2009 June 11th

LEGISLATION ON LEGAL CERTAINTY OF SECURITIES HOLDING AND DISPOSITIONS

Consultation document of the Services of the Directorate-General Internal Market and Services

General comments

AFG[1] welcomes the European Commission's consultation on Securities Law. We appreciate that this consultation aims at covering a very large scope, referring to concepts that exist in the various Member States.

However, the text does not define exactly what these legal realities are. AFG is deeply concerned that this inaccuracy might constitute a source of misunderstanding, as legal concepts vary largely from one Member State to another.

From this latter perspective, AFG strongly regrets that the consultation has not been made available in more than one language: ambiguities are even more obvious if consultees do not have access to national language versions of EU consultations. AFG believes that ambiguities would have been widely resolved through the issuance of national versions of the Commission consultation – either in all EU official languages or at least in the three working languages of the Commission, as the issues raised by the consultation are considerable. The lack of various language versions lets expect major interpretation trouble in the future, which will slow down at the end of the day the smooth process of any legislative action to be undertaken by the Commission in this area.

Please find below AFG's main conclusions with regards to the consultation:

- *AFG agrees that harmonising the legal framework for acquisition or disposition of book-entry securities would improve the current situation.*
- *However, we do not think that there is a need for harmonising the national securities legislations as such (this would be too cumbersome and would impact civil laws for example).*
- *We agree that harmonising the determination of the applicable law would be useful. In case of a conflict-of-laws, we suggest applying the law of the country where the issuer is located.*
- *Finally, AFG agrees that the service of safekeeping and administration of financial instruments for the account of clients should be made an investment service in the sense of MiFID, provided that it issuers are excluded from this disposition.*

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1 The Association Française de la Gestion financière (AFG)[1] represents the France-based investment management industry, both for collective and discretionary individual portfolio managements.

Our members include 409 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing more than 2300 billion euros in the field of investment management, making in particular the French industry *the leader in Europe in terms of financial management location* for collective investments (with nearly 1400 billion euros managed, i.e. 21% of all EU investment funds assets under management), wherever the funds are domiciled in the EU, *and second at worldwide level after the US*. In the field of collective investment, our industry includes – beside UCITS – the employee savings schemes and products such as regulated hedge funds/funds of hedge funds as well as a significant part of private equity funds. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

1. LEGAL FRAMEWORK OF HOLDING AND DISPOSITION OF BOOK-ENTRY SECURITIES

1.1. General need to harmonise laws in the relevant area

Question 1: The far greatest part of securities are held and administered through securities accounts maintained by an account provider (e.g., a bank, a broker, a custodian or similar). What is your estimate regarding the percentage of securities which are *not* held through a securities account?

First and foremost, AFG wishes to state that it understands the word 'securities' as referring to stocks and bonds. It is a specific category of financial instruments as defined in the MiFID for instance.

In France, all securities are in the form of non paper securities, most of them being registered electronically (only a few types of companies issue securities that are not registered electronically).

Question 2: Do you assume that the application of the legal framework for acquisition or disposition of book-entry securities, including the creation of collateral interest, is more complex as soon as there are cross-jurisdictional elements to be taken into account? [Yes, considerably more complex/Yes, slightly more complex/No/I don't know. Please specify and make a distinction between operations occurring inside and outside a securities settlement system, if possible.]

Yes. This is even more costly when there is no CSD.

While there is no need for harmonising the national securities legislations as such (as it would be too cumbersome and would have to touch at civil laws for instance), from an operational point of view:

- *When no CSD exists, there is a need to find out who the appropriate registrar is.*
- *A CSD offers a unique point of entry and facilitates the application of legal rules (in this case, the applicable rules are those of the country where the CSD is located). Common rules are shared through the use of the CSD, which contributes to increasing safety and harmonisation).*

Therefore, harmonising specifically the legal framework for acquisition or disposition of book-entry securities would improve the existing situation.

1.2. The legal nature of book-entry securities / minimum harmonisation

Question 3: Do you think that harmonisation of the law of holding and disposition of book-entry securities should be done by way of minimum harmonisation, i.e. that in general, Member States' law shall continue to define the general legal characterisation of book-entry securities, whereas certain characteristics of book-entry securities are harmonised? [Yes/No/I don't know; please specify]

Yes, AFG supports a minimum harmonisation of the law of holding and disposition of book-entry securities. However, we believe that Member States should keep their freedom to create and define specific securities.

