

Account segregation practices at European CSDs

TABLE OF CONTENTS

Executive Summary 3

1. Account segregation: Key concepts 6

2. Current practices in CSDs across Europe 9

3. Implications of different levels of segregation 19

4. European regulatory framework 27

5. Future trends 29

Annex 1: Glossary 31

Annex 2: Useful references 33

Executive Summary

This report aims to inform the debate on account segregation from the perspective of central securities depositories (CSDs). It focuses on the domestic practices of CSDs and their participants.

All financial institutions providing securities accounts to clients are subject to specific rules on account segregation. In recent years, several new rules have been adopted, especially at EU level, to determine the cases where securities accounts of clients must be maintained separately from the accounts of other clients. Segregation can take different forms, and it can occur at different levels, e.g. at financial intermediaries or at the level of financial market infrastructures like central clearing counterparties (CCPs) and CSDs.

The first two sections of the report describe current segregation practices at European CSDs using a new methodology of harmonised definitions. The 41 members of ECSDA are classified into four groups according to the type of segregated accounts made available to CSD participants and whether or not the use of segregated accounts is compulsory. This is summarised below.

| | |
|--|--|
| <p>Group A: Omnibus markets</p> <p>CSDs do not have direct access to information on the identity of individual clients of CSD participants or on end investors, even if CSD participants use different accounts for segregation purposes.</p> | <p>14 countries (15 CSDs):</p> <p>AT, BE, CH, DE, FR, HU, IT, LT, LV, NL, PL, PT, RU, UA</p> |
| <p>Group B: Hybrid markets with individual client segregation</p> <p>CSDs offer a special type of account allowing CSD participants to segregate securities of individual clients, whereby the CSD has direct access to information on the identity of individual clients.</p> | <p>2 countries (4 CSDs):</p> <p>ES, LU</p> |
| <p>Group C: Hybrid markets with end investor segregation</p> <p>CSDs offer a special type of account allowing CSD participants to segregate securities of end investors, whereby the CSD has direct access to information on the identity of end investors.</p> | <p>9 countries (9 CSDs):</p> <p>CY, CZ, DK, EE, IS, RO, SE, SK, UK</p> |
| <p>Group D: Segregated markets</p> <p>CSDs offer a special type of account allowing CSD participants to segregate securities of individual clients or end investors whereby the CSD has direct access to information on the identity of individual clients or end investors. In addition, the use of segregated accounts is legally compulsory for domestic participants and/or investors, at least for shares and sometimes for all financial instruments.</p> | <p>12 countries (13 CSDs):</p> <p>BA, BG, FI, GR, HR, ME, MK, MT, NO, RS, SI, TR</p> |

The last three sections of the report examine the implications of different segregation options for CSDs, their clients, end investors, issuers and regulators.

The report does not seek to recommend a particular segregation model but merely aims at informing the current debate on account segregation. Here are some key conclusions:

- There is a **multiplicity of segregation models used for domestic settlement** across Europe. In addition, within each grouping, the practicalities of account segregation can vary (e.g. whether subaccounts or separate accounts are used), as well as market participant preferences (in hybrid markets in particular, segregated accounts may be seldom or very frequently used). A consistent terminology and a better understanding of existing practices and challenges at CSD level is necessary before a more detailed analysis is undertaken on the pros and cons of different segregation models.
- **The right level of segregation cannot be reduced to a trade-off between safety and efficiency.** In fact, in many cases, national law appears to be a much more determining factor than CSD account segregation practices in terms of investor protection and issuer transparency. Most CSDs which took part in the ECSDA survey indicated that there was no difference in terms of investor protection between omnibus and segregated accounts. In other words, investor rights seem more dependent on the national legal framework than on the type of account used in the CSD.
- **Individual client or end investor account segregation typically does not apply in cross-border scenarios.** CSD links operate on the basis of omnibus accounts in order to avoid complex and inefficient procedures for cross-border settlement. Even in markets which require significant segregation by domestic participants (up to the level of end investors), omnibus accounts are allowed and recognised as necessary to allow non-domestic CSDs to access the local market efficiently. This is especially true for CSDs participating in the Eurosystem TARGET2-Securities (T2S) project.
- **There is a complex and sometimes inconsistent interaction between different pieces of EU law as regards segregation rules for securities accounts.** The development of CSD links, encouraged by T2S, has resulted in more widespread availability of omnibus accounts at CSDs. However, some pieces of EU law such as EMIR seem to encourage the use of segregated accounts, at least at the level of market intermediaries. Recent non-binding ESMA guidance on asset management legislation (AIFMD) also seems to impose greater segregation on certain CSD participants (fund depositary banks), although this is not entirely clear and somewhat contradicts Level 1 legislation.

- Although regulatory complexity creates uncertainty on the combined impact of existing and future account segregation rules, the notion of "investor choice" introduced by the CSD Regulation (2014) could in the medium term result in a **progressive convergence of existing practices at CSDs, with segregated and omnibus accounts being offered as a choice, rather than being imposed by law.**

ECSDA hopes that this report will contribute to a better understanding of CSD account segregation practices and that it will stimulate a more informed debate on the issue of segregation with other stakeholders including market intermediaries, issuers, investors and regulators.

1. Account segregation: Key concepts

Account segregation refers to the practice of maintaining separate accounts for securities belonging to different clients, different groups of clients, different business lines, or securities belonging to the same client but with different characteristics (e.g. different types of financial instruments or instruments used for different purposes). The concept can also apply for cash accounts, and it is not uncommon to hear the term "asset segregation" used interchangeably with account segregation, although the meaning of this concept varies depending on what is deemed to constitute an "asset".

This report focuses on account segregation in relation to securities, in a CSD context where CSD participants have the possibility – or, in some cases, the obligation – to open several accounts at the CSD to distinguish between different types of securities holdings. Segregation at the level of intermediaries is outside the scope of this report and the following definitions should thus be understood as referring to accounts maintained at CSD level:

| | |
|----------------------------------|--|
| End investor | The underlying investor, whether a natural or legal person, who holds securities for its own account and enjoys the benefits of ownership in the securities, even if the securities are held or recorded in the CSD in another name (e.g. trustee or nominee). Also called "beneficial owner". |
| End investor account | A securities account in which all the securities belong to a single end investor. Even if the end investor account is maintained by a CSD participant, the CSD has access to information about the identity of end investors. Also called "beneficial owner account". |
| Individual client account | A securities account in which all the securities belong to a single client of a CSD participant. Also called "single client account". |
| Omnibus account | A securities account in which the securities belong to multiple clients of a CSD participant, including or excluding a CSD participant's own securities. |
| Segregated account | A securities account maintained by a CSD participant which is distinct from other securities accounts of that participant. A segregated account can: <ul style="list-style-type: none"> - Be a fully separate account from the other accounts of the CSD participant or be a subaccount of the CSD participant; - Be opened in the name of a single client or in the name of the CSD participant (who might give the account any denomination it chooses); - Include securities belonging to a single end investor (end investor account) or to multiple end investors (individual client account), depending on whether the single client of the CSD participant is itself holding securities on behalf of others. |

Subaccount

A securities account opened and managed by a CSD participant with reference to another, "main" account. Participants typically open several subaccounts in order to maintain separate sub-balances within the overall balances of the main securities account. From a functional perspective, separate subaccounts function as if they were separate accounts. The main difference with a separate securities account is that the client data attached to the subaccount is necessarily identical to that of the main account, whereas separate securities accounts (even if managed by a single CSD participant) can have different client data attached to them.

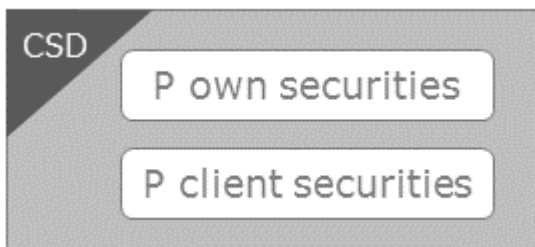
See also Annex 1 for a full glossary of the terms and acronyms used in this report.

