ECSDA
European Central Securities Depositories Association

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ECSDA comments on the proposed review of the Shareholders Rights Directive (SRD Review)

On 9 April 2014, the European Commission issued a legislative proposal amending the Shareholders Rights Directive (SRD) of 2007. In this paper, ECSDA describes the expected impact of the proposal on central securities depositories (CSDs), and highlights some issues for consideration by the European legislator.

CSDs are financial market infrastructures which act as the first entry point for newly issued securities, including company shares. They record the initial deposit of securities by an issuer and subsequently allow investors to deliver these securities against cash, i.e. to settle transactions in these securities. CSDs also maintain securities accounts at the top tier level of the holding chain. The following comments thus only cover those sections of the legislative proposal which are CSD-relevant, i.e. article 1(2) amending the SRD definitions and the Chapter IA (new articles 3a to 3e) on the *"identification of shareholders, transmission of information and facilitation of exercise of shareholder rights"* added by article 1(3) of the Directive[1].

ECSDA supports the objective of the Commission Proposal to increase shareholder transparency and to facilitate the exercise of shareholder rights, especially in cross-border situations. CSDs, like other actors in the securities processing chain, have an important role to play in achieving this objective. **ECSDA recognises that the obligations imposed on "intermediaries" under Chapter IA of the SRD Proposal will in some cases be relevant for CSDs, especially those CSDs providing shareholder identification services.**

That said, due attention must be paid to the special characteristics of CSDs, and some clarifications might be needed as regards the applicability of the SRD requirements to CSDs. This paper consequently elaborates on the relevance of individual articles of the draft directive for CSDs and outlines some specificities that should be taken into account during the legislative process and/or during transposition into national law in order to ensure that CSDs can continue to contribute to well-functioning and efficient shareholder identification processes in the EU.

[1] All references to specific articles in this paper are based on the new numbering of the amended Directive 2007/36/EC.

1. CSDs and the definition of "intermediaries" (art.2)

The proposed new article 2(d) defines an intermediary as *"a legal person that has its registered office, central administration or principal place of business in the European Union and maintains securities accounts for clients."* Based on this generic wording, ECSDA understands that all CSDs would fall under the definition of "intermediary", since CSDs maintain securities accounts for their participants. We understand that the SRD follows a functional approach and that, as such, it intentionally covers different types of institutions under the term "intermediary". We do not seek to exclude CSDs from the scope of the SRD, and we recognise that CSDs should be covered by some of the proposed requirements given their role in the securities holding chain, especially as regards the transmission of information.

However, the legislator should be aware that CSDs are financial market infrastructures which are usually not considered as "intermediaries" because they, uniquely, record the initial deposit of newly issued securities (so-called notary service) and provide securities accounts at the top tier level (so-called central maintenance service), playing a central role in the market they serve. Given their top tier position in the holding chain, CSDs also often provide other services which are relevant for the purpose of the SRD, including maintaining the integrity of the issue[2], maintaining the shareholders' register (for registered securities), and/or providing other shareholder information services ensuring a high level of information accuracy (see Annex of this paper for more details).

All these CSD services are strictly regulated under the upcoming CSD Regulation (CSDR)[3]. Section B of the Annex in particular recognises that *"services related to shareholders' registers"* and other services facilitating the exercise of shareholder rights (such as the processing of corporate actions) are *"related to the notary and central maintenance services"* of CSDs, both of which are defined as core CSD services under Section A of the Annex. In other words, CSDs are regulated under a specific framework (including the global CPSS-IOSCO Principles for financial market infrastructures) which differs from the framework applicable to intermediaries like credit institutions or investment firms. It is also worth noting that CSD participants are never individuals but always eligible (usually financial) wholesale institutions, even when CSDs maintain beneficial owner securities accounts[4].

