recording its securities in a CSD, the latter shall treat such request promptly and provide a response to the requesting issuer within three months.

3. A CSD may refuse to provide services to an issuer. Such refusal may only be based on:

(a) a comprehensive risk analysis; or

(b) the absence of access by the CSD to transaction feeds from the market where the requesting issuer's securities will be traded; or

(c) insufficient information from the issuer as to the rights and obligations required or permitted by the company law which applies to the issuer or to the relevant securities; or

(d) in the case of shares, the CSD being required to bear additional material costs to ensure that the company and its shareholders will be able to exercise their rights and meet their obligations as referred to in paragraph 1.

4. The authorities of the Member State where the company that issues securities is established shall be competent for ensuring that Article 47(1) is applied. If the appropriate authority of that Member State determines that Article 47(1) is not applied, it may require the issuer to arrange for its securities to be recorded in a CSD which will ensure that Article 47(1) is applied.

Recital 37 (last sentence)

In order to protect the rights of holders of transferable securities, the right of issuers to choose a CSD and the provisions of this Regulation should not prevent the application of the national company laws to the issuers of transferable securities, the holders of such transferable securities or the relationship between the issuer and such holders and their rights and obligations in relation to such transferable securities.

Yours sincerely

Vanessa Knapp