

AFME Outline on Securities Law Reform & Close-out Netting

As the **Commission's Action Plan on Building a Capital Markets Union of 30 September 2015** correctly points out despite progress made under EU legislation such as EMIR, CSDR and MiFID II in fostering efficient and safe post-trade infrastructures, barriers in the form of legal uncertainty remain in the field of cross-border clearing and settlement based on divergent national property and insolvency laws in the field of securities laws, but also close-out netting.

AFME wishes to take the opportunity to put forward a **step-by-step approach** on the future evolution of the legal **framework for securities transactions and close-out netting**:

1. Extending the rules of the Financial Collateral Directive regarding securities laws

The **2002 Financial Collateral Directive (FCD)** is a very successful element of the EU's financial market legal framework. While it addresses some of the most important concerns, it is **limited in scope** to collateral transactions and the nature of the rule setting under a **directive** requiring implementation in EU Member States does not guarantee a fully uniform legal framework. Thus, the following critical issues remain:

- **Clear rules for dispositions**: Some jurisdictions have undergone reforms of their securities laws in the last years and link the legal enforceability of acquisitions and dispositions of centrally cleared securities to the relevant book entry credits and/or debits. This appears to be a natural determinant of the legal position an acquirer obtains. **It is, however, essential, in order to ensure legal certainty, that this concept becomes an EU-wide general standard and that the book entry relevant for determining the applicable laws is selected consistently.**
- **Good-faith acquisitions**: In anonymous, highly volatile markets, acquirers can never determine whether previous acquisitions of the relevant securities were legally valid. It is essential for market participants that they can rely on the law for ensuring their valid acquisition, even if one of the earlier acquisitions were invalid (good faith acquisition), and avoiding a double existence of the same right for multiple beneficiaries. **Therefore, the legal concept within the EU for good faith acquisition needs to be consistent and it must be clearly defined which party must suffer a loss following a good faith acquisition.**

AFME and its members believe that delivering on the above mentioned critical points can best be achieved by an extension of the conflict of laws rule contained in the FCD. The rule should define **that the proprietary aspect of the holding and transfer of securities should be governed by the law of the country where the securities account is maintained on which a securities transactions is booked, whether the account provider is market infrastructure or a market participant.**

2. Extending the Insolvency Regulation regarding close-out netting rules

The current legal framework on close-out netting does not consistently and in a way applicable to all market participants provide an answer to the questions (1) which law applies to questions of enforceability of close-out netting and collateral (forum or contract law), and (2) which law governs the question of who can use close-out netting? **While on enforceability a conflict of laws rule leading to contract law (as in the Banks Winding-up Directive) seems the best solution-, on eligibility the choice of the *lex fori concursus* seems to be appropriate.**

3. New rules in the form of Regulations

To ensure consistent rules throughout the EU Member States, **harmonization of the before mentioned aspects should be in the form of directly applicable Regulations.**

HOW TO PROGRESS?

- **Commercial law aspects on securities transactions should be addressed in an independent legal instrument or could be integrated within a future, more comprehensive, version of the Financial Collateral Directive.**
- **Regulatory issues could be addressed in an instrument either within, or complementary to the CSDR (applicable to all securities intermediaries).**
- **On close-out netting additions to the Insolvency Regulations seem appropriate.**