

## **HM Treasury Consultation (8 December 2015) on implementing CSDR**

### **Law Society and City of London Law Society Company Law Committee Joint CREST Working Party Response**

#### **Introduction**

The Law Society is the professional body for solicitors in England and Wales, representing over 160,000 registered legal practitioners ('the Society'). The Society represents the profession to parliament, government and regulatory bodies and has a public interest in the reform of the law.

The City of London Law Society ('CLLS') represents approximately 15,000 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, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

The CREST Joint Working Party is made up of senior and specialist corporate lawyers from both the Society and the CLLS who have a particular focus on issues relating to the UK system of dematerialised securities.

Our comments relate solely to the company law aspects of the changes proposed to domestic legislation, and therefore relate only to the consultation questions listed below.

**Question 11: (Section 3: Recognised CSDs and authorisation) Do you believe the proposed changes to the USRs on removing the Operator approval regime is appropriate and consistent with CSDR?**

Yes, we agree.

**Question 12: (Section 3: Recognised CSDs and authorisation) Do you believe the proposed transitional arrangements are adequate and in keeping with the requirements of CSDR?**

Yes we agree.

**Question 15: (Section 4: Enforcement powers and additional provisions) Do you believe that section 293 of FSMA should be amended to extend the scope beyond recognised bodies to include EEA CSDs?**

Yes, we agree that the scope should include EEA CSD's.

**Question 16: (Section 4: Enforcement powers and additional provisions) Should section 293A of FSMA be limited to EEA CSDs with branches in the UK? Are other restrictions on the power appropriate?**

We think that the enforcement powers should not be by reference to whether there is a branch in the UK but by reference to what is reasonably required by the Bank of England. As regards what information may reasonably be required, we query whether the correct test is what is required in connection with the Bank of England's functions under the CSDR. We think that the power should cover information reasonably required in connection with the functions of the EEA CSD that are subject to the CSDR.

**Question 17: (Section 4: Enforcement powers and additional provisions) Do you agree the proposed changes in section 295A and section 296 are appropriate for the purposes of CSDR?**

Yes, we agree.

**Question 18: (Section 4: Enforcement powers and additional provisions) In the context of Article 25 of CSDR, is it appropriate to give the Bank of England any information-gathering or enforcement powers in respect of third country CSDs providing services in the UK, and if so, which powers and in what circumstances?**

Yes, we consider that the Bank of England should have information-gathering and enforcement powers in relation to third country CSD's recognised by ESMA as they are also allowed to passport their services into the UK. We suggest that the test should be by reference to what is reasonably required by the Bank of England in connection with the CSD's role as Operator under the USRs. We assume that the Bank of England may not necessarily have direct arrangements with any regulator of the third country CSD and we therefore wonder whether there is an argument for the Bank to have wider powers in relation to such CSDs. In this respect we note that Article 25 of the CSDR provides that ESMA does not directly regulate third country CSD's but instead is required to put in place co-operation agreements with the relevant third country and that the competent authority of a Member State in which the third country CSD provides services may request information from the responsible third country authority.

**Question 28: (Section 4: Enforcement powers and additional provisions) Is the proposed approach to amending section 182 of the Companies Act 1989 adequate in ensuring compliance with Article 38 of CSDR?**

We query whether the amendment to section 182 is required by Article 38, given that Article 38 just relates to the need for a CSD operator to maintain segregated accounts.

**Question 30: (Section 5: Freedom to issue in an authorised CSD and other relevant provisions) Do you agree with the proposed approach of implementing Article 49(1) of CSDR? Are proposed new regulation 2A and the proposed amendments to regulations 14 and 19 suitable for this purpose?**

We do not think that it is necessary for the purpose of implementing the CSDR for the USRs to include a reference to EEA shares and securities governed by a non-UK EEA law. If the UK government nevertheless considers that it is necessary to refer to EEA shares and EEA securities (in order to implement the CSDR), it should be sufficient to include a statement in Regulation 2A by way of an acknowledgement. So Regulation 2A(1) could be redrafted to delete the words "Except as provided in paragraphs (2) and (3)," and paragraphs (2) and (3) could start with the words "Nothing in these Regulations shall prevent title to .....being evidenced in....." .

The reference to a "relevant system" in Regulation 2A(2) and (3) does not currently work. This is because Regulation 2 of the USRs defines a relevant system by reference to units of a "security" and the proposal is to amend the definition of "securities" in Regulation 3 so that it excludes EEA securities within the meaning of Regulation 2A, meaning that the reference to a "relevant system" could not be applicable to those securities. One way of dealing with this would be to add to the amendment to the definition of "securities" after the words "but does not include" the words "(except for the purposes of Regulation 2A(2) and (3))". We also think that the definition of "securities" should exclude EEA shares as those are a type of "security" for the purposes of the "relevant system" definition and do not (under the drafting of Regulation 2A) fall within the definition of an "EEA securities", so this would mean adding in the proposed amendment to the definition of "securities", after the words "EEA securities", the words "or EEA shares".