To sum up, the obligations imposed on "intermediaries" by the SRD review proposal are in our view generally appropriate also for CSDs, but **they need to be applied in a way that is consistent with CSDs' particular and unique role in the securities holding chain, and in line with the relevant European Market Standards on General Meetings[5] and on Corporate Actions Processing[6].**

[2] As a result of legal requirements and securities accounting procedures, most CSDs are responsible for ensuring that the number of securities issued is, at all times, equal to the total number of securities in circulation (i.e. validly booked in investors' accounts).
[3] Proposal COM(2012)0073.
[4] In markets where beneficial owner accounts are maintained at CSD level, beneficial owners are not direct participants in the CSD and their account is often (but not invariably) operated by a participant (intermediary) called « account operator ». In most cases, beneficial owners have a contractual relationship with a CSD participant but not with the CSD itself. In certain markets (e.g. Greece, Malta and Cyprus), the CSD might however communicate directly with beneficial owners, for example to allow shareholders to update their identification information (e.g. personal address).
[5] See: http://www.ecsda.eu/uploads/tx_doclibrary/2010_09_09_GM_Market_Standards_Final.pdf
[6] See: http://www.ecsda.eu/uploads/tx_doclibrary/2012_CA_Market_Standards.pdf

2. CSDs and the identification of shareholders (new art.3a)

- **General obligation imposed on intermediaries by art.3a(1)**

ECSDA understands that the objective of Article 3a is to ensure that issuers in all jurisdictions are offered the possibility to have their shareholders identified, without necessarily imposing a single model or process to achieve this objective in all EU Member States.

For ECSDA, paragraph 1, *"Member States shall ensure that intermediaries offer to companies the possibility to have their shareholders identified",* should be understood in this context, and should not be read as a requirement for each and every institution falling under the definition of "intermediary" to provide shareholder identification services (defined as a service, involving special investigations, aimed at providing issuers with information on the identity of their shareholders, including shareholders which are not clients of the service provider). Rather, each intermediary established in the EU should be expected, based on article 3a(1), to provide information on its clients which are shareholders in a given company at the request of this company or its agent.

From a CSD perspective, there are three dimensions to consider:

1. **In most markets, for registered securities, the CSD maintains a nominative register which constitutes the legal record of shareholders**. The CSD manages operations related to positions in the register such as changes in ownership, corporate actions, etc. When the CSD does not maintain the shareholders' register, it provides the relevant registrars with records on the new owners of the securities as a result of the settlement process. When the CSD maintains the shareholders' register and shareholder identification is mandatory under the applicable laws (e.g. when the CSD settles at an individual-segregated account level), the CSD might be responsible for all related ownership data and the issuers' right to identify its shareholders is satisfied accordingly.

2. **Very few shareholders (i.e. the ultimate owners of the securities) have a direct contractual relationship with a CSD**, given that CSD participants, as a rule, are not retail investors. This is often also the case in markets where beneficial owner accounts are maintained at the CSD level (see footnote 4). In some cases however, a financial institution acting as CSD participant can be the ultimate shareholder in a company (if it holds securities on its own behalf rather than on behalf of its clients, e.g. institutional investors). In such cases, CSDs will thus fall under the obligation to provide the company with information on the identity of that participant if the company so requests.

3. **In some EU markets, CSDs can play a role as central collectors of information on shareholders** whereby the CSD, on behalf of the issuer or its agent, requests information on ultimate owners from intermediaries further down the holding chain and reconciles this information

with the positions held by these institutions in the CSD's books (to protect the integrity of the securities issue)[7]. Such central mechanisms are often considered as highly efficient by companies using them and, for ECSDA, it is important that these be preserved and, if necessary, further improved and developed in the future. We do not think that article 3a(1) should be read as imposing a different model in these markets. Instead, **we believe that art 3a(1) of the proposal should allow Member States to accommodate well-functioning mechanisms already in place, as long as the national framework in each country supports the achievement of the SRD objectives.**

- **Clarifications required on art.3a(3)**

Point (3) of art.3a requires intermediaries to inform shareholders *"that their name and contact details may be transmitted for the purpose of identification in accordance with this article"*. **It is important to clarify that, where the shares are indirectly held through intermediaries, this responsibility rests with the intermediary which directly provides a securities account for the shareholder and not with other intermediaries on higher levels of the holding chain which do not have a direct relationship with the shareholder.** Furthermore, in addition to the name and contact details, we believe that it is important to report the amount of rights held by the shareholder. This information should contribute to the reconciliation of rights at top tier level and prevent the creation of rights going beyond the number of securities issued.

