

EU Market Integration and Supervision Package (MISP)

The SSMA's drafting comments regarding the settlement finality regulation and the financial collateral directive

The Swedish Securities Markets Association ("SSMA") is a trade association representing the interests of investment firms and credit institutions conducting securities business on the Swedish market. In this document we present the SSMA's drafting comments and suggestions regarding the MISP settlement finality regulation (SFR) and the Directive 2002/47/EC on financial collateral arrangements (FCD).

The comments include the Commission's proposal and, where relevant, the European Parliament's Rapporteur's draft report.

Background and general comments

Collateral security and conflict-of-laws provisions

For the SSMA it is a priority that provisions regarding applicable law and conflict-of-laws are clear. As regards the provision on applicable law in article 25, Collateral security, it should be clarified what is meant by the collateral security being legally recorded on a register, account or centralised deposit system. The meaning of the wording in article 9(2) in the SFD, which is similar to the proposed wording in article 25(2), has been subject to a lot of discussions. In 2018 the Commission published a communication on the applicable law to the proprietary effects of transactions in securities, in which the topic was addressed.¹ Despite the communication there are still uncertainties regarding when and where the collateral security is considered to be legally recorded and what is meant by the word account in this context. Does "account" include custody accounts provided by banks and investment firms or only security accounts at CSD level? Neither the definition of account in article 2(1)(26), nor the provision in article 25 clarifies this. A bank or investment firm might have branches in other countries than its home member state and provide its clients with custody or security accounts from the branch, which is the applicable law in that scenario? Are securities kept as collateral considered to be legally recorded even when they are not in scope of the relevant national legislation regarding book-entry securities? For example, the provisions on the effects of legal recording in the Swedish Central Securities Depositories and Financial Instruments Accounts Act (1998:1479) do not cover securities registered in CSDs outside of Sweden, nor units in non-exchange traded funds that are held at a client's custody account. Furthermore, for securities held at custody accounts, the *requirements in rem*, i.e. the action that is required for protection against creditors, under Swedish law is a notice of assignment of claim, rather than the recording that is done in the bank's or investment firm's custody account system. Are these still considered to be legally recorded and covered by the protection given by the article? We support the Rapporteur's proposed amendment in article 25(2) subparagraph 2 that where an account is opened with a

¹ Communication COM(2018) 89 on the applicable law to the proprietary effects of transactions in securities, [EUR-Lex - 52018DC0089 - EN - EUR-Lex](#)

branch situated in a different Member State, the proposed rule would inappropriately switch the applicable law to the head office jurisdiction. From the proposed amendment, we understand that the protection provided by article 25 is intended to cover custody accounts provided by banks and investment firms (including through their branches), as well as accounts at CSD level, and propose that this is further clarified in a recital.

Moreover, the Commission has not proposed any amendment to clarify the conflict-of-laws provisions in the FCD, article 9(1) and (2) even though the meaning of the wording in those provisions have also been subject to discussions and the Commission's communication from 2018. The SSMA welcomes that the Rapporteur has suggested some amendments to the FCD article 9 regarding branches, that are coordinated with the Rapporteurs suggested amendments to SFR article 25. It is essential that the rights to collateral security is protected – for all types of financial instruments, held either at a CSD securities account or at a custody account – and that the provisions on how to determine the applicable law in all of the relevant directives and regulations are clear. There are still questions outstanding regarding the meaning of the wording of the provisions in the legal acts currently in force, and we believe that the legislator should strive to clarify any uncertainties in the ongoing legislative process.

Third country systems

The SSMA supports a harmonisation of the requirements for registration of third-country systems. From a Swedish perspective, we have good experience with registration of third country systems, with the Swedish legislator being forward-looking and introducing the necessary legislation at quite an early stage.² From the market participants' point of view, this has also worked well in practice.³ Some aspects of the proposed provisions regarding third country systems do however merit further discussions.