Question 4: Do you think that book-entry securities should confer upon the account holder the following minimum rights [Yes/No/I don't know, please specify and indicate whether additional elements should be harmonised]:

(a) the right to exercise and receive the rights attached to the securities, as far as the account holder itself is identified by the issuer law as the person entitled to these rights;

Let's first stress that the notion of 'account holder' is understood by us as meaning the actual owner of the relevant securities.

On that basis, our response is yes.

(b) the right to instruct the account provider to dispose of the securities;

Yes, as long as the instruction to dispose of the securities abides by sureties law.

(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 the applicable law allows holding otherwise than with an account provider.

Yes.

More widely, AFG believes that account holders should receive all information (financial and non financial) regarding the rights they are entitled to (e.g. information regarding the General Meetings, and on any "operation sur titres" in general).

1.3. Acquisition and disposition of book-entry securities

Question 5: Do you think that a fix set of methods for acquisition and disposition of book-entry securities (crediting an account; debiting an account; earmarking book-entry securities in an account, or earmarking a securities account; removing of such earmarking; concluding a control agreement; concluding an agreement with and in favour of an account provider) should be available to market participants throughout all EU jurisdictions? [Yes/No/I don't know; please specify]

AFG agrees that a fix set of methods for acquisition and disposition of book-entry securities should be set in the Community. Unfortunately, we do not understand why the Commission proposed for 6 different methods, as for instance crediting and debiting an account are a single method, and is compatible with the other methods. In addition, several proposed methods (e.g. 'earmarking' and 'control agreements') are ambiguous in their practical meaning. As a consequence we can not approve the list proposed in the consultation. In our view, only double entry accounting ('comptabilité en partie double) is a clear and therefore safe method.

Question 6: In the event of not all six methods listed in Question 5 becoming available to market participants in all Member States: do you think that the law of any Member State should recognise, in particular in an insolvency proceeding, acquisitions and dispositions effected by one of these methods under the law of another Member State, even if the law of the first Member State does not provide for that method? [Yes/No/I don't know; please specify]

No. This would create opposability issues. The law of a Member State can not recognise acquisitions or dispositions effected by a method which exists in another country but that the Member State does not provide for. The legal act must exist for all in order to be opposable. For instance, it is not possible to impose a law that does not exist in a Member State for its national citizens. Discrepancies between the legal systems of the Member States can create real problems. For example, currently the opacity regarding the effective identity of shareholders resulting from the loan of securities among foreign shareholders constitutes a real issue for votes cast at French companies' general meetings.

Question 7: Do you think that future legislation should leave to Member States the possibility of making the effectiveness of an acquisition or disposition subject to a condition contractually agreed upon between account holder and account provider, in particular a condition that a corresponding acquisition or disposition occurs? [Yes/No/ I don't know; please specify]

No. In general, AFG believes that acquisitions or dispositions that have been booked can not be undone. Acquisitions or dispositions subject to a condition contractually agreed upon between account holder and account provider should follow specific rules and should be booked in a specific manner, different from that applying to acquisitions or dispositions that are not subject to conditions contractually agreed upon between account holder and account provider.

Question 8: Do you think that there should be a short, harmonised list of conditions giving rise to a reversal of an acquisition or disposition, notably

(a) the consent of the account holder;

AFG supports the possibility of reversing an acquisition or disposition only if the acquisition or disposition was made without the consent of the account holder, provided that the account holder is kept informed by the account provider.

(b) the credit or debit which was made in error;

AFG supports the possibility of reversing an acquisition or disposition if the acquisition or disposition results from a material mistake committed by the account provider, provided that the account holder is kept informed by the account provider.

(c) the debit or earmarking or removal of an earmarking which was not authorised. [Yes/No/I don't know, please specify, indicating which one to add/delete, if any]

Yes. AFG supports the possibility of reversing an acquisition or disposition in these three cases, as they imply that the acquisition or disposition was made without the consent of the account holder, provided that the account holder is kept informed by the account provider.