Article 3a(3) also states that *"the intermediary […] shall not conserve the information relating to the shareholder for longer than 24 months after receiving it."* ECSDA wonders whether, for consistency purposes, it might not be preferable to refer to applicable data protection rules rather than to include an explicit limit of 24 months in the directive. **In any event, ECSDA calls on the EU legislator to ensure that the requirements on the retention of shareholder information under art.3a(3), where relevant for CSDs, will not conflict with art.29 of the CSD Regulation on recordkeeping** which requires CSDs to *"maintain, for a period of at least ten years, all the records on the services and activity provided, including on the ancillary services referred to in Sections B and C of the Annex."*[8]

[7] For instance, in Italy, the national law provides that: *"Where envisaged in the Articles of Association, Italian companies with shares admitted for trading with the consent of the issuer on regulated markets or multilateral trading systems in Italy or another European Union country, may at any time and at their own expense call upon intermediaries – through a central depository – to provide data identifying shareholders that have not specifically denied consent to such disclosures, together with the number of shares registered on accounts in their names."* This provision allows the CSD to pass on information from issuer to intermediary and vice versa using a standard communication procedure.

[8] See http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208512%202014%20INIT. The details of the CSDR recordkeeping requirements will be further specified in technical standards, including a list of the required records to be kept by CSDs.

3. CSDs and the transmission of information (new art.3b)

ECSDA fully agrees with the principle behind the requirements in article 3b, i.e. that intermediaries should pass on any request for information (or a response to a request for information) on shareholders to other intermediaries in the chain. Nonetheless, in order to ensure a fair and proportionate application of this principle, **the CSD (or intermediary) should not be held liable in case the information it transmits to other intermediaries is incorrect if it has itself received such incorrect information from another entity in the chain.** It would be neither realistic nor efficient, indeed, to expect each intermediary in the chain to check and investigate whether the information it has received from a third party is accurate. In the case of CSDs, limiting such liabilities is especially important to ensure that the CSD maintains a low risk profile, as required by the CSD Regulation.

As previously noted, in some markets, CSDs not only hold the shareholders' register, which contains the list of legal owners in the securities, but also centralise shareholder information for those securities held in nominee accounts. In such cases, we understand that articles 3a and 3b will require other intermediaries (including CSD participants and their clients) to transmit the relevant information to the CSD upon request – directly or via a chain of intermediaries, so that the CSD can provide complete information to the issuer.

4. Facilitating the exercise of shareholder rights (new art.3c)

ECSDA understands that the objective of article 3c(1) is to ensure that shareholders have the possibility to exercise their rights, and that intermediaries maintaining accounts on behalf of shareholders do not impede on that right. ECSDA supports this objective and agrees that intermediaries maintaining accounts for shareholders should provide services to facilitate the exercise of shareholder rights. We also note that, due to their unique role as providers of securities accounts at the top tier level and due to their proximity with the issuer, CSDs facilitate the exercise of shareholder rights. In particular, CSDs are responsible for initiating corporate actions, such as the distribution of dividends, options or other rights flowing from securities, upon the instruction of the issuer.

Nonetheless, we wish to ensure that art.3c, including the somewhat confusing phrase *"at least either"* in the second sentence of paragraph 1, is not interpreted as an obligation for CSDs to provide services such as casting votes on behalf of shareholders, which they typically do not provide today[9].

[9] Article 3c(1)(b) refers to cases where *"the intermediary exercises the rights flowing from the shares upon the explicit authorisation and instruction of the shareholder and for his benefit."* ECSDA understands that in a few markets it might be possible for CSDs to be appointed by shareholders to hold the shares on their behalf, but this is not a widespread practice.

5. Transparency of costs (new art.3d)

ECSDA accepts that **CSDs providing the services referred to in Chapter IA should be subject to the transparency requirements under article 3d, similarly to intermediaries and other actors providing such services.** We believe that justifications can be provided to explain the difference in costs between domestic and cross-border services, and we note that cross-border services typically involve more complex investigation, lengthy (and hence costly) procedures resulting from existing differences in national securities and company laws, market practices and tax regimes, as well as from the usually 'longer chain' of intermediaries.