As the current Swedish legislation works well, we would like to see the same level of protection being upheld. The SSMA would therefore like to encourage the legislator to make sure that the wording of the provisions in the regulation gives the same level of protection as under existing national regimes that extend the protection of SFD to third-country systems.

² See for example the descriptions of the Swedish market in the report on the review of settlement finality in payment and securities settlement systems including its application to domestic institutions participating in third-country systems and of financial collateral arrangements under Directives 98/26/EC and 202/47/EC, [REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL](#)

³ The rules were e.g. applied in the process of registration of some British systems post Brexit (Swedish news source): [FI beslutar om likställande av avvecklingssystem | Finansinspektionen](#)

Comments and proposed amendments to the Commission's proposed texts and the Rapporteur's draft report

The proposed settlement finality regulation

Recital 20

Text proposed by the Commission

It is necessary to provide a conflict of laws rule regarding the rights of holders of collateral security in order to ensure that the law of the Member State where the collateral security was validly created in a register, account or centralised deposit system, determines also the validity and enforceability of that collateral security against the system, the system operator, and against any other person claiming directly or indirectly through it. That rule should **only** apply to a register, account or centralised deposit system which evidences the existence of proprietary rights in or for the delivery or transfer of the collateral security concerned.

SSMA's proposed amendment

It is necessary to provide a conflict of laws rule regarding the rights of holders of collateral security in order to ensure that the law of the Member State where the collateral security was validly created in a register, account or centralised deposit system, determines also the validity and enforceability of that collateral security against the system, the system operator, and against any other person claiming directly or indirectly through it. That rule should apply to a register, account or centralised deposit system – **at the top tier level as well as throughout the custody chain** – which evidences the existence of proprietary rights in or for the delivery or transfer of the collateral security concerned.

Justification

It is essential that the rights to collateral security is protected – for all types of financial instruments, held either at a CSD securities account or at a custody account – and that the provisions on how to determine the applicable law in all of the relevant directives and regulations are clear. It should be clarified that both accounts at the top tier CSD level and custody accounts provided by banks and investment firms are covered by the regulatory protection.

Article 1 – paragraph 2

Text proposed by the Commission

This Regulation also lays down requirements for the registration of third-country systems in one or several Member States in order to enable institutions established in those Member States, which participate in those third-country systems, to benefit from the extension of the insolvency protection provided for in Articles 17, 19, 22(1), 23, 24 and 25(1) **to transfer orders entered into in such third-country systems.**

SSMA's proposed amendment

This Regulation also lays down requirements for the registration of third-country systems in one or several Member States in order to enable institutions established in those Member States, which participate in those third-country systems, to benefit from the extension of the insolvency protection provided for in Articles 17, 19, 22(1), 23, 24 and 25(1).

In the case of an insolvency of a member of such a system, **transfer orders entered by that member shall be protected where both** the following conditions are met:

In the case of an insolvency of a member of such a system, **the insolvency protection provided for in Articles 17, 19, 22(1), 23, 24 and 25(1) shall apply where** the following conditions are met

Justification

According to the proposed article 1(2), the insolvency protections in the specified articles should only apply in relation to "transfer orders entered into in a registered third-country system". With this limitation, registered third-country systems would have much more limited protection against the insolvency of their EU participants than the SFR (or the existing SFD) confers on designated (EU) systems in relation to their EU participants. Third country systems might also have more limited protection than under existing national regimes that extend the protection of SFD to third-country systems. This could have negative effects on the willingness of third country systems to admit and retain EU members, which would undermine the objective of the new regime for third-country systems.

Article 12

Text proposed by the Commission

Each of the registering authorities in any of the Member States in which a member **participating** in a third-country system is established may decide to register such a third-country system in accordance with the procedure set out in Article 13, provided that the member is an institution as defined in Article 2(1), points (10)(a)(i) to (iv), or Article 2(1), point (10)(b). Each of those registering authorities shall assess the application for registration of the third-country system.