These definitions enable us to distinguish three main degrees of segregation at CSD level:

Level "0" corresponds to a situation where a securities account is used by a CSD participant to hold both securities belonging to the participant itself, and securities belonging to the participant's clients (if such commingling is permitted by the participant's regulatory framework). In other words, there is no segregation of client assets other than the separation between the account of participant P from the accounts maintained by other participants in the CSD.

Within the securities account of P, the CSD is not able to identify which securities belong to the participant itself, and which securities are held on behalf of the participant's clients.

- **Level 1: Omnibus client segregation**



The first level of segregation at a CSD corresponds to a situation where a participant P uses separate accounts for holding its own securities and for holding securities on behalf of its clients.

The term "omnibus client segregation" is defined in article 38 of the CSD Regulation (CSDR).

- **Level 2: Individual client segregation**

Under Level 2, a participant maintains separate accounts at the CSD for separate clients. If Participant P, for example, holds securities on behalf of two clients A and B, individual client segregation requires two separate accounts at the CSD: one for holding securities belonging to A, and one for holding securities belonging to B.



P, for example, holds securities on behalf of two clients A and B, individual client segregation requires two separate accounts at the CSD: one for holding securities belonging to A, and one for holding securities belonging to B.

Several set-ups are possible at this level, all of which are compatible with the definition of "individual client segregation" contained in article 38 of the CSDR:

- The accounts may be fully independent accounts or subaccounts of the CSD participant;
- The accounts may be opened in the name of the participant, or they may be opened in the name of A or B respectively;
- The CSD may or may not have access to information on the identity of clients A and B, and it may or may not know that the securities held in the individually segregated accounts are held on behalf of A and B;
- Clients A and B may be end investors, or they may be intermediaries holding securities on behalf of other investors.

▪ **Level 3: End investor segregation**

Level 3 involves the highest degree of segregation. It requires the opening of a separate securities account for each end investor, including retail investors. Under this model, the information on the identity of the end investor is usually attached to the securities account maintained at the CSD, although the



CSD has no direct relation with the end investor and the securities account is managed by a CSD participant.

For example, participant P operates two accounts at the CSD, for end investor X and end investor Y

respectively. Both are clients of bank A, A being a client of P. Client A may have proprietary holdings (whereby it invests in securities for its own account), in which case these securities will also be held in a segregated "end investor account" at the CSD.

In practice, securities are not deposited with P, but with the CSD: P operates the three accounts at the level of the CSD.

What about nominees?

The term "nominee" is sometimes used to refer to omnibus accounts, although it is not an exact synonym. A nominee arrangement is a legal structure which may be used to support an omnibus account structure. Nominee companies are commonly used in the UK and Ireland to optimise asset protection when holding securities on behalf of clients at a CSD or at another financial institution. In other jurisdictions, the term nominee may be used as a simple identifier which indicates that a CSD participant holds securities on behalf of third parties (its clients).

2. Current practices in CSDs across Europe

In order to assess the impact of regulation and to anticipate future trends in account segregation practices, it is important to first understand the current account segregation options available at CSDs. From April to June 2015, ECSDA carried out a fact-finding survey among its members in order to collect comparable information on prevalent segregation practices. All 41 ECSDA members participated in the survey, covering 37 European countries.

For ease of reading, individual CSDs are subsequently referred to by using a 2-letter country code or short name, as follows:

| Country | Short name / Acronym | Full name |
|---------|----------------------|---|
| AT | OeKB CSD | OeKB CSD GmbH |
| BA RS | Central Registry RS | Central Registry of Securities JSC Banja Luka |
| BA | RVP | Registry of Securities |
| BE | EB | Euroclear Bank |
| BE | EBE | Euroclear Belgium |
| BG | CDAD | Central Depository AD |
| CH | SIX SIS | SIX SIS Ltd |
| CY | CSE | Cyprus Stock Exchange |
| CZ | CSD Prague | Central Securities Depository Prague |
| DE | CBF | Clearstream Banking AG |
| DK | VP | VP Securities |
| EE | ECSD | Estonian CSD |
| ES | Iberclear | Iberclear |
| FI | EFI | Euroclear Finland |
| FR | EF | Euroclear France |
| GR | ATHEXCSD | Hellenic Central Securities Depository SA |
| HR | SKDD | Central Depository & Clearing Company Inc. |
| HU | KELER | KELER Ltd. |
| IS | NCSD | Nasdaq CSD Iceland |
| IT | Monte Titoli | Monte Titoli |
| LT | CSDL | Central Securities Depository of Lithuania |
| LU | CBL | Clearstream Banking Luxembourg |
| LU | globeSettle | globeSettle SA |
| LU | LuxCSD | LuxCSD SA |
| LV | LCD | Latvian Central Depository |
| ME | CDA | Central Depository Agency of Montenegro |
| MK | CSD AD Skopje | Central Securities Depository AD Skopje |
| MT | MSE | Malta Stock Exchange |
| NL | ENL | Euroclear Nederland |
| NO | VPS | The Norwegian Central Securities Depository |
| PL | KDPW | The Central Securities Depository of Poland |
| PT | Interbolsa | Interbolsa |

| | | |
|----|---------|--|
| RO | DC | Depozitarul Central |
| RS | CR HoV | Central Securities Depository and Clearing House |
| RU | NSD | National Settlement Depository |
| SE | ESE | Euroclear Sweden |
| SI | KDD | Central Securities Clearing Corporation |
| SK | CDCP SR | Central Securities Depository of the Slovak Republic |
| TR | MKK | Central Securities Depository of Turkey |
| UA | NDU | National Depository of Ukraine |
| UK | EUI | Euroclear UK & Ireland |

2.1 General considerations

Comparing existing account segregation models of CSDs is not an easy task. Many CSDs offer several types of accounts, but they rarely use the same denominations, and the lack of harmonised terminology is a first obstacle. Second, there are differences in legal requirements, with national law sometimes imposing the use of segregated accounts at CSDs, at least in certain cases. Third, there are differences in market practices and investor preferences, which explain why CSDs offering broadly similar account segregation options and operating in markets of similar size may still display a higher or lower number of securities accounts. Lastly, there are some operational and practical considerations linked to the CSD system, for example some CSDs work with subaccounts whereas others do not work with subaccounts at all.

The concepts defined in Section 1 are not legal terms. They only aim at providing a harmonised terminology so that CSD account segregation practices can be compared in a meaningful way. Indeed, existing legal definitions only imperfectly capture actual segregation practices. For example, the definition of "beneficial owner" in EU law does not include all end investors in securities, but only individuals or entities who are considered to exercise control over a corporation or other legal entity (e.g. by owning more than 25% of the shares in a company), or on behalf of whom a transaction or activity is conducted¹. The notion of "end investor", in contrast, does not necessarily imply control (an end investor could own only 0.1% of the shares of a company) and is not linked to a legal entity, but rather to a financial instrument (which can be an investment fund or a bond, for instance).

Moreover, the CSDR definitions of "omnibus client segregation" and "individual client segregation" are not sufficient to understand existing CSD models of account segregation. This is because all CSDs allow for individual client segregation, and the vast majority of CSDs allow for omnibus client segregation; they are not mutually exclusive. Even in those markets where the use of segregated accounts is legally required at CSD level, omnibus accounts are often allowed for foreign custodians or CSDs.

¹ See art.3(6) of the 4th EU Anti-Money Laundering Directive (Directive 2015/849 of 20 May 2015). The definition of "beneficial owner" in the AML Directive does not involve any considerations from the point of view of property law or company law but aims at identifying ownership interests in corporate entities.