In any case, these approaches should be followed in a manner consistent with the law applicable to the rights of third parties – such as creditors in particular.

Question 9: Do you think that account holders in whose favour a credit has been made should be protected against the reversal unless they knew or ought to have known that the credit should not have been made? [Yes/No/I don't know; please specify]

Yes, in case of a significant mistake. In any case, the reversal should be submitted to the account holder. If reversals are made unknown to the account holder, AFG is concerned that a reversal of the burden of proof might occur at the expense of the account holder. Moreover, we fear that systematic reversals might have a snowball effect on other players in the holding chain.

Question 10: Do you think that interests in book-entry securities, notably security interests, which are "visible" in the account, should have priority over book-entry securities which are not "visible" in the account? [Yes/No/I don't know; please specify]

No, as this question appears unclear to us. In any case, AFG believes that interests in book-entry securities should all be visible in the account.

1.4. Integrity of the issue and protection in the event of insolvency of the account provider

Question 11: Do you think that there should be a legal obligation for account providers to maintain, for securities of the same description, a number of securities or book-entry securities that corresponds to the aggregate number of book-entry securities of that description credited to the accounts of the account holder's clients plus those securities held for its own account, if any? [Yes/No/I don't know; please specify]

Yes. Besides, AFG recommends a complete and clear segregation between client accounts and account provider own accounts.

Question 12: Do you think that, in case of insolvency of the account provider, securities kept by it for its own account shall be attributed to its account holders, as far as the number of securities kept by the account provider for its account holders is insufficient?
[Yes/No/I don't know; please specify]

In case of insolvency of the account provider, AFG agrees that securities kept by it for its own account may be attributed to its account holders. However, this might imply the modification of national regimes regarding bankruptcy law and order of creditor privilege rules would have to be revised. In our opinion, the principle of segregation (as described above, effectively applied, should limit this issue.

Question 13: Do you think that a remaining shortage should be shared amongst account holders of that account provider, in the case of its insolvency? [Yes/No/I don't know; please specify].

No if the accounts are clearly segregated – what we wish. Yes if the accounts are not segregated: then we recommend that the potential remaining shortage is shared on a prorata basis.

1.5. Identification of the applicable law

Question 14: Have you encountered difficulties in the application of the legal framework regarding holding and disposition of book-entry securities that could be fully or partially attributed to an unsatisfactory conflict-of-laws regime? [Yes/No/I don't know; if yes, please specify the difficulties]

Yes. For example, the loan of securities among foreign shareholders results in an opacity regarding the effective identity of shareholder, which constitutes a real issue for votes cast at French companies' general meetings.

Question 15: Do you think that future legislation on the legal framework of book-entry securities holding and disposition should harmonise issues of substantive law as well as the question of which law is applicable to holding and disposition of book-entry securities, including the creation of security interests? [Yes/No/I don't know; please
specify]

AFG does not think such future legislation should harmonise issues of substantive law. However, we believe it should harmonise the question of which law is applicable.

Question 15bis: If yes: do you think that a uniform conflict-of-laws rule should govern the issues within the scope of the Settlement Finality Directive, the Directive on Winding-Up of Credit Institutions and the Financial Collateral Directive plus the aspects which are to-date not included in the scope of the three directives? [Yes/No/I don't know; please specify]

Yes, we are in favour of a harmonisation of determination of the applicable law in case of a conflict of laws, as long as it is consistent with the other directives. But as far as possible, in case of a conflict, we recommend applying the law of the country where the issuer is located.

1.6. Cost related to aspects addressed in sections 1.1 – 1.5

Question 16: Do you think that holding and disposition of book-entry securities is more costly in cases where the situation involves a cross-jurisdictional element? [Yes/No/I don't know; please specify]

Yes, especially when there is no CSD – a situation which generates higher costs.

Question 16bis: If yes, could you give your best estimate of the additional cost and specify what types of cost arise?

See above.