SSMA's proposed amendment

Each of the registering authorities in any of the Member States in which a member **that participates or intends to participate** in a third-country system is established may decide to register such a third-country system in accordance with the procedure set out in Article 13, provided that the member is an institution as defined in Article 2(1), points (10)(a)(i) to (iv), or Article 2(1), point (10)(b). Each of those registering authorities shall assess the application for registration of the third-country system.

Justification

It should also be clarified that a third country system can be registered where that system has admitted or intends to admit a member established in that Member State, to allow for a registration before a member is admitted, since the registration is likely to be a precondition for the admittance.

Article 14 – paragraph 1 – point d

Text proposed by the Commission

(d) the system identifies clearly in its common rules and standardised procedures all of the following moments:

SSMA's proposed amendment

deleted

- (i) the moment of entry of a transfer order into the system referred to in Article 18(1);**
(ii) the moment of irrevocability of a transfer order entered into the system referred to in Article 20(1);
(iii) the moment of final settlement of a transfer order entered into a system referred to in Article 21(1).

Justification

The SSMA agrees with the Rapporteur's proposed deletion of this point (AM 12). The text proposed by the Commission seems to go beyond the requirements in Principle 8: Settlement finality of the Principles for Financial Market Infrastructure.⁴ It is also unclear how the technical mandated in article 21(3) and (4) would affect this condition.

Article 25 – paragraph 2 – subparagraph 1

Text proposed by the Commission

The rights of participants, system operators, a central bank of a Member State, the European Central Bank and of any nominee, agent or third party acting on their behalf with respect to the financial instruments, including rights in those financial instruments, which are provided as collateral security that is **legally recorded on a register**, including where recorded on a distributed ledger, account or centralised deposit system located in a Member State, shall be governed by the law of that Member State.

SSMA's proposed amendment

The rights of participants, system operators, a central bank of a Member State, the European Central Bank and of any nominee, agent or third party acting on their behalf with respect to the financial instruments, including rights in those financial instruments, which are provided as collateral security that is **validly created**, including where recorded on a distributed ledger, account or centralised deposit system located in a Member State, shall be governed by the law of that Member State.

Justification

It is essential that the rights to collateral security is protected – for all types of financial instruments, held either at a CSD securities account or at a custody account – and that the provisions on how to determine the applicable law in all of the relevant directives and regulations are clear. The phrase “legally recorded on a register, account or centralised deposit system”, which is used in the corresponding article in the Settlement Finality Directive (article 9(2)), has been subject to discussions since it is not clear from the wording when and where the collateral security is considered to be legally recorded and what is meant by the word account in that context. The Term “validly created”, which is used in the proposed recital 20 in SFR, is more appropriate than “legally recorded”, since it neutral as regards the means for creating the right, and requirement in rem, i.e. the action that is required for protection against creditors, e.g. registration or a notice of assignment of claim. In the Nordic countries,

⁴ [Principles for Financial Market Infrastructures](#)

the formal requirement for making a claim effective against third parties is in many cases, including for securities held in a custody account, a notice of assignment of claim, not a registration in a system.

Article 25 – paragraph 2 – subparagraph 2

Text proposed by the Commission

For the purposes of the first subparagraph, the location of a register, account or centralised deposit held at a legal entity shall be the Member State where that **entity has its registered** office.

SSMA's proposed amendment

For the purposes of the first subparagraph, the location of a register, account or centralised deposit held at a **branch or office in a Member State of a** legal entity shall be the Member State where that **branch or office is located**.

Justification

The SSMA agrees with the Rapporteur's proposed amendment to this paragraph (AM 26). The proposed amendment, together with the proposed amendment in FCD article 9 (1), would be a welcome clarification that the applicable law is the law of the Member State where the branch or office from which the account is provided to the client, is located.

