Financial Services User Group's (FSUG)

response

on Central securities depositories (CSDs) and securities settlement in the EU

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At the specific request of Commission Officials, FSUG was requested to make a response to the consultation addressing, but not limited to the following matters.

Where are the key issues for you in post-trading?

- issuers
- retail investors
- institutional investors
- what do you think of freedom of access to issuers?
- what about shifts and splits?
- maw applicable to the issue
- corporate actions
- relationship with the SLD.

FSUG, recognising the increasingly important role and contribution that Central Securities Depositories play and can make to financial stability and ultimately in reducing the risk of costs to the European taxpayer, support the Commission's initiative to achieve a common regulatory framework within which all CSDs should function.

It also welcomes the gradual evolution that has occurred in recent years from a contractual to an institutional framework so as to regulate and oversee all standardised OTC derivative trading contracts and supports the Commission's endeavours to put in place suitable legislative requirements that they be traded on exchanges or electronic platforms, as appropriate, and cleared through central counterparties by the end of 2012.

Importance of CSD

Thus, FSUG welcomes the idea of the systemic importance of CSDs. There is a strong need for an appropriate regulatory framework for CSDs.

As stated in the public consultation on central securities depositaries (CSDs) and on the harmonisation of certain aspects of securities settlement in the European Union, CSDs are systemically important post-trading infrastructures.

The importance of CDS is also stressed in a paper of the European Central Bank (2007):

"With high trading volumes, the movement of massive amounts of physical securities could cause delays and errors that would result in more delays. Severely delayed settlement of securities transactions could give rise to liquidity problems in the financial markets. Physical certificates could also increase the probability of fraud and forgeries."[1]

"The constitution and range of CSD services become highly diverse, but they do share some key common features. They are central service providers established with a common objective, which is to provide the definitive record of ownership and subsequent transfer of title and – through immobilisation of securities – to facilitate the central settlement of securities without the movement of physical certificates.

1 *The securities custody industry*, Occasional Paper Series, No 68, August 2007, European Central Bank, Diana Chan, Florence Fontan, Simonetta Rosati and Daniela Russo, pp. 6-8.

The particular importance of CSDs, as the cornerstones of any efficient settlement system, has progressively led to their supervision by national central banks and securities market authorities, which pay considerable attention to the prevention of systemic risk. Supervisors generally require CSDs to manage operational risks with robust mitigation measures and to avoid taking credit risks."[2]

Importance from consumers' point of view

Questions

Q1-2: Functional definition of CSDs seems to be the most appropriate as it should cover all required institutions. However it must be noticed that potential exemptions should be monitored to assure proper coverage of the legislation. That is why future review of the directive should pay special attention to this issue.

Q3: We agree with the concept of establishing three core functions in order to describe the characteristics of CSD services. This will clarify the key competences of CSDs.

From the consumers' point of view the definition of the notary function should be clearly worked out, in particular referring to the ascertaining of the validity of securities. Within the Member States there are differences as far as the depth of assessment of the validity of securities is concerned. A precise definition of ascertaining the validity of securities is currently missing but would be useful.

It should be taken into consideration that possible failures at the beginning (process of notary function) might lead to detriments for small investors at the end of the holding chain.

Also being responsible for the notary function should not automatically imply that the CSD be also in charge of managing the general meetings of issuers in terms of notification and proxy collection. FSUG wishes to stress that this is a different responsibility and a different business. For example, in cooperative house building, it is not the notary public who performs these services but the real estate manager appointed by the co-owners.

Regarding this issue FSUG wishes to stress that Euroshareholders has obtained evidence of the often poor quality work performed by financial CSDs in that other business service, and in its *Reply to the Green Paper on Corporate governance in financial institutions and remuneration policies*, dated 1 September 2010[3] has claimed that shareholders have to pay up to EUR 70 (fees charged by deposit banks and Clearstream/Euroclear) per ballot (which means even for one share) if they want to cast their vote for shares from another country.

Thus, FSUG respectfully asks the EC to consider making a clear distinction of these services to the others performed by CSDs, and to facilitate the decoupling of these services to enable professional providers to compete in this area.

Last but not least, and also related with the notary function, FSUG wishes to highlight the evidence of necessity for the investor to pass a rule for which the intermediary (bank which is selling the securities) must give the investor – (at the same moment of the selling) – clear and comprehensive information about the data (name, address, e-mail, phone, etc.) of the CSD where the purchased securities are going to be deposited, also of the ISIN code of them, and finally about the necessity to proceed by the investor ordering the blocking of the

2 Ibid, p. 8.

3 http://www.euroshareholders.eu/upload/positions/Euroshareholders%20reply%20Green%20Paper%20Corp%20gov%20fin%20Institutions1283854210.pdf

securities in case he intends to sue at court the issuer of them (for example for having been unpaid the fixed coupon, or in bankruptcy proceedings), because he will have to present a property and blocking certification at court (issued by the CSD) accompanying his sue, otherwise probably his sue would have problems in order to be admitted at court.