As for the possibility not to segregate at all (not even at the level of omnibus client segregation), it is rather marginal as 33 out of 37 European markets have rules in place requiring CSD participants to use separate accounts for their own assets and for client assets. Besides, even in the few countries where omnibus client segregation is not explicitly required by law, there is typically a legal presumption that assets held by participants at the CSD are client assets, unless they are explicitly notified to the CSD as proprietary assets of the participant. This presumption serves to protect investors in case of a participant's insolvency.

2.2 CSD groupings

Considering the limitations of CSDR definitions, ECSDA has sought to determine additional criteria, keeping in mind that any type of categorisation is somewhat arbitrary and leads to over-simplifying certain realities in order to facilitate comparisons. The below criteria include three additional considerations, in order to more accurately reflect the diversity of account segregation models:

- The distinction between "individual client segregation" (defined in the CSDR) and "end investor segregation" (not defined in the CSDR);
- Whether or not the CSD has direct access to information on the identity of the account holder on behalf of whom the segregated account is maintained (whether the account holder is an individual client of a CSD participant or an end investor);
- Whether the use of segregated accounts is required by law (whether for individual clients of CSD participants or for end investors), at least for certain financial instruments and/or for certain types of account holders.

The result is shown in Table 1. The four groups of CSDs identified in the table are only one of many possible ways to look at CSDs' account segregation practices. As imperfect as these groupings are, they can help us understand how national markets have evolved to date, and how CSDs and their participants go about managing securities accounts.

Table 1: Main CSD groupings based on account segregation practices

| | Group A: Omnibus markets | Group B: Hybrid markets with individual client segregation | Group C: Hybrid markets with end investor segregation | Group D: Segregated markets |
|--|---|---|--|---|
| Level 1: Omnibus client segregation | Possible | Possible | Possible | Only possible in limited cases, often restricted to cross-border activity |
| Level 2: Individual client segregation | Possible, but not visible to the CSD | Optional, visible to the CSD | Optional, visible to the CSD | Mandatory: individual client or end investor segregation is required by law |
| Level 3: End investor segregation | Possible, but not visible to the CSD | Possible, but not visible to the CSD | Optional, visible to the CSD | |

▪ **Group A: Omnibus markets**

This is the largest grouping among ECSDA members. These markets are characterised by the absence of a special type of securities account for segregating individual client or end investor holdings at CSD level. CSD participants can open a segregated securities accounts for any of their clients (either in the form of separate accounts or subaccounts), but these accounts are not necessarily opened in the name of individual clients or end investors and the CSD does not usually have access to information on the identity of the account holders, unless provided by the CSD's direct client.

14 markets fall under this grouping: AT, BE, CH, DE, FR, HU, IT, LT, LV, NL, PL, PT, RU, UA.

In these markets, omnibus accounts are the norm at CSD level and individual client accounts are typically maintained in the books of intermediaries (CSD participants and their own clients).

In practice, there is no operational or legal difference between segregated accounts and omnibus accounts, even if many CSDs allow participants to flag certain accounts as "proprietary" accounts, i.e. accounts in which CSD participants hold their own securities, as opposed to client securities.

Although information on the identity of individual clients or end investors is not directly accessible to the CSD through the accounts maintained in the CSD system, the CSD often retains the right to request beneficial ownership information from its participants for compliance purposes, or in the context of investor identification services performed on behalf of securities issuers.

Despite the absence of a legal obligation requiring CSD participants to maintain segregated accounts for individual clients or end investors at CSD level, omnibus markets can be subject to targeted segregation requirements for certain types of investments. In Portugal for instance, CSD participants

are required by law (CMVM Regulation 14/200) to open a segregated account at the CSD for their clients which are investment funds and pension funds. Nevertheless, even in this case, the CSD (Interbolsa) does not have access to the information on the identity of the end investor.

- **Group B: Hybrid markets with individual client segregation**

In hybrid markets with individual client segregation, there exists a special type of securities account at CSD level allowing CSD participants to segregate individual client holdings, whereby the CSD has direct access to information on the identity of the individual client on behalf of whom the segregated account is maintained.

Today, this model is in force in Luxembourg, and it is expected to be implemented in Spain in the near future following a reform of the securities market (until then, Spain is still falling under Group A).

Like in Group A markets, omnibus accounts are commonly used by CSD participants. However, unlike in Group A markets, information on the identity of individual clients of CSD participants is available to the CSD in the CSD system when CSD participants make use of segregated accounts.

In Luxembourg, CBL, LuxCSD and globeSettle offer a type of account called "segregated account", which the CSD can operationally distinguish from an omnibus account. The use of omnibus accounts is actually only allowed if CSD participants are authorised as professional securities intermediaries. Segregated accounts, however, are not necessarily end investor accounts. CSD participants, when using such accounts, are requested to provide the identity of their individual client, who may or may not be the end investor in the security.

In Spain, Iberclear will offer participants the possibility to open individually segregated accounts as well as omnibus accounts at CSD level. For segregated accounts, participants will be requested to provide the identity of individual clients, so that the latter benefit from the presumption of being the legitimate owners of the securities registered therein.

In case individual clients of CSD participants are also the end investors in the securities, there is no practical difference between Group B and Group C markets. However, where the individual clients of CSD participants are not end investors and there is a longer chain of intermediaries, the CSD will not have access to end investor information, unlike in Group C markets.

- **Group C: Hybrid markets with end investor client segregation**

These markets are characterised by the possibility for CSD participants to open a special type of segregated account for end investors (usually called "beneficial owner account") which allows the CSD to access information on the identity of end investors.

The 9 hybrid markets with end investor client segregation are CY, CZ, DK, EE, IS, RO, SE, SK, UK.

This grouping is heterogeneous and includes CSDs with millions of end investor accounts (e.g. DK, RO) as well as CSDs in which the number of end investor accounts is limited to a few thousands (e.g. UK). Although the number of end investor accounts is almost always higher than the number of omnibus accounts, in practice the value of securities held on all omnibus accounts can be higher than the value of securities held on all end investor accounts (e.g. SE).

Unlike in Group D markets, CSD participants are not legally required to use segregated accounts at CSD level. Nonetheless, Group C markets sometimes consider end investor accounts as the "default option", whether through provisions in the law or in the CSD's own rules. In Denmark and Estonia for instance, an end investor can opt to hold its securities holdings in an omnibus account at the CSD, but the law foresees the use of end investor accounts as standard practice, requiring financial intermediaries to obtain prior express written consent from end investors in order to hold client assets in an omnibus account.

In Romania and the Czech Republic, the high number of end investor accounts maintained at the CSD is in large part a result of the mass privatisation programmes of the 1990s². Since then, however, the number of omnibus accounts has increased. In Romania, all CSD participants now resort to omnibus accounts for holding client securities, whereas in the Czech Republic, omnibus accounts are currently used by less than half of CSD participants. In both cases, end investor accounts exist as a distinct option next to omnibus accounts and, whenever end investor accounts are used, the CSD has access to information about the identity of end investors.

In Cyprus, until recently, end investor accounts at CSD level were required for holding equities, and omnibus accounts were only allowed for government securities. Today, however, it is possible for CSD participants to open omnibus accounts for holding any kind of securities, albeit subject to strict conditions: participants must comply with European regulations on anti-money laundering and the fight against the financing of terrorism; they must obtain the consent of end investors; and they must maintain detailed information on beneficial owners allowing them to respond promptly to any request from the Cyprus Securities and Exchange Commission.