Article 28 – paragraph 1

Text proposed by the Commission

1. By way of derogation from Article 3, a system designated under Directive 98/26/EC prior to [**OP insert date** = entry into force of this Regulation] shall **continue to** be designated for the purposes of this Regulation until **it** is re-designated under that Article or until [**OP insert date**= 5 years after the entry into force of this Regulation], whichever is earlier. **In the meantime, the Member State law on the designation of a system shall continue to apply.**

SSMA's proposed amendment

1. By way of derogation from Article 3, a system designated under Directive 98/26/EC prior to [**date of** entry into force of this Regulation] shall be **considered as** designated for the purposes of this Regulation:
(a) until **the system** is re-designated under that Article or until [5 years after the entry into force of this Regulation], whichever is earlier, **or**
(b) if the system operator applies for designation of that system under Article 3 before [5 years after the entry into force of this Regulation] and the application is still pending on that date, until the system is re-designated under that Article, a decision has been made rejecting the application or the application is withdrawn.

Justification

The SSMA agrees with the Rapporteur's proposed amendment to this paragraph (AM 28). Already designated or registered systems should continue to benefit from the protections

conferred by the SFR where the application for designation is made before the end of the five-year transitional period, even if the re-designation is not finalised by the end of that period, to make allowances for unforeseen delays.

Article 28 – paragraph 2

Text proposed by the Commission

2. By way of derogation from Article 12, a third-country system to which a Member State has extended the protections granted under Directive 98/26/EC prior to [OP insert date = entry into force of this Regulation] shall be considered as registered in that Member State for the purposes of this Regulation until **it** is registered in accordance with that Article in that same Member State or until [OP insert date = 5 years after the **date of** entry into force of this Regulation], whichever is earlier.

SSMA's proposed amendment

2. By way of derogation from Article 12, a third-country system to which a Member State has extended **one or more of** the protections granted under Directive 98/26/EC **or has applied similar protections** prior to [entry into force of this Regulation] shall be considered as registered in that Member State for the purposes of this Regulation:
(a) until the system is registered in accordance with that Article in that same Member State or until [5 years after the entry into force of this Regulation], whichever is earlier, or
(b) if the system operator applies for registration of the system under Article 12 in that same Member State before [5 years after the entry into force of this Regulation] and the application is still pending on that date, until the system is registered in accordance with that Article in that Member State, a decision has been made rejecting the application or the application has been withdrawn.

Justification

The SSMA agrees with the Rapporteur's proposed amendment to this paragraph (AM 29). Already designated or registered systems should continue to benefit from the protections conferred by the SFR where the application for designation is made before the end of the five-year transitional period, even if the re-designation is not finalised by the end of that period, to make allowances for unforeseen delays.

Article 31, amendments to the financial collateral directive (2002/47/EC)

Article 31 – paragraph 1 – new point

[Article 1 – paragraph 2 – point (e) FCD]

Present text (no amendments by COM)

a person **other than a natural person**, including unincorporated firms **and** partnerships, provided that the other party is an institution as defined in points (a) to (d).

SSMA's proposed amendment

a person, including unincorporated firms, partnerships **and natural persons**, provided that the other party is an institution as defined in points (a) to (d).

Justification

Since there are natural persons that enter into agreements regarding financial collateral arrangements, it is appropriate to include them in the list of collateral takers and providers, to facilitate getting the necessary legal opinions and lower capital requirement under the capital requirement regulation (575/20132/EU). This would reduce the capital cost, and hence the fees/rates for the natural persons (consumers) that enter into agreements regarding financial collateral arrangements.

Article 31 – paragraph 1 – point 2 a (new)

[Article 9 – paragraph 1 -subparagraph 1 a (new) FCD]

Text proposed by the Commission

SSMA's proposed amendment

**(2a) in Article 9(1), the following subparagraph is added:
'For the purpose of the first subparagraph, the location of an account held at a branch or office of a legal entity shall be the country where that branch or office is located'.**

Justification

The SSMA agrees with the Rapporteur's proposed new paragraph (AM 32). The proposed amendment, together with the proposed amendment in SFR article 25(2), would be a welcome clarification that the applicable law is the law of the Member State where the branch or office from which the account is provided to the client, is located.