6. The importance of national transposition

We recognise that, by definition, a Directive is not as precise as a Regulation and that some flexibility is needed for Member States to transpose the SRD requirements into national law, taking into account the existing market structure and local constraints. For CSDs, such flexibility is important given the variety of solutions that have been developed in different markets to achieve shareholder transparency. The role of the CSD in facilitating shareholder identification and the exercise of shareholder rights, in particular, varies greatly from one market to the other, as does the breadth of services provided to issuers and/or shareholders by CSDs. **Rather than imposing a single model for shareholder identification, the SRD review should allow Member States, when applicable, to maintain or even reinforce the well-functioning models of shareholder identification that are already in place today.**

Annex: Role played by CSDs in relation to shareholder rights and identification

In addition to providing securities accounts at the top tier level and the initial recording of securities in a book-entry system, CSDs are also typically responsible for maintaining the integrity of the issue, as defined under article 37 of the CSD Regulation. This means that CSDs must *"verify that the number of securities making up a securities issue (…) is equal to the sum of securities recorded on the securities accounts of the participants of the securities settlement system operated by the CSD and, where relevant, on owner accounts maintained by the CSD."* This function is unique to CSDs and distinguishes them from intermediaries.

Other types of "issuer services" are offered by CSDs across Europe. They are described in a report published by ECSDA in October 2013[10] and include, among others:

- **registrar services**, whereby the CSD maintains a nominative register which constitutes the legal record of shareholders. The CSD manages operations related to positions in the register such as changes in ownership, corporate actions, etc.;
- **shareholder information services**, whereby the CSD provides information (whether aggregated or not) to issuers or the public regarding the shareholders of a company.

In practice, the vast majority of CSDs provide registrar services[11] for registered shares (81% according to the ECSDA report), sometimes as a compulsory service under national law, while only around 60% of CSDs provide shareholder information services, usually on an optional basis. It is also important to note that even in cases where the CSD does not maintain the shareholders' register, as the change in legal ownership is a result of the finality of the settlement process, the relevant registrars use the information provided by the CSD to determine the owners of the securities and update the register.

Shareholder information services are typically provided by CSDs to help issuers overcome the limitations of "nominee accounts", which do not allow for the identification of the ultimate beneficial owners since the shares are registered in the name of the intermediary holding the shares on behalf of the investor. Such services are especially important in a cross border context because even direct holding markets requiring beneficial owner accounts at CSD level typically allow intermediaries to open omnibus / nominee accounts for non-domestic investors. An example of the latter case is VPS' "Nominee ID" service[12]. VPS, the Norwegian central securities depository, helps companies (which subscribe to the service) identify the actual beneficial owners of shares rather than the nominee name shown on the company's register of shareholders in VPS. Such services are often provided by CSDs in cooperation with other market actors.

[10] See http://www.ecsda.eu/uploads/tx_doclibrary/2013_10_ECSDA_IS_Report.pdf

[11] CSDs can be described as the "first entry point" for newly created securities, although not all CSDs are responsible for maintaining the register of shareholders/investors and for ensuring the integrity of the issue. In some countries like the UK, ownership records in securities are maintained by third parties called registrars. In other countries like Switzerland, registration and information services are not provided by the CSD entity itself (SIX SIS), but by another, separate entity within the same corporate group (SIX SAG, a subsidiary of SIX SIS Ltd). For the many CSDs performing that role, however, it is natural that they are seen by market participants, issuers and regulators as a central source of information on securities holders.

[12] See more details at: http://www.vps.no/vps_eng/Issuer/Products/Nominee-ID

Finally, in addition to providing services to issuers, the CSD in which the securities are issued also performs services to facilitate the exercise of shareholder rights. For example, the CSD is responsible for initiating the corporate actions process (e.g. distribution of dividends, options or performing swaps on the date determined by the issuer) and for launching the cascade of information related to securities (e.g. on debt restructuring).