In the UK, the CSD offers the possibility of "personal membership"³, which in effect allows end investors to obtain a segregated account at the CSD, as well as to appear on the legal register (becoming not only beneficial owners but also legal owners). Personal member accounts are *de facto* end investor accounts and CSD participants acting as "sponsors" for personal members can be compared to account

² In Romania for example, according to the first Privatization Law, every Romanian citizen over 18 years old received coupons which have been subscribed in exchange for shares in one of the joint stock companies participating in the privatization process. The majority of these shareholders do not trade their shares and keep them in the Registry Section of the CSD, in order to benefit of dividends or other rights. It is usually when they sell their shares that they conclude an agreement with a CSD participant, thereby allowing the shares registered in the Registry Section to be transferred to a participant's omnibus account at the CSD.

³ See <https://www.euroclear.com/dam/Brochures/Personal-membership-EUI.pdf>

operators in fully segregated markets. Most end investors however opt for an omnibus account with their intermediary.

- **Group D: Segregated markets**

This group includes CSDs operating in markets where the use of segregated accounts at CSD level is mandatory, at least for certain types of financial instruments and/or for certain types of account holders. This means that CSD participants can only use omnibus accounts in specific cases, often for cross-border activity. CSDs in these markets offer a special type of segregated accounts for end investors, often called "beneficial owner account". More rarely, segregated accounts are maintained at the level of individual clients of CSD participants (who are not necessarily the end investors). These segregated accounts include information on the identity of the account holders, which is available to the CSD.

12 markets call under this grouping: BA (including the Republika Srpska), BG, FI, GR, HR, ME, MK, MT, NO, RS, SI, TR.

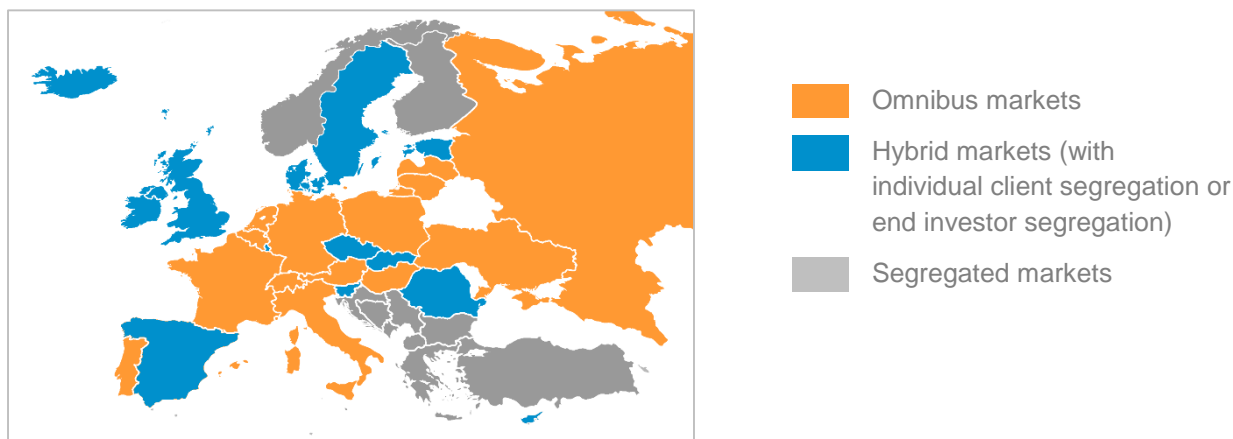
Due to the legal requirement to use segregated accounts, CSDs operating in Group D markets tend to maintain a high number of securities accounts. End investors however do not interact directly with the CSD and segregated accounts are managed by authorised CSD participants, often called "account operators" because they are mandated by clients to manage their securities accounts at the CSD. Account operators are responsible for performing know-your-customer (KYC) and anti-money laundering (AML) checks, as well as for managing the relationship with end investors. In some markets (e.g. Nordics) and only in very limited cases, the CSD might act itself as account operator for end investors, but such a scenario is marginal and typically reserved for inactive investors (long-term holdings with no trading activity). As soon as these investors wish to transact in the securities or access value-added services, they have to appoint a bank as account operator⁴.

The requirement to use end investor accounts at CSD level varies from country to country. In most markets, compulsory segregation applies to all or most financial instruments (e.g. shares, bonds, money market instruments, investment funds), and irrespective of whether the issuer of the financial instrument is a foreign or domestic entity. In Norway however, end investor segregation is only required for equity holdings, provided that the companies issuing the shares are domestic companies. Omnibus accounts are commonly used for holdings in debt instruments.

Omnibus accounts are usually allowed in limited cases, for example in the case of non-domestic CSD participants (foreign custodians). While the compulsory segregation requirement always applies to domestic CSD participants, in 2/3 of the markets, foreign participants are also subject to the requirement, although it usually only applies to domestic end investors (e.g. FI). In 4 markets (BA, BG, ME, NO), foreign participants are exempt from the segregation requirement.

⁴ This is also true for some hybrid markets with end investor segregation.

Chart 1. Segregation models in 37 European markets



How does T2S accommodate segregated markets?

TARGET2-Securities (T2S) is an IT platform developed by the Eurosystem to which CSDs can outsource the processing of settlement instructions in central bank money. T2S is not a full scale CSD system: the platform allows for a standardisation of the settlement process between CSDs and intermediaries, but it does not provide CSD services in relation to issuance or corporate actions.

T2S works on the basis of omnibus client segregation, and a solution has had to be developed to allow CSDs operating in segregated markets to use T2S without being exposed to unreasonable costs and complexity. This solution is called the "layered model".

Segregated markets have the option to open two types of securities accounts in T2S:

(1) "Normal" accounts are mirrored 1:1 in both T2S and the CSD-systems, as in the case of omnibus accounts. These accounts are used for transfers between CSD participants and/or for safekeeping purposes.

(2) "Special" accounts correspond to end investor accounts in the CSD system, mirrored by a pooled omnibus account in the name of the CSD at T2S level. For example, if Client X of Participant P1 has a delivery to Client Y of Participant P2, the transaction occurs as follows:

(a) P1 needs to instruct a free of payment (FoP) delivery from the end investor account of Client X in the CSD to the P1 omnibus account maintained by the CSD in T2S. In T2S, this means an FoP transfer from the "special" omnibus account of the CSD to P1's account.

(b) A delivery-versus-payment (DvP) settlement occurs between the accounts of P1 and P2 maintained by the CSD in T2S.

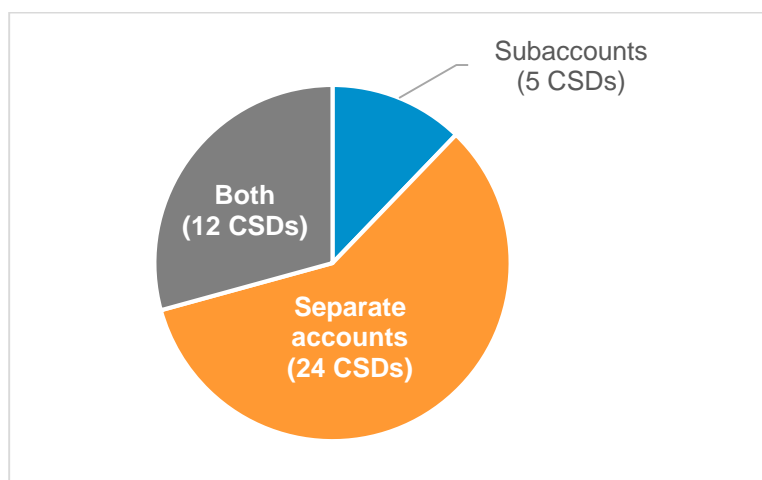
(c) Finally, P2 instructs an FoP delivery from its omnibus account maintained by the CSD in T2S to the end investor account of Client Y in the CSD. In T2S, this means an FoP transfer from P2's account to the "special" omnibus account of the CSD.

