

LCG's Advice: outline of a securities law directive in Europe



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The Giovannini Report, "Cross-Border Clearing and Settlement Arrangements in the European Union", noted that the absence of a European legal framework regarding securities law was an obstacle to the introduction of efficient and secure cross-border clearing and settlement systems. In 2004, the European Commission published a plan of action to create an integrated market for clearing and settlement and proposed the creation of the *Legal Certainty Group* ("LCG"). With around thirty legal experts, the task set by the European Commission for the LCG is to study solutions for lifting legal barriers for constructing a European post-market. It is under this framework that LCG delivered its Advice in August 2008, which, beyond its consultative aspect, outlines the major principles of a European directive on securities law, which will be put forward by the European Commission at the end of 2009. A uniform legal framework would enable clients, who deposit securities with different financial intermediaries in the Union, to benefit from a minimum level of protection applicable from one Member State of the Union to another (obligation of information, rights of clients in the event of the bankruptcy of an intermediary and protection of the purchaser in good faith) and to lessen the prejudicial variances in the

regulations that were observed during the bankruptcy of Lehman Brothers or the Madoff fraud. The Advice, which consists of fifteen recommendations, proposes a minimum and common base for holding dematerialised securities through a chain of intermediaries and is built on the following principles.

Firstly, LCG is focussed on the mechanisms common to the Member States. Thus, through a functional approach, certain operations have been identified and can be, according to the LCG, the subject of a common legal framework. The objective is to avoid putting forward to the European Commission amendments to the current legislation that are too generalised. However, this approach has been criticised because it does not take into account the specificity of the key players in the back office, such as central securities depositories or clearing houses, which played a saving role during the financial crisis of September 2008.

Secondly, LCG proposes to create a legislative framework for dematerialised securities (Giovannini Barrier no. 13) by tackling all possible legal effects of securities account registration, as well as a set of regulations such as the different methods for constituting an interest, priority rules in account registration or, the protection of the acquirer in good faith.

Furthermore, in order to remove the barrier concerning the diversity of the regulations for processing securities transactions (Giovannini Barrier no. 3),

the LCG proposes to create regulations on the obligations of intermediaries regarding the circulation of information between investors and issuers, as well as on the exercising of certain investors' rights at all levels of the holding chain. On this point, the exercising of rights could be carried out by intermediaries if an instruction from the end client exists, who must be notified. However, there is one question that remains open, and for which the Advice does not provide a clear answer: do the conditions for accessing the account holder service need to be more stringent, and does the intermediary account holder need to comply with MiFID regulations?

Lastly LCG recommends leaving the issuers to choose the securities settlement system and their central securities depositories (solution to Giovannini Barrier no. 9 on restrictions concerning the location of securities). This freedom would considerably strengthen competition and the possibility of consolidating post-trading infrastructures.

At this stage, discussions have only just begun. Further to public consultation, which ended in June 2009, the European Commission will analyse the proposals formulated in the Advice, and will propose a harmonisation of the legislation before the end of 2009. The Advice of LCG and the work that will result from it will certainly fuel reflections concerning UCITS depository in Europe (in particular, the notion of the custody of assets), for which a European Commission consultation will be completed in September 2009.

Target2-Securities (T2S) on track



**“Much
has been
achieved,
much remains
to be done...”**

said Gertrude Tumpel-Gugerell, member of the executive Board of the ECB when concluding her introductory speech at the T2S Memorandum of Understanding (MoU) signing ceremony which took place in Frankfurt on 16 July 2009.

On that day, CEOs of 27 CSDs from 25 countries and the Governors of the NCBs

signed a formal document, the first step towards a binding agreement between the ECB that commits to delivering the service, and the CSDs, that commit to using it.

It isn't just the Euro zone that is concerned - 7 European CSDs are located outside of the Euro area and two others from countries that do not pertain to the EU. Moreover, 3 non-Euro NCBs are considering the possibility to entrust T2S for the settlement of transactions denominated in their domestic currency.

The idea of having a single settlement platform in Europe was launched by the ECB 3 years ago and has progressively gained ground with the support of all the stakeholders, in particular the users, which have shown continuous and growing commitment since the launch. SGSS plays a prominent part in this project.

Before the MoU can be signed, a lot of energy has been spent in drafting the User Requirements, elaborating the General Functional and Technical Specifications and drawing-up the basis of a framework agreement. Initiatives have also been launched aiming at building a harmonised, functional, technical, operational and legal environment within which the platform will operate, without forgetting the preparation of test and migration strategies.

Until the new platform finally becomes operational in 2013, much remains to be done in all these areas. The community of stakeholders will continue to work hard during the forthcoming months to make the dream become a reality and to allow this ambitious project to reach its initial objective: a single and low cost settlement engine for Europe, making cross border investment domestic.

Eric de Nexon

The AIFM Directive

On 30 April 2009, the Commission published a proposed Directive called the AIFM Directive for Alternative Investment Fund Managers.

The AIFM Directive applies to “all AIFM established in the Community, which provide management services to one or more alternative investment funds (AIF)”. The proposed AIFM Directive, therefore, has a wide scope and concerns hedge funds, private equity funds, commodity funds, funds of funds ... all non UCITS funds.

The proposed AIFM Directive will:

- Only apply to the AIFM managing a portfolio of more than €100 million. A higher threshold of €500 million applies to AIFM not using leverage (and having a five years lock-in period for their investors) as they are not regarded as posing systemic risk. The choice of a threshold of €100 million implies that roughly 30% of hedge fund managers, managing almost 90% of assets of EU domiciled hedge funds, would be covered by the Directive;
- Regulate the key service providers, including asset managers, depositaries, valuers and administrators;
- Enhance the transparency of AIFM and the funds they manage for supervisors, investors and other key stakeholders;
- Ensure that all AIFM are subject to appropriate governance standards and have robust systems in place for the management of risks, liquidity and conflicts of interest.
- Grant access to the European market to third country funds after a transitional period of three years. This should allow the EU to verify whether the necessary guarantees are in place in the countries where the funds are domiciled (equivalence of regulatory and supervisory standards, exchange of information on tax matters).

The draft Directive is now being submitted to the European Parliament and Council for approval. The text should be amended by these institutions as both the politicians and the industry esteem that the text could be improved.

The Commission plans for approval of the final text by the end of 2009 and the Directive could thus be implemented in 2011.

Fanny Rodriguez