We understand that one way in which a UK based Operator may wish to act as CSD in relation to EEA shares and EEA securities is by way of the use of book entry form holdings and transfers of interests in the EEA shares or other securities, with holdings and transfers of those interests being

governed by UK law. We consider that the key question to be determined in relation to such an arrangement for the purposes of the USRs is whether such interests would constitute "securities" governed by UK law for the purposes of the USRs such that Regulation 19 would apply to the arrangement. If the interests do not constitute securities as defined in the USRs, then Regulation 19 would not apply, and the arrangement would be outside the USR requirements. If this could be the case, as a policy matter we think the Government should consider whether safeguards and procedures need to be put in place in relation to such an arrangement and, if so, what these should be. We note in this respect that the definition of securities in the USRs includes "other securities of any description and interests in a security" and that the definitions of an "EEA share" and "EEA security" which would be excluded from that definition of security are by reference to the law governing the relevant share or security. Article 49 of the CSDR refers to an issuer having the right to arrange for its securities to be admitted to a CSD and our understanding is that the book entry system operates on the basis that the only issuer is the issuer of the EEA securities and that there is no separate "issuer" of the book entry interests (the only person that could be characterised as a third party issuer would be the CSD itself). We also note that Article 3 of the CSDR refers to securities being represented in "book entry form as immobilisation" and the structure may therefore be regarded as falling within this concept. Guidance may be needed from ESMA in relation to the application of the CSDR to such structures.

We agree with the amendments to Regulations 14 and 19 and in particular the fact that they continue to allow holdings of shares and securities in a relevant system in cases where the CSDR does not apply.

**Question 31: (Section 5: Freedom to issue in an authorised CSD and other relevant provisions) Do you agree with the government's view that the requirements which have been retained in regulations 14, 15, 16, and 19 are outside the scope of CSDR?**

Yes, we agree.

**Question 32: (Section 5: Freedom to issue in an authorised CSD and other relevant provisions) Do you agree with the government's approach to include third country CSDs within the definition of "Operator" and in particular to treat third country CSDs in the same way as EEA CSDs under the proposed new regulation 2A?**

Yes, we agree, subject to our comments under Question 18 above as regards enforcement powers against third country CSDs.

**Question 33: (Section 5: Freedom to issue in an authorised CSD and other relevant provisions) Do you agree with the government's approach to enforcement of Article 49 of CSDR?**

Yes, provided that adequate provision is made in the FSMA regarding enforcement (see our answers to Questions 16 and 18 above). As regards the amendment to section 296 of the FSMA which is intended to cover any Article 49 complaint, we do not think that a reference to "access" is the correct expression, and we think that the wording should track that in Article 49(4) which is a refusal to "provide services".

**Question 34: (Section 5: Freedom to issue in an authorised CSD and other relevant provisions) Do you agree with the proposed approach of not requiring Article 49(2) requests from issuers who currently have securities and shares recorded in the UK's CSD?**

Yes, we do not think that the CSDR means that issuers who are already using a CSD need to reapply, and note in particular that Article 49 creates new rights rather than obligations for issuers. For the same reason, we do not believe that the transitional provision in Regulation 9 of the amendment Regulations is necessary for existing issuers, but we have no objection to the inclusion of the provision and think that it may be helpful as an express confirmation for issuers.

**Question 35: (Section 5: Freedom to issue in an authorised CSD and other relevant provisions) Do you believe the proposed revision of regulation 5 is appropriate and consistent with CSDR?**

Yes, we agree that it is necessary to continue to include those matters that are set out in Schedule 1 that relate to the relevant system rather than the authorisation requirements, and we therefore agree with the new title and scope of Regulation 5 and agree that it is consistent with the CSDR

**Question 36: (Section 5: Freedom to issue in an authorised CSD and other relevant provisions) Do you consider that the proposed omissions in Schedule 1 are appropriate, and are there other provisions in Schedule 1 to the USRs that you believe should be omitted due to inconsistencies or overlapping with CSDR's requirements?**

We agree with the new title and overall scope of Schedule 1 and agree that this is consistent with the CSDR. Of the paragraphs that are proposed to be deleted, paragraphs 7, 8 and 23 are provisions which relate to the UK requirements for the holding and transfer of securities and we think that it would be preferable to keep these. We do not think that they are inconsistent with the CSDR requirements. As regards the requirements in the CSDR applying to third country CSDs, has the Government considered whether the CSDR systems requirements apply to them, and if not whether those requirements should be included in Schedule 1 as regards third country CSDs?

**3 February 2016**