2.3 Subaccounts

Segregated accounts can take the form of fully independent accounts or of subaccounts, the distinction being primarily operational and dependent on how the CSD system is designed. A subaccount is a special type of securities account which is attached to the "main" account of a CSD participant. Participants typically open several subaccounts in order to maintain separate sub-balances within the overall balances of their main account. The consideration of whether a subaccount is used is not very relevant when comparing CSD groupings, but it is nevertheless interesting to understand why and how often subaccounts might be used. Based on the findings of the ECSDA survey, it appears that:

- In omnibus markets (Group A), CSD participants can usually segregate client assets using subaccounts. They nonetheless retain the possibility to use separate accounts if they so wish. In Portugal, Interbolsa does not offer subaccounts and separate securities accounts must thus be used for segregation purposes;
- In hybrid markets (Groups B and C), segregated accounts usually take the form of separate accounts. Subaccounts, where available, are primarily used by CSD participants for omnibus and individual client segregation (rather than for end investor segregation);
- In segregated markets (Group D), separate accounts are used for end investor segregation. In the two cases where CSDs also offer the possibility to use subaccounts (FI, MT), separate accounts remain the rule.

Chart 2. Type of CSD accounts available for segregation purposes



CSD participants have full discretion to manage and name subaccounts, and they can decide to segregate assets in these accounts based on any criterion they deem relevant (e.g. separating assets of different clients but also potentially different asset classes, assets subject to a different tax regime, etc.). When subaccounts are used for segregating individual client or end investor assets, the name or contact details of the (end) investor is typically not attached to the subaccount in any way visible to the

CSD. In practice, the CSD might be able to identify whether a given subaccount contains securities held on behalf of one or multiple end investors. It may even sometimes have access to information on the name of the (end) investor if the participant uses this name in the denomination of the subaccount. But this is left to the discretion of the CSD participant and further identification data is usually not available (e.g. place of residence of the end investor). Furthermore, the CSD does not have any means to assess whether the information contained in the denomination of the end investor subaccount is correct, and the CSD participant remains in any case the account owner.

In contrast, the use of separate securities accounts at CSD level often requires investor data to be attached to the account, although depending on the markets, end investor data is not always required, and CSD participants can open separate accounts for their own clients without necessarily including details on these clients, let alone on end investors.

3. Implications of different levels of segregation

The ongoing policy debate on "What is the right level of segregation?" has several dimensions. The main entities subject to account segregation requirements are intermediaries (banks, investment firms, brokers) rather than infrastructures like CSDs. Nonetheless, a discussion of optimal account structures should include a discussion on the role of CSDs, so that the responsibilities for segregation are clearly determined at all levels of the securities holding chain.

There are several ways to assess the pros and cons of account segregation, and the optimal outcome might differ depending on the perspective adopted. Amongst others, one can look at account segregation in relation to:

- Investor protection (investors' perspective);
- Investor identification and transparency (issuers' perspective);
- Legal and fiscal compliance (regulators' perspective);
- Costs and operational efficiency (operators' perspective).

This report does not cover any of these dimensions in detail, and in fact such an analysis would need to cover all levels of the securities chain, not just CSDs. However, this section provides some general considerations on the implications of different levels of account segregation in order to demonstrate that account segregation practices in themselves are only one of several factors allowing regulators, investors, issuers, CSDs and market participants to achieve their aims and perform their role in an optimal way.

3.1 Investor protection

Account segregation is often presented as a way to enhance investor protection. In practice however, the use of segregated accounts, whether at the level of banks or CSDs, does not necessarily mean that the rights of end investors are better protected. In fact, whether account segregation results in enhanced legal protection for investors depends first and foremost on national law.

- **In many markets, the same legal regime applies irrespective of the type of account used at CSD level.**

Asked whether end investor accounts at CSD level afforded investors with a higher level of legal protection on their assets, around 3/4 of the survey respondents indicated that there was no difference in terms of investor protection. For example, in all markets, when a CSD participant or another intermediary is unable to return assets belonging to an investor, the investor can claim compensation

with the relevant investor compensation scheme⁵. This applies equally to investor assets held in omnibus accounts, individual client accounts, and end investor accounts.

In omnibus markets, there is often no legal recognition of end investor accounts: national law protects the rights of all investors irrespective of the type of account used at CSD level. In other words, the fact that a segregated account is used at CSD level affects neither the legal nature of the holdings nor the rights of the investor. This is also the case in several hybrid markets.

Only in some markets (BG, DK, FI, GR, NO, RO, UK) does the use of end investor accounts at CSD level have an impact on the nature of the legal rights of investors. Where end investor accounts are used, investors' rights may be enforceable against the CSD (e.g. DK) or directly against the issuer (e.g. FI), whereas they will be enforceable against the relevant intermediary where omnibus accounts are used. In Denmark for example, the Securities Trading Act (§66) considers the account holder as the rightful owner of the securities whenever end investor accounts are used at the CSD, whereas for omnibus accounts, determining the rightful owner requires an examination of the CSD participant's records (since the information is not visible in the CSD). Such records might not be always be as accessible and as reliable as the CSD records.

But even where a different legal regime applies to segregated accounts, the extent to which such accounts provide higher investor protection can vary from one country to another, depending on the legal nature of the holdings in terms of actual, enforceable rights for end investors. Against this background, account segregation practices can be seen as a consequence of the domestic legal regime in force, rather than as a determinant of the level of investor protection. In other words, in the absence of a harmonisation of securities laws across EU countries, investor rights are more dependent on the national legal framework than they are on the type of account used in the CSD.

Different types of omnibus accounts

In some markets, there are two different types of omnibus accounts, depending on whether CSD participants are domestic or foreign entities. The reason for this difference lies in national law, and illustrates the interlinkage between national law and investor rights, irrespective of the account structure.

In Poland for example, national law distinguishes between "depository accounts" and "omnibus accounts". Both types of accounts are *de facto* omnibus accounts, according to the definition contained in this report. Depository accounts, however, are opened by domestic participants of the CSD, whereas "omnibus accounts" are reserved for non-domestic participants. In the case of depository accounts, the law determines that the amount of securities held at the CSD must correspond to the amount of securities held in end investor accounts in the CSD participant's own books (outside the CSD). This two-tier system contrasts with the case of non-domestic CSD participants, which may operate based on

⁵ In the European Union, investor compensation schemes are regulated by Directive 1997/9/EC. Non-EU markets typically have similar arrangements in place at national level.

longer chains of intermediaries, and for which end investor identification data is kept in foreign systems. In other words, foreign intermediaries are not subject to the two-tier system imposed on domestic intermediaries.

Another example is Russia where, until 2013, national law did not recognise the concept of "foreign nominee". At the time, foreign CSD participants using omnibus accounts were considered by Russian law as the absolute owners of the securities, unlike domestic CSD participants using omnibus accounts, which were deemed to hold securities on behalf of actual investors. Following the 2013 reform, it is now possible for foreign participants of NSD, the Russian CSD, to use omnibus accounts under the "foreign nominee" concept, meaning that the underlying investors of foreign participants have their ownership rights recognised by Russian law.

- **Other factors than segregation play a key role in protecting investor rights in case of an intermediary's default.**

The reason why account segregation is seen as beneficial to investor protection is that it provides a way to "ring-fence" client securities in case an intermediary becomes insolvent. It is indisputable that segregated securities accounts can contribute to a swift and reliable identification of client assets in default scenarios, although segregation details can also be found at the level of intermediaries rather than CSDs. In some markets where end investor segregation is widespread (e.g. DK, FI), the CSD can be allowed to take over the role of account operator in replacement of a defaulting participant to ensure that end investor accounts are protected from the effects of the insolvency, for example in cases where end investors do not immediately find a new intermediary to replace the defaulting CSD participant⁶. The use of end investor accounts in these markets can allow the CSD to process a corporate action (e.g. a dividend payment) on securities held in an end investor account even when the CSD participant acting as account operator for the end investor has been declared bankrupt, whereas if the same securities are held in an omnibus account at the CSD, bankruptcy estate's actions will be required for the corporate actions to be processed.

