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**AFG Representative Number**  
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**AFG response  
to the European Commission's consultation paper  
on Central Securities Depositories (CSDs) and  
on the harmonisation of certain Aspects of Securities Settlement in the  
European Union**

The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include 413 management companies. They are entrepreneurial or belong to French or foreign banking or insurance or asset management groups. AFG members manage 2,600 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 over 1,300 billion euros managed from France, i.e. 20% of all EU assets managed in the form of investment funds), 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 – employee savings schemes and products such as regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment. AFG is of course an active member of the European Fund and Investment 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).

AFG is grateful for the opportunity to comment on the Commission Services' consultation paper on Central Securities Depositories (CSDs) and on the Harmonisation of Certain Aspects of Securities Settlement in the European Union.

We very strongly regret, however, that this consultation is only held in English, which introduces, *nolens volens*, detrimental bias against some basic principles of continental law

## D) GENERAL COMMENTS

AFG is grateful for the opportunity to comment on the Commission's consultation paper on Central Securities Depositories (CSDs) and on the Harmonisation of Certain Aspects of Securities Settlement in the European Union.

AFG welcomes the Commission's objective to achieve an efficient, integrated and safe system for the clearing and settlement of securities transactions in the EU. Investment managers are convinced that improving the efficiency and the safety of clearing and settlement systems in Europe will benefit all investors and further promote a pan-European Securities Market.

More particularly, AFG would like to underline that French asset managers are concerned by the present consultation for the two following reasons:

- as financial asset managers, they are concerned by the custody of assets by central depositories and, in particular, they are concerned by the protection of their clients' assets or managed funds (property rights and restitution)
- as fund managers, they are concerned by the potential risks inherent to infrastructures, as they themselves issue securities that are processed by central depositories, provided of course that it is clearly established that funds are included in the scope of the present consultation, which to our opinion needs to be clarified.

Given these reasons, their vigilance is particularly acute on the following general points:

- given that the proposed Regulation will apply to all Member States, it should be ensured that it does not impact their national securities law, and in particular, their property rights and conflict of law rules. The proposed Regulation should therefore be examined in light of current negotiations on Securities Law Directive (SLD), especially as our industry has voiced deep concerns or oppositions regarding the latter proposal, which conflicts with some basic principles of continental law. The objectives of the present proposal should thus be clarified in this direction.
- as issuers of shares of funds, we would like to reassert our position on the main principle underpinning the dematerialisation of securities, i.e. the issuer or its representative should hold a global and unique account enforceable to all third parties, including the central depository, in case the system defaults. This is particularly important in case of a partial admission of operations by several CSDs resulting from the removal of the Giovannini barrier number 9 (geographical management, different categories of securities of an entity...).
- regarding the wording used, we believe that it is essential to distinguish CSDs that, like CCPs, play a central role in the functioning of securities markets (and can with them share the name "market infrastructures") from "ICSD" that act as members of CSDs or direct representatives of an issuer (e.g. euro bonds). AFG considers indeed

that this last activity comes under contractual freedom which only could cause ancillary services (such as banking services). On the opposite, the core services must be considered as coming under “public utility”. AFG considers that it is crucial to preserve CSD against any credit or counterparty risk by limiting the scope of its regulatory activities here above described.

We therefore believe that it is essential to protect CSDs against any counterparty risk by limiting the scope of their activities to the core functions described above.

- as the present proposal aims at harmonisation at European level, it should be ensured that it is consistent with other key projects that are under way, in particular with Target 2 Securities (T2S).

## **II. DETAILED ANSWER:**

### **1. SCOPE AND DEFINITIONS**

#### **1.1 Personal scope and exemptions**

##### *1 What is your opinion on a functional definition of CSDs?*

**AFG supports the Commission’s proposal to develop a functional definition of the CSD provided that such definition clearly highlights that the CSD’s role is central in the organisation of securities markets and its function is of public interest.**

##### *2 What is your opinion on the scope of the possible legislation and providing for any exemptions (such as for central banks, government debt management offices, transfer agents for UCITS, registrars, account operators)?*

**AFG agrees that some limited exemptions should be included in the text (central bank, government debt management offices); however, it believes that some of the proposed exemptions should by nature not be set out as exemptions but should rather lie in the scope of application of the very proposal (e.g.: registrars, T.A., account operators, which are service providers or representatives of securities issuers).**

**Regarding transfer agents, we believe that it is crucial to recall that their function relates both to UCITS funds and funds in the scope of the AIFM Directive (AIFs). Therefore they should be both systematically treated in the same way, in particular when considering including funds in general in the scope of the proposal.**

#### **1.2 Definition of CSD services – Background**

#### **1.3 Core CSD services**

##### *3 What is your opinion on the above description of the core functions of a CSD?*

4 Which core functions should an entity perform at a minimum in order to be qualified as a CSD?

5 Should the definition of securities settlement systems be reviewed?

**Notarial function:**

AFG agrees on the proposed definition provided it is completed by:

-the mission of control at all times that the number of securities issued (registered in the books of an issuer) equals the sum of the securities in circulation (registered for that securities issue in the books of the participants to the CSD system),

-the function of central safekeeping.