Q10: FSUG sees very necessary that in order to improve market transparency, every authorisation of a CSD should be notified to European Securities and Markets Authority (ESMA), and that ESMA would be entrusted with publication and regular updating of a list of CSDs, detailing the scope of the activities for which they are licensed. In our view, it is important to establish a register for CSDs to be kept by ESMA. This is particularly due to the fact that privately owned CSDs have achieved a considerable market share in the field of settlement. Furthermore, competition between the CSDs is expected to increase in future.

Supervision authorities have supervisory powers over financial services providers (e.g. credit institutions, investment firms, insurance companies, credit rating agencies). It is coherent to give competent authorities all existing powers to supervise CSDs as well.

Q11: In our opinion, the proposal for a temporary grandfathering rule for existing CSDs would not be a good idea because of the possibility that it would create confusion among investors whether the existing CSDs are authorised, or not. Instead of grandfathering provisions we clearly opt for a short vacatio legis applicable for all market participants, and that once the rule on authorisation procedure enters into force it is for each and every CSD which have already been granted the authorisation. Doing it that way will be beneficial for the legal certainty principle, thus it would be good for investors and for the market itself.

Q12: We think that the approach to capital requirements of CSDs is appropriate. As CSDs play an important role in the capital markets, they should be obliged to keep minimum capital. We support the concept that since risks may vary considerably depending of the nature of services and of securities covered by CSDs, it would be better not to consider a lump sum capital requirement but instead provide for a calculation method of capital requirement, depending on the nature of the risks involved in each CSDs activity. In addition, different kind of guarantees could be included in the value of required capital, provided that the quality of the said guarantees is outstanding and, of course, they are properly supervised by the competent EU authorities.

Q13: Yes, FSUG thinks that – without prejudice of the competence of central banks concerning the oversight of systems – the competent EU authorities should have at all times strong and sound supervisory powers in order to ensure that a CSD complies with the requirements that future legislation will set (prudential and other rules). The powers already identified by the Commission Services seem to be a good minimum starting point and cover the most important areas of activity of CSDs. However the activity of supervisory authority should take into consideration the rule of proportionality to the nature, scale and complexity of the entities and should also include powers to impose penalties in cases of misbehaviour or risky practices of the governance bodies of CSDs, including, the power of removing the management board.

Q14: In our opinion a special purpose banking license would be appropriate for 'banking type services' provided by CSDs. In this sense, it is clear that all banking type services involve special risks which have to be properly supervised, without prejudice that the direct addressee of the mentioned services is a retail investor, or not.

Q16-19: Freedom of access to issuers/splits and shifts/corporate issues:

FSUG is of the view that, to the greatest extent possible, all market participants should have access to CSDs of their choice. But the EC should clearly define who the 'market participants' are. For example, FSUG was quite surprised to notice that, in the newly designated Securities and Markets Stakeholder Group, individual shareholders, bondholders, etc. were not considered as 'market participants', but as 'consumers'.

All restrictions which limit access by all market participants, or otherwise hinder competition, should be removed. However, participants should make decisions in accordance with a prudential assessment of the potential risks resulting from such decisions, and should have available to them data and other market entity intelligence to support their decision making. To this end FSUG queries if consideration should be given to a legal requirement for all entities to place on public record information and data to allow a resultant adequate risk assessment and management process. With regard to the location of securities (Barrier 9) choice should be with the issuer, and while national law may require local location of securities, issuers should be able to exercise the option of entering securities depositories of any other Member States. Nevertheless, we believe that company law may diverge on this matter (and many others) and recommend that the Commission should consider how increased harmonisation of corporate laws across the EU27 might be progressed. ‘Shift’ and/or ‘split’ of an issue may in certain circumstances have significant implications of ownership, control, accounting and reporting for shareholders/beneficial owners, and consequently should not be implemented without the explicit knowledge and consent of the rightful owner(s).

Q43: FSUG strongly believes that including provisions addressing price transparency and service unbundling from the existing Code of Conduct into the future legislation will foster competition between CSDs and will help final investors to be better informed.

Q52: In order to establish a common and well known standard of a settlement period, we support a settlement period of T+2.