Other factors are however crucially important to ensure that investors can move their assets to another intermediary without that their securities holdings be impacted by the default. These include a solid legal framework ensuring the portability of investor holdings as well as efficient CSD procedures for handling the default of a participant.

In the European Union, the choice has been made to focus on solid CSD procedures rather than on mandating end investor accounts. Article 41 of the CSDR requires CSDs to disclose and regularly test

⁶ In case of a participant default whereby an end investor account is taken over by another CSD participant / account operator, the account and registrations on the account usually remain the same. This has the advantage of ensuring that registrations on the account for the benefit of third parties (e.g. for collateral management purposes) remain effective and valid without any interruption that could endanger third parties' rights on the securities.

their rules and procedures as regards participant defaults. Article 20(5) even goes further by foreseeing a mechanism to protect client securities in case a CSD were to lose its licence.

3.2 Investor transparency

End investor accounts at CSD level can present advantages for issuers of securities, especially shares, by allowing the CSD to provide issuers with detailed information on the identity of shareholders. In some hybrid and segregated markets, CSDs have developed an online interface allowing issuers to view the full list of investors in their securities in almost in real time.

That said, there is not necessarily a direct correspondence between the account structure at CSD level and the level of information provided to issuers. In fact, the "golden source" for information on investors in a given financial instrument is not the CSD account system, but the investors' register. In several EU markets, the register is maintained by the CSD (at least for shares), but this is not always the case, and in some markets like the UK, several registrars compete to provide the service. In other words, the ability for issuers to identify their shareholders/investors depends on the quality and depth of the register, irrespective of the account structure used at the CSD and irrespective of whether the CSD or another entity acts as registrar.

It is out of the scope of this report to provide a detailed description of the registration process in different EU markets, but it is worth recalling that omnibus accounts at CSD level do not prevent the omnibus account holders (CSD participants) from recording the names of individual clients in the register. For example, some markets (ES, PL, SK) work with a two-tier register:

- The first tier corresponds to the central registry maintained by the CSD and includes, for each CSD participant, the amount of securities held on own account and the amount of securities held on behalf of clients;
- The second tier registry, which is maintained by CSD participants, includes details on the amounts held by each investor having an account with a CSD participant.

Issuers can thus access details about investors without that this information be contained in securities accounts maintained at CSD level.

The impact of segregated accounts on investor transparency for issuers thus depends in part on whether the owners listed on the register are omnibus account holders (e.g. CSD participants) rather than beneficial owners (the actual end investors). In markets where intermediaries are listed as owners in the register, the register will not provide sufficient information for issuers to identify end investors and a mechanism has to be developed to allow issuers or their agent to collect information on end investors from those intermediaries. In contrast to markets where end investor information can be obtained in quasi real time (at least for domestic holdings), the process of collecting end investor information from intermediaries can be more or less speedy and complex in omnibus markets. This depends on the number of intermediaries involved in the securities holding chain, knowing that in a cross-border

scenario the chain is inevitably longer. In some cases, the issuer needs to request the information in order to obtain a picture of its investors at a given moment in time, and in other cases investor information reports are provided at regular intervals (e.g. yearly, quarterly, or monthly).

The relationship between securities settlement and registration is complex and differs across markets. In omnibus markets, different solutions have been developed to combine the freedom for CSD participants to pool investor securities and the possibility for the CSD or issuer agent to collect investor information in a timely way. Finding the right balance is not always easy and, in some markets, the use of omnibus accounts, although legally possible, is *de facto* restricted by the need for CSD participants to allow the CSD to promptly and automatically collect end investor identification data from them. In the Czech Republic for instance, a special technical arrangement must be put in place by a CSD participant using omnibus accounts for the transmission of end investor information to be possible. This constraint is one of the reasons why omnibus accounts are still only being used by a minority of participants in CSD Prague, despite being allowed since 2010.

There are still considerable national differences in terms of the level of investor transparency, and several other factors than account segregation enter into play. As evidenced by a report on "[Transparency of share ownership, shareholder communications and voting in global capital markets](#)" published by Computershare in June 2014, investor transparency largely depends on the national legal framework, but also on technical solutions developed by CSDs and registrars, as well as on market practices (e.g. whether registered or bearer securities are used).

Shareholder transparency regimes in Europe

In 2011, a task force on shareholder transparency, working under the auspices of the European Central Bank in the context of the TARGET2-Securities project, released a [market study](#) comparing existing regimes for the disclosure of shareholder information across 28 European countries. Although the study did not aim to address CSD account segregation options in details, it included a valuable description of existing processes for obtaining information about end investors from a CSD perspective. The report acknowledges that both segregated, hybrid and omnibus markets have developed efficient mechanisms allowing issuers to easily identify their shareholders, but it stresses the persistent difficulties of identifying shareholders in cross-border scenarios due to the diversity of legal systems and market practices across Europe. For instance:

- In 16 markets out of 28, end investors are considered as the owners of the securities, whereas in 7 markets CSD participants are considered as the owners, the remaining markets having different regimes depending on the nature of the entity acting as CSD participant. Interestingly, each grouping has a mix of segregated, hybrid and omnibus markets;
- Irrespective of whether the CSD acts as the shares registrar, issuers automatically receive shareholder information in 11 markets (the frequency varies from daily to quarterly reports), whereas in most other markets, they need to make ad hoc queries with the CSD or the registrar for investor information (sometimes the information can be obtained using a secured website);

- In several markets, foreign intermediaries are not subject to the same obligations as domestic intermediaries in relation to investor identification;
- In general, issuers receive the following fields from the CSD or registrar: identity number, full name, address, country of residence, transaction type and volume traded. In some countries, additional information might be available.

In all markets, the challenge is to provide issuers with the same level of transparency for foreign and domestic investors. Investor identification data is often more difficult to obtain in cross-border scenarios, and even in segregated markets, this typically requires the development of special services by CSDs or other providers, as explained in the [ECSDA comments on the proposed review of the Shareholders Rights Directive](#) (15 July 2014).

3.3 Legal and fiscal compliance

An issue which is closely related to investor transparency is that of the identification of beneficial owners for legal and fiscal compliance purposes. Indeed, regulators, and not only issuers, are keen to ensure that omnibus accounts are not used to hide the identity of certain investors who might not comply with legal and fiscal rules. For example, an individual not allowed to hold assets in a given country may try to use an intermediary to hold assets on his or her behalf at the CSD of that country. This explains why there tends to be a perception, especially among regulators, that omnibus accounts can constitute an obstacle in the fight against fraud or market abuse, at least if they do not allow for a proper identification of end investors. The question is thus whether more segregation of accounts is a solution to ensure that all investors fulfil their legal and fiscal obligations, or whether other solutions can be developed to allow for a rigorous identification of beneficial owners and transparency towards regulators while preserving the efficiencies attached to the use of omnibus accounts.

Another question is whether segregation needs to occur at infrastructure level (e.g. CSD), or at the level of intermediaries (e.g. CSD participants). Some local authorities in segregated markets favour the use of end investor accounts at CSD level as a way for them to more easily control that domestic investors subject to local taxes on their securities holdings are complying with their fiscal obligations. It is important to recall that, irrespective of whether omnibus or end investor accounts are used, CSD participants, rather than CSDs, are typically responsible for performing Know-Your-Customer (KYC) and anti-money laundering (AML) checks on end investors. This is why regulators have developed oversight standards primarily aimed at banks, such as the [IOSCO Principles on client identification and beneficial ownership for the securities industry](#) (2004). The recently published [Financial Crime Compliance Principles for Securities Custody and Settlement](#) (2015) of the Internal Securities Services Association (ISSA) also aim to promote a high level of compliance irrespective of the account segregation practices of individual markets.