**Settlement function**

AFG is not in favour of including a reference to another text in a definition (risk of inconsistency or complication due to subsequent updates) in particular when the text covers banking activities. Rather, AFG supports a clear definition directly included in the text itself, for example: ensure and verify the settlement of the mutual obligations of the parties to a transaction (termination of any obligation), i.e. instruct simultaneously the payment (in central bank money via the CSD participants' accounts) and delivery of the relevant securities (registration in the books) according to the principle of delivery versus payment (simultaneity).

**1.4 Ancillary services**

6 What is your opinion of the above description of ancillary services of a CSD? Is the list above comprehensive? Do you see particular issues as to including one or several of them?

In our opinion, it is essential that the CSD should be protected against any credit and counterparty risk by limiting the scope of its activities to the core functions described above. However, in order to facilitate the smooth functioning of the system based on the simultaneity of settlement and delivery, the service of securities lending and borrowing operated on the basis of an organised system (by the CSD) should be provided directly on the accounts of the members participating to the system, with no exposure of the CSD itself in order to avoid any systemic risk.

AFG also supports any service of the CSD facilitating the management by issuers of corporate actions impacting their securities:

- instruction for payment of coupons or dividends,

- information and management of events impacting the life of the security (securities mergers, cancellations, ...) or of the issuer (voting rights, participations to meetings...)

## 2. AUTHORISATION AND ONGOING SUPERVISION OF CSDs

### 2.2 Non-domestic activities of a CSD

7 *According to you, could the abovementioned cases impact a future regime of authorisation and supervision? Yes? No? No opinion? Please explain why. Are there other cases which could have an influence on a future regime of authorisation and supervision?*

**AFG agrees with the European Commission proposal to subject CSDs to an authorisation and supervision regime taking into account the location of their activity.**

**AFG shares most of the issues identified as “element of externality”, except the following:**

- **the participation of a member of a settlement system located in a jurisdiction different from that of the CSD, as such member should uppermost remain subject to the regulation applicable to the local CSD (thanks to general rules harmonised at European level)**
- **the opening of a branch or subsidiary by the CSD in another Member State; the acquisition of an existing CSD in another Member State (group structures), as local rules should be respected,**
- **Performing settlement through a common IT platform between CSDs of different Member States, as such common IT platform is subject to authorisation and supervision by a European central authority, for example the European Central Bank)**

### 2.3 Initial authorization procedure

8 *What other elements should be submitted as part of the initial application procedure by a CSD?*

**The CSD should not have to specify a choice of binding core functions, which, to our opinion, should include the securities settlement system.**

9 *According to you should the authorisation procedure of a CSD be distinct from the designation and notification procedure under Art. 10 of the SFD? Yes? No? No opinion? Please explain why.*

**The authorisation procedure of a CSD is sufficient to AFG point of view. The 3rd paragraph of Article 10 of the SFD should be amended in order to avoid any significant divergence in the application of the rules by the different Member States.**

## 2.4 CSD Register and grandfathering

10 *What is your view on establishing a register for CSDs?*

AFG shares the idea proposed by the Commission of establishing a register for CSDs, which would be open to the public and would be fed by national authorities authorised to do so by the concerned CSD. For this purpose, Article 10 of SFD should be amended in order to replace the Commission by ESMA.

11 *What is your view on the above proposal for a temporary grandfathering rule for existing CSDs?*

We agree with the proposal to introduce a grandfathering clause which would allow more time to existing CSDs to comply with the new applicable regulations, provided that such clause contains its own expiry date.

## 2.5 Capital requirements

12 *According to you, does the above approach concerning capital requirements, suit the diversity of CSDs? Yes? No? No opinion? Please explain why.*

In our point of view (cf. definition of services), because the CSD's core activity is not exposed to credit or counterparty risks, the CSD should have sufficient liquid capital to ensure the continuity of its core activity for a reasonable period of time (to be determined). However, certain types of ancillary services might require additional capital requirements in order to cover the corresponding specific risks they incur. For this purpose, such additional requirements could be efficiently implemented through existing legal compensation schemes or through contractual insurance schemes (compulsory private insurance)

## 2.6 Supervision

13 *According to you, should the competent authorities have the above mentioned powers? Yes? No? No opinion? Please explain why.*

## 2.7 Licence/ Passport regime

14 *Would a special purpose banking license be appropriate for "banking type services"?*

15 *Which of these three passporting options would you support? Full passporting? Limited passporting? Opt out regime? Please explain why.*

AFG agrees with the need for a proper EU authorization and supervision regime considering the increasing cross-border nature of core services provided by CSDs. In this context, AFG considers that the EU passporting regime should be limited to the CSD's core activities, ancillary services being already subject to their own regulation (for example, banking services being subject to credit institutions' authorisation and supervision regime).