2. PROCESSING OF RIGHTS FLOWING FROM SECURITIES

2.1. Need to harmonise the relevant laws

Question 17: Do you think that investors face difficulties in exercising rights flowing from securities as soon as they hold through a cross-border holding chain? [Yes, considerable difficulties/Yes, slightly more difficulties than in a domestic context/No/I don't know, if yes, please specify the difficulties]

Yes. For example:

- *in some countries, voting in person is made mandatory;*
- *right of representation may vary from country to country;*
- *the process of sending votes through an electronic channel may disfunction;*
- *it seems that physically some voting right forms or tax credit forms get lost when crossing national borders.*

2.2. Facilitation of the exercise

Question 18: Do you think that the law of Member States should bind account providers to facilitate the exercise of rights flowing from the securities (e.g. by providing the investor, upon demand, with a certificate confirming his holdings; or, by making the investor the account provider's representative with respect to the exercise of the relevant rights proxy}), where the exercise of rights would be impossible or cumbersome without the assistance of the account provider? [Yes/No/I don't know; please specify]

Yes. We believe that account providers should have the obligation to facilitate the exercise of these rights in all cases.

Question 19: Do you know other cases where assistance of the account provider is a prerequisite for the exercise of the right by the investor? [Yes/No/I don't know; if yes, please specify]

AFG believe that account providers play a crucial role in maintaining book-entry securities accounts. Therefore we think that they should provide services that facilitate the exercise of the rights flowing from securities as well as the circulation of information regarding these rights. For example, account providers should inform account holders when general meetings are held. As well, ballot papers, as they represent material elements of the exercise of voting rights, should be made readily available to account holders. More generally, AFG believes that the rules applying to voting rights should be further harmonised at a European level.

2.3. Exercise of rights by an account provider on behalf of the investor

Question 20: Do you think that Member States' law should make possible the exercise of rights flowing from securities by an account provider on behalf of the investor where the exercise of the rights by the investor himself is impossible? [Yes/No/I don't know; please specify]

Yes, in very specific cases, and provided this is in the interest and with the agreement of the investor. It is imperative that account holders have the possibility to exercise their voting rights. In no situation should account providers take the place of or decide for account holders. However, account holders should be allowed to delegate their rights to their account provider.

Question 20bis: In the affirmative case, do you think that this possibility should be subject
(a) to feasibility on the side of the account provider [Yes/No/ I don't know, please specify, in particular, the exact scope of such feasibility exemption], and/or
(b) to contractually agreed levels of service between the account holder and the account provider? [Yes/No,/ I don't know, please specify].

No. The account provider should highlight the situations where it is not possible for it to exercise these before it agrees to service the account. The contractual agreement should be used to define the scope of the account provider's obligations and if needs be to set exceptions (for example, the account provider might not be bound to fulfil its obligations if it is not present in the relevant country).

Question 21: Do you think that Member States' law should make possible the exercise of rights flowing from securities by an account provider on behalf of the investor, in a scenario where the investor does not want to exercise the rights himself? [Yes/No/I don't know; please specify]

Absolutely not, except when the investor previously and expressly asked for it. In no situation should the account provider exercise the rights flowing from securities on behalf of the account holder if the latter does not want to exercise them.

Question 21bis: In the affirmative case, do you think that this possibility should be subject

(a) to feasibility on the side of the account provider [Yes/No/ I don't know, please specify, in particular the exact scope of such feasibility exemption], and/or

(b) to contractually agreed levels of service between the account holder and the account provider? [Yes/No/I don't know; please specify].

Please refer to Questions 20.

Question 22: Do you think that an account provider should be bound to exercise, on behalf of the investor, the following rights flowing from securities:
(a) Rights entailing a change of the relevant security itself (e.g. conversions, reorganisation) [Yes/No/I don't know; please specify];
(b) Collection of dividends or other payments and subscription rights
[Yes/No/I don't know; please specify];
(c) Acceptance or refusal of takeover bids and other purchase offers?
[Yes/No/I don't know; please specify];
(d) Other rights [please specify which and why]

Yes. We agree that an account provider should be bound to exercise all of these rights on behalf of the investor if the latter previously and expressly asked for this. Additionally (for letter d), AFG recommends that an account provider should also be bound to exercise voting rights and to collect tax credits granted in another Member State following an explicit request by the account holder.

2.4. Passing up and down of the necessary information

Question 23: Do you think that account providers should be bound to pass on information with respect to book-entry securities which is required in order to exercise a right enshrined in the securities which exists against the issuer? [Yes/No/I don't know; please specify];

Yes. Account providers should pass on all the information that is available to them (in particular the information passed by issuers to account providers through the holding chain). Please refer to question 18.