Difficulties around the notion of "end investors"

There is no harmonised definition of beneficial ownership in Europe, at least as regards beneficial ownership in securities⁷. In fact, in many European markets (e.g. ES, LU), there is no legal definition of end investors, i.e. the ultimate securities holders, and instead there is a legal presumption that the names included on the register are those of the legitimate owners of the securities, even if in practice the "legitimate" owner holds the securities on behalf of someone else (the end investor). In contrast, segregated markets tend to have a definition of end investors/beneficial owners in national law⁸.

The lack of harmonised definition presents some challenges when talking about segregation. For example, the notion of "individual client segregation" works perfectly in omnibus markets where there is no notion of "end investors" and where the client of CSD participants are likely to be the owners of the securities (but not necessarily the beneficial owners). In some segregated markets, however, the notion of "individual client segregation" does not fully correspond to actual segregation practices at CSDs, where separate accounts are opened not only on behalf of individual clients of CSD participants, but on behalf of the ultimate holders of securities, i.e. end investors.

3.4 Costs and operational efficiency

The number of securities accounts maintained by a CSD depends both on the prevailing account segregation practices, as well as on the size of the market(s) it serves. This explains why some ECSDA members maintain hundreds of securities accounts, while others have several millions. From a CSD participant perspective, the choice of an omnibus account is often motivated by operational efficiencies, and this is why compulsory segregated accounts at CSD level are sometimes seen as an obstacle by foreign custodians wishing to enter a new market. Having fewer accounts at CSD level reduces the number of deliveries between accounts (as illustrated by the T2S example under section 2.2), which can reduce complexity and costs, for example as regards the reconciliation process. On the other hand, some CSDs in segregated markets have been functioning successfully for many years (at least for domestic holdings) with millions of end investor accounts, and technological progress means that the marginal cost of opening new securities accounts tends to become negligible.

The maintenance of end investor accounts at CSD level can actually make some processes more efficient. In certain segregated markets, the CSD can allocate corporate actions such as dividends directly to the specified cash and securities accounts of end investors, reducing the work load and risk for CSD participants, while ensuring a speedy and efficient process. End investor segregation at CSD

⁷ As explained in Section 2.1, EU law defines beneficial ownership in relation to control over a legal entity, such as a corporation or a foundation. The Anti-Money Laundering Directives limit beneficial ownership to certain thresholds of control (e.g. voting rights), which means that this definition does not capture all owners / investors in a security.

⁸ Recitals 56 and 57 of the CSD Regulation state that a harmonisation of property or company law aspects of securities holdings is outside of the scope of the CSD Regulation.

level can also make it easier for the CSD to swiftly and efficiently update the list of investors on the securities register, i.e. as soon as the securities transfers settle in the CSD accounts.

In contrast, areas in which omnibus accounts have traditionally been seen as essential to generate operational efficiencies are CSD links, collateral management, and securities lending and borrowing services. In a 2013 [report](#) on CSD account segregation practices, the T2S Harmonisation Steering Group insisted that *"current national account segregation rules go against the concept of T2S interoperability and, in a wider sense, the EU financial integration agenda"*. As for securities lending and collateral management services of CSDs in particular, they make it possible to automate the mobilisation of securities, an operation made easier where securities are commingled in a single account, since the pooled assets provide a more liquid "basket" from which substitution and realignment of securities can be performed.

4. European regulatory framework

CSD account segregation practices are in large part shaped by existing national legal systems. In recent years, several pieces of EU law have been adopted which contain legal provisions on account segregation. Almost all these laws target specific entities, i.e. certain types of account providers or account holders. This means that EU segregation rules often do not depend on the type of financial instrument held, but rather on the type of financial institutions providing securities accounts, or on the type of entity holding securities at an account provider. For example, the CSDR contains provisions on account segregation at CSD level, while EMIR contains provisions on account segregation at CCP level. The UCITS and AIFM directives, on the other hand, regulate account segregation in relation to the assets of investment funds.

In the absence of horizontal provisions covering all account providers, it can be difficult to understand how the existing requirements fit with one another, let alone what they mean for individual investors. The use of different terminology in the different pieces of EU law further complicates the matter. For instance, segregation is sometimes imposed as an obligation, and at other times it is defined as a right for the account holder. In the case of the CSDR, the requirements involve a mix of rights and obligations since CSDs are required to give a "right to choose" to their participants. The term "segregation" itself is not always used, for example the verb "segregate" is used in the CSDR whereas EMIR uses the verb "distinguish", although the requirements are otherwise very similar in their wording.

Furthermore, segregation rules in the CSDR and EMIR are binding and directly applicable, whereas other requirements such as those contained in the UCITS and AIFM directives have to be transposed into national law, potentially allowing for slightly different declinations of the requirements in different Member States.

The combined impact of recent EU legislation on the use of account segregation options at CSDs is hard to assess, especially given the different account holding models currently in use across Europe. The overall perception is that recent regulation is pushing for more segregation at financial institutions, although from a CSD perspective the trend is less obvious. Some pieces of EU legislation not directly aimed at CSDs could have an indirect impact: for example, the latest Anti-Money Laundering Directive, although it does not impose any requirements in relation to account segregation, might encourage account segregation at CSDs and intermediaries as a means to make information on beneficial ownership more easily accessible.

As regards the directives on investment funds, they do not in principle include CSDs in their scope. Indeed, the UCITS and AIFMD rules on the delegation of the custody function do not apply to assets deposited with a securities settlement system. Nonetheless, recent ESMA guidance⁹ somewhat seems to contradict Level 1 legislation by suggesting that fund depositaries and their subcustodians may be

⁹ ESMA, [Questions and Answers: Application of the AIFMD](#), 1 October 2015.

required to maintain segregated accounts at CSD level in cases where a CSD is deemed to provide "custody" services. Such "custody" services are defined neither in the UCITS and AIFM directives, nor in the CSDR. The fact that CSD settlement and safekeeping services are intrinsically linked makes it all the more difficult to interpret the scope of ESMA's guidance. But if "custody" is interpreted as applying to CSDs holding assets on behalf of fund depositaries at other CSDs in the context of CSD links, this could result in a major increase in the number of accounts maintained at CSDs. Although the implications of the ESMA guidance have not yet been fully assessed, there is a risk that requiring the use of segregated accounts by a subcategory of CSD participants could have a detrimental impact on the efficiency of CSD links, potentially hampering cross-border collateral movements, without any obvious benefits in terms of asset safety or investor protection.

As for the CSDR, it does not impose more segregation at CSD level. In fact, it seems to discourage end investor segregation by restricting the possibility to impose segregation by law to those Member States which already have such provisions in place. It even goes further by specifying that compulsory segregation is only allowed as long as the relevant national law is not amended, suggesting that the ideal account holding model should be one where investors (CSD participants' clients, rather than end investors) are given the choice of whether or not they wish to use segregated accounts at CSD level. On the other hand, by imposing new disclosure requirements on the costs and level of protection associated with different account segregating options, the CSDR may encourage some CSD participants and their clients to opt for more segregation - at least if the level of legal protection is deemed higher, and the cost is moderate.

The upcoming CSDR technical standards might also have an impact on segregation practices, although article 38 of the CSDR on account segregation is not subject to technical standards. Indeed, in the draft standards recently published by ESMA¹⁰, a suggestion is made that CSDs should be able to distinguish whether a participant account is an "own account", an omnibus account or an individually segregated account. Today, this is not always the case and, for some securities accounts, the CSD may not be aware of the way in which a participant uses its securities account. In fact, the definitions of "omnibus client segregation" and "individual client segregation" in article 38 of the CSDR do not require CSD participants to inform the CSD about which accounts are "omnibus accounts" and which accounts are "segregated accounts". CSDs are only required to offer the possibility for participants to maintain multiple accounts, some of which will include securities held on behalf of multiple clients.