### 3. Access and interoperability

#### 3.1 Background

#### 3.2 *Access of Market participants to CSDs*

16 *What is your opinion about granting a right for market participants to access the CSD of their choice?*

#### 3.3 *Access of issuers to CSDs*

17 *What is your opinion on the abolition of restrictions of access between issuers and CSDs?*

18 *According to you, should the removal of Barrier 9 be without prejudice to corporate law? Yes? No? No opinion? Please explain why.*

19 *How could the integrity of an issue be ensured in the case of a split of an issue?*

**Regardless of hereafter comments, AFG is not in favour of the removal of Barrier 9. Indeed, splitting the notary function of a given securities issuance between several CSDs could severely jeopardize the security of the management system of the issuer's account. In addition, it could encourage the risk of inflation of securities and would make impossible the capacity of the issuer to precisely know the totality of its shareholders on time.**

#### 3.4 *Access and interoperability between CSDs*

20 *What is your opinion on granting a CSD access rights to other CSDs and what should their scope be?*

21 *What is your opinion on a CCP's right of access to a CSD?*

22 *What is your opinion on access conditions by trading venues to CSDs? Should MiFID be complemented and clarified? Should requirements be introduced for access by MTFs and regulated markets to CSDs? Under what conditions?*

23 *According to you, should a CSD have a right to access transactions feeds? Yes? No? No opinion? Please explain why.*

24 *What kind of access rights would a CSD need to effectively compete with incumbent providers of CSD services? Should such access be defined in detail?*

**General comments on point 3: AFG concurs with the proposed measures to achieve access and interoperability; and more specifically:**

**- Issuers should be free in the choice of CSD for their financial instruments. It is central to the issuers' concern that they have the option of choosing whatever CSD they consider appropriate. It should be noted in this regard that the corporate law applicable to the issuance should remain unaffected by the choice of the CSD. 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 and, which is equally the *lex societatis* of the home jurisdiction.

- AFG agrees that the forthcoming legislation should provide a framework for access between CSDs, including the possibility for the investor CSD – or a third party acting on behalf of the investor CSD – to open an account in another CSD (the issuer CSD), so as to enable the cross-system settlement of securities transactions. Understandably, the question has been raised whether the “receiving CSD” may refuse the access request from the “requesting CSD”. In general, AFG is of the view that access rights should be granted on a non-discriminatory basis: equivalent conditions should be applied to equivalent circumstances. In order to avoid any arbitrariness, criteria should be set forward to enable an objective assessment of whether predetermined conditions are met or not. Refusal of establishing connections shall indeed not happen in an arbitrary manner but be motivated,, with full disclosure of the reasons for such refusal. The contracts that will be entered into by connecting infrastructures and trading platforms in order to effectuate interoperability are also to be disclosed.

#### 4. Prudential rules

##### 4.1 Background

##### 4.2 Legal Framework

25 *Do you think that the legal framework applicable to the operations performed by CSDs needs to be further strengthened?*

AFG considers as crucial to protect the CSD’ participants against any retroactive cancellation of final orders entered by insolvent participants.

Pursuant to this principle, AFG is of the opinion that provisions contained in SFD are sufficient and states its important reserves relative to the current SLD proposition particularly concerning the envisaged amendments to the conflict of law rules which could generate legal insecurity.

26 *In particular should all settlement systems operated by CSDs be subject to an obligation of designation and notification?*

##### 4.3 Securities Lending ...

27 *What do you think of the general elements of these requirements, particularly with respect to the obligation for CSDs to facilitate securities lending and the obligation of counterparties to securities loans to put in place adequate risk controls?*

Please see question 6 above. AFG is in favour of a system which could reduce the risk of failure concerning the settlement being taking into account that the CSD should not be exposed itself (duty of facilitation only).

##### 4.4 Book entry form

28 *What do you think about the requirement for issuers to pass their securities through a CSD into a book entry form? If such an obligation were considered, which securities*

*should it concern? Only listed securities? All securities with an ISIN code? Only equities? Eligibility approach?*

29 *What is your opinion with respect to grandfathering ?*

#### 4.5 DVP

30 *What do you think about the requirements above for DVP? Do you see any issues in respect of the different DVP models?*

31 *What are your particular views on the grandfathering principle coupled with the requirement for the introduction of a guarantee fund?*

**AFG agrees that the envisioned legislation should contain specific provisions aiming at improving the legal framework. Imposing recourse to DVP would prevent, as indicated above, systemic risk. Requiring the use of Central Bank money for the settlement of cash has the advantage of eliminating both the credit risk and the settlement risk (delivery versus payment), given that cash transfers take place on the books of the central bank.**