Question 24: Do you think that this obligation should be restricted to information

(a) which is received "through the holding chain", (i.e. directly either from the issuer or an account provider which maintains an account for the account provider in question, or from the investor or another account provider for which the account provider in question maintains an account.) [Yes/No/I don't know; please specify];

Yes. We believe account providers should not truncate information.

(b) which is directed to all investors in securities of that description [Yes/No/I don't know; please specify]?

No. We believe this is not a service usually provided by account providers (this would imply account providers looking for information).

Question 25: Would you advise other/additional restrictions to this duty? [Please specify]

No.

2.5. Cost related to aspects addressed in sections 2.1-2.5

Question 26: Do you think that the processing of rights flowing from securities is more costly in case where the situation involves a cross-jurisdictional element? [Yes/No/I don't know]

Yes. Please refer to question 16.

Question 26bis: If yes, could you give your best estimate of the additional cost and specify what types of cost arise?

3. FREE CHOICE REGARDING INITIAL ENTRY INTO A HOLDING AND SETTLEMENT STRUCTURE, IN PARTICULAR FREE CHOICE OF CSD, BY THE ISSUER

Question 27: Do you think that an issuer incorporated under the law of an EU Member State should be allowed to arrange for its securities to be initially entered into holding and settlement structures (in particular those maintained by a central securities depository) in, or governed by the law of, another EU Member State? [Yes/No/I don't know; please specify]

No. There would be a risk of diluting the capital and a risk of error regarding the total amount of capital. As described previously, AFG recommends the application of the law of the country where the issuer is located.

Question 28: Do you think that holding and settlement structures for securities, in particular those maintained by a Central Securities Depository, which are governed by the law of an EU Member State, should be open for securities constituted under the law of another EU Member State? [Yes/No/I don't know; please specify]

No. For reasons detailed above and because entering into a particular holding and settlement structure implies the acceptance of its rules, hence a risk of conflict of rules.

Question 29: Are there, in your view, issues stemming from other branches of law, such as corporate law, fiscal law, etc., or regulatory/supervisory concerns that could advise against the establishment of free choice by an issuer, as set out above. [Yes/No/I don't know; if yes, please specify the issues]

Yes. For example, issues arising from fiscal law could affect the issuer's freedom to decide on its location.

Question 30: Do you at present incur additional cost because either or both of the above possibilities of choice do not exist? [Yes/No/I don't know/Not applicable]

It is hard for us to answer this question. However, we believe that having these possibilities of choice would imply new costs that are difficult to foresee.

Question 30bis: If yes, could you give your best estimate of the additional cost and specify what types of cost arise?

4. DUTIES OF ACCOUNT PROVIDERS

Question 31: Do you think that all providers of securities accounts established in the EU should be subject to authorisation and supervision in relation to their services of maintaining securities accounts? [Yes/No/I don't know; please specify]

Yes. AFG is in favour of harmonising account providers' role and responsibility in the Community. It would give a better protection to investors by giving a clearer legal safety related to the relevant securities.

Question 31bis: If no, which account providers should not be subject to authorisation and supervision by competent authorities? [Please designate the type of account provider and specify why.]

AFG believes that issuers (which may hold security accounts on those securities they have issued – "nominatif") should not be subject to such authorisation and supervision and that it should be confined to service providers.

Question 32: Do you think that the service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management (which is a so-called ancillary service under MiFID) should be made an investment service in the sense of MiFID (i.e. inserted in Section A of Annex I of the MiFID and be deleted from Section B)? [Yes/No/I don't know; please specify]

Yes, provided that issuers are excluded (MiFID only applies to service providers) and that the rules are tailored to the specific nature of the service of safekeeping and administration of financial instruments. Similar to issuers, another exclusion should concern UCITS management companies which issue UCITS units as this activity is analogous to the one of other securities' issuers.

Question 32bis: If yes, do you see any specific difficulties in including certain types of account provider in the full or even a limited scope of MiFID? [Yes/No/I don't know; if yes, please specify the difficulties]

Yes, please see above.