¹⁰ See page 165 of the [Draft technical standards under CSDR](#) published by ESMA on 28 September 2015.

5. Future trends

▪ Trends at national level

Most ECSDA members (around 3/4) do not expect to witness significant changes in account segregation practices in the next five years as a result of the entry into force of new segregation requirements with the CSD Regulation. In many cases, this is because CSDs already offer all account segregation options required by the CSDR, and because there is no evidence that market participants' preferences will change in the near future.

Since EU Regulations are directly applicable, there is no requirement for EU Member States to adapt their national legal framework as a result of the CSDR. Nonetheless, some jurisdictions are considering repealing existing provisions which are not compatible with the CSDR and, as a result, are also pondering whether to implement some further changes to the domestic legal framework. Although segregated markets are allowed to maintain the legal obligation to use end investor accounts at CSDs, the fact that non-segregated markets are not allowed to adopt this model might lead some national authorities to consider lifting the legal obligation in favour of optional segregation at some stage in the future. In some cases, a move away from mandatory segregation will require amendments to company law, not only securities law.

In omnibus markets, a few CSDs believe that market demand for segregated accounts (not necessarily end investor accounts) might increase in the coming years as a result of the transparency requirements imposed on CSD participants by article 38 of the CSDR, although probably not to a large scale. Account segregation rules resulting from EU legislation on investment funds is actually perceived as having a potential wider impact than the CSDR, since recent guidance of ESMA on AIFMD suggests that account segregation may become compulsory for some of the assets of (subcustodians of) fund depositary banks held at CSDs, for example in the context of a cross-border CSD link.

Finally, in one non-EU country where omnibus client segregation is not currently mandatory, the national regulator is considering making it minimum requirement, so that client assets and own assets of CSD participants can no longer be commingled in a single account at the CSD.

▪ Trends at European level

Due to the many factors at play, it is difficult to predict whether the aggregate number of securities accounts at European CSDs will increase or decrease in the future. Whereas the general perception tends to be of a growing regulatory push towards more segregation, the outlook for CSDs is not necessarily the same as for other financial intermediaries.

The reliance of TARGET2-Securities on omnibus accounts for facilitating cross-CSD links and the prohibition on EU countries imposing segregated accounts at CSD level in the future are two important

factors suggesting that omnibus client segregation will become or remain a widespread practice at CSD level.

As for a possible increase in the demand for segregated accounts, it will largely depend on market preference and on the implementation of the disclosure obligation included in the CSDR - requiring that CSDs and their participants disclose *"the levels of protection and the costs associated with the different levels of segregation that they provide."*

Looking at the impact of the CSDR alone, a likely outcome is that account segregation practices at CSDs will progressively converge towards a model where CSD participants and their clients have more freedom to determine the type of accounts they wish to use, being less constrained than they are today by national legal and market practices. Such an evolution however seems partly countered by recent ESMA guidance on alternative investment funds, which may require compulsory segregation at CSD level in certain cases (e.g. CSD links) and for certain CSD participants (e.g. fund depositaries).

In any event, a progressive convergence of CSD account segregation practices, if it occurs, will probably take several years. It is not unreasonable to expect that CSDs in omnibus markets will progressively see more participants asking for segregated accounts (including in cases where segregation is not mandatory), whereas CSDs in segregated markets will face a higher demand for omnibus accounts, at least in certain cases, such as for the purpose of cross-border settlement activity in TARGET2-Securities.

Against this background, it will be interesting to see whether the notion of "individual client segregation" progressively supplements or merely adds itself to the notion of "end investor segregation" in segregated markets. More generally, it is not obvious whether changes in account segregation practices at CSDs will have an impact on the overall level of investor protection. In the absence of a harmonisation of securities laws across the EU, national law will continue to determine the nature of investor rights to a greater extent than the type of securities account used at the CSD.

Importantly, the progressive convergence of CSD account segregation practices cannot be considered in isolation and the true impact of recent regulatory reforms will largely depend on the changes in account segregation practices at intermediaries. ECSDA thus hopes that this report will contribute to bring the CSD perspective into the ongoing debate on account segregation in financial markets. We look forward to discussing future evolutions with CSD participants, issuers, regulators, and all other stakeholders working to promote efficient securities transactions and safe investor holdings in Europe.

Annex 1: Glossary

| | |
|--------------------------------------|--|
| AIFM(D) | Directive 2011/61/EU on Alternative Investment Fund Managers |
| CSDR | Central Securities Depositories Regulation, EU Regulation 909/2014 |
| EMIR | European Market Infrastructure Regulation, EU Regulation 648/2012 |
| End investor | The underlying investor, whether a natural or legal person, who holds securities for its own account and enjoys the benefits of ownership in the securities, even if the securities are held or recorded in the CSD in another name (e.g. trustee or nominee). Also called "beneficial owner". |
| End investor account | A securities account in which all the securities belong to a single end investor. Even if the end investor account is maintained by a CSD participant, the CSD has access to information about the identity of end investors. Also called "beneficial owner account". |
| End investor segregation | Use of end investor accounts by a CSD participant for holding securities belonging to a single end investor, whether or not the end investor is itself a direct client of the CSD participant |
| Individual client account | A securities account in which all the securities belong to a single client of a CSD participant. Also called "single client account". |
| Individual client segregation | Use of a separate securities account by a CSD participant for holding securities belonging to a single underlying client of that participant |
| Omnibus account | A securities account in which the securities belong to multiple clients of a CSD participant, including or excluding a CSD participant's own securities. |
| Omnibus client segregation | Use of a single securities account by a CSD participant to hold securities belonging to several clients of that participant |
| Register | An official list containing information on the legal owners of a given financial instrument, maintained on behalf of the issuer of the financial instrument. The register typically includes the name of each legal owner, some other identification data (e.g. address), and the number of units held by each investor. It is updated on a regular basis to reflect any changes in ownership. Sometimes also called "registry". |
| Registrar | The entity responsible for maintaining the securities register, which can be a CSD or another entity, depending on market practice. |

Segregated account A securities account maintained by a CSD participant which is distinct from other securities accounts of that participant. A segregated account can:

- Be a fully separate account from the other accounts of the CSD participant or be a subaccount of the CSD participant;
- Be opened in the name of a single client or in the name of the CSD participant (who might give the account any denomination it chooses);
- Include securities belonging to a single end investor (end investor account) or to multiple end investors (individual client account), depending on whether the single client of the CSD participant is itself holding securities on behalf of others.

Subaccount A securities account opened and managed by a CSD participant with reference to another, "main" account. Participants typically open several subaccounts in order to maintain separate sub-balances within the overall balances of the main securities account. From a functional perspective, separate subaccounts function as if they were separate accounts. The main difference with a separate securities account is that the client data attached to the subaccount is necessarily identical to that of the main account, whereas separate securities accounts (even if managed by a single CSD participant) can have different client data attached to them.

UCITS [Directive 2014/91/EU](#) on undertakings for collective investment in transferable securities

Annex 2: Useful references

| Year | Author(s) | Report |
|------|---|--|
| 2015 | ISSA | Principles for Financial Crime Compliance Principles for Securities Custody and Settlement |
| 2015 | Prof. Weinstein and Dr. Yekini (for ISSA) | Transparency in securities transactions and custody chains: Study on the Benefits and Costs of Securities Accounting Systems |
| 2013 | T2S HSG | CSD account segregation rules |
| 2012 | AFME | CSD Account Structure: Issues and Proposals |
| 2012 | UNIDROIT | Methods and rules for the segregation of securities |
| 2008 | Legal Certainty Group | Second advice |
| 2006 | Legal Certainty Group | Comparative survey |
| 2004 | IOSCO | Principles on client identification and beneficial ownership for the securities industry |