#### 4.6 Settlement of the cash leg in central or commercial bank money

32 *What do you think about a preference of settlement in central bank money? Should such a preference be applied equally to all types of securities?*

33 *Do you think that the principles outlined above could be transposed in future legislation?*

34 *What is your opinion about the extent of the requirements that should be imposed when commercial bank money is used?*

**AFG fully supports the principle of settlement of the cash leg in central bank money, as proposed by the Commission and envisaged by the T2S project.**

#### 4.7 Reconciliation and segregation

35 *What do you think about the rules above?*

**AFG fully supports the principle of segregation envisaged by the Commission and is in favour of segregation in the books of the CSD and of its participants pursuant a “three level principle” as follows:**

- Participants’ assets,**
- Clients’ participants assets,**
- UCITS and AIF assets of for which participants are custodian.**

36 *Are further rules needed in order to ensure reconciliation and segregation?*

#### 4.8 Operational risks/ Governance

37 *Do you think that these six basic principles cover sufficiently operational risks?*

#### 4.9 Governance

38 *What do you think about the eight principles above, particularly with respect to board composition and the need for a risk committee?*

#### 4.10 Outsourcing

39 *According to you, should CSDs be subject to a principle of full responsibility and control on outsourced tasks? Yes? No? No opinion? Please explain why.*

40 *Should there be any other exemptions from the principle of responsibility and control of CSDs on outsourced tasks?*

**AFG agrees with the proposal that the future legislation should aim at limiting outsourcing by CSD “to certain tasks under specific conditions”.**

**A specific reference should be made in this respect to the ECB Target 2 Securities (T2S) project, under which the settlement process will be outsourced by the Eurozone CSDs to a single platform. AFG takes note of the fact that that the performance of the CSDs core activities, including their notary function (e.g. record-keeping for issuers), falls outside the scope of the T2S project, and remains attributed to each CSD which “will continue to be legally responsible for opening, maintaining and closing the securities account of its users”. T2S will only deliver the settlement process (delivery versus payment- DVP), which will be brought together on the single platform, while national CSDs retain legal responsibility vis-à-vis end-users (banks, investment firms).**

#### 4.11 Financial risks incurred by CSDs

41 *What is your opinion on the above prudential framework for risks directly incurred by CSDs?*

#### 4.12 Credit risks controls when CSDs act as facilitators

**Please question 6 above.**

42 *What do you think about the principles above?*

#### 4.13 Price transparency and unbundling

43 *What do you think about including these elements of the Code in legislation?*

**AFG considers that the current European applicable legislation are sufficient.**

### 3. HARMONISATION OF CERTAIN ASPECTS OF SECURITIES SETTLEMENT IN THE EUROPEAN UNION

44 *According to you, is the above described harmonisation of key post trade processes important for the smooth functioning of cross-border investment? Yes? No? No opinion? If yes, please provide some practical examples where the functioning of the internal market is hampered by absence of harmonisation of key post trading processes. If no, please explain your reasoning.*

45 *45. Do you identify any other possible area where harmonisation of securities processing would be beneficial?*

#### 5. Settlement discipline

46 *According to you, is a common definition of settlement fails in the EU needed? Yes? No? No opinion? Please explain why. If yes, what should be the key elements of a definition?*

47 *According to you, should future legislation promote measures to reduce settlement fails? Yes? No? No opinion? If yes, how could these measures look like? Who should be responsible for putting them in place? If no, please explain.*

48 *What do you think about promoting and harmonising these ex-ante measures via legislation?*

49 *What do you think about promoting and harmonising these ex-post measures via legislation?*

**AFG is in favour of harmonised rules in order to reduce the number of settlement failures. In this framework, AFG is favourable to the implementation of penalties punishing any failure and which should be aggravated in case of deliberate or persistent offenders. The worst penalties could then be an exclusion of the participant and its description to the European authority of supervision.**

#### Harmonisation of Settlement periods

50 *According to you, is there a need for the harmonisation of settlement periods? Yes? No? No opinion? Please explain why*

**AFG is in favour of a harmonisation of settlement periods. Please note in this context that the asset managers (because of the accrual basis principle of their investment strategy ) considers that “the faster would be the better”. In this frame, AFG think that the settlement periods proposed by the T2S project could be a good reference.**

51 *In what markets do you see the most urgent need for harmonisation? Please explain giving concrete examples*

- 52 *What should be the length of a harmonised period? Please explain your reasoning*
- 53 *What types of trading venues should be covered by a harmonisation? Please explain your reasoning*
- 54 *What types of transactions should be covered by a harmonisation? Please explain your reasoning.*
- 55 *What would be an appropriate time span for markets to adapt to a change? Please explain.*