EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 8 December 2008

at the request of the French Ministry for Economic Affairs, Industry and Employment

on a draft order relating to financial instruments

(CON/2008/85)

Introduction and legal basis

On 31 October 2008 the European Central Bank (ECB) received a request from the French Ministry for Economic Affairs, Industry and Employment for an opinion on a draft order relating to financial instruments and amending the Monetary and Financial Code and the Commercial Code (hereinafter the 'draft order').

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the third, fifth and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the draft order relates to the Banque de France, payment and settlement systems and rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft order

1.1. The draft order aims[2] at reforming the law applicable to financial instruments and market infrastructures with a view to: (i) reforming and simplifying the rules applicable to financial instruments by amending the definitions, terminology and presentation of the relevant provisions so as to make the law on securities more coherent and to integrate and anticipate developments in European standards and international agreements in the field of securities law; and (ii) amending the list of participants in a securities settlement system for financial instruments so as to make these systems more stable. It also aims at reforming the indexing limits applicable to debt instruments and financial futures and introduces some amendments to the rules applicable to negotiable debt securities (*titres de créance négociables*).

1 OJ L 189, 3.7.1998, p. 42.

2 On the basis of the authorisation granted to the French Government by Article 152(1)(g) and (h) of Law No 2008-776 of 4 August 2008 on the modernisation of the economy (*Journal Officiel de la République française* No 0181 of 5 August 2008).

1.2. The draft order liberalises the indexing of debt instruments and financial futures and introduces[3] a new provision in the Monetary and Financial Code (hereinafter the 'Code') which expressly authorises the indexing of debt instruments and financial futures without any restriction[4].

1.3. The reform of the rules applicable to financial instruments is largely a reorganisation of the existing provisions of the Code on financial instruments in order to group them all in Book II of the Code. Among the provisions moved to Book II of the Code are the rules governing the transfer of ownership in financial securities[5]. These rules first state the principle that transfer of ownership in financial securities results from the securities being entered on the acquiring party's securities account. They then set out the detailed provisions, which remain unchanged in substance, applicable to the transfer of ownership: (i) where financial securities are admitted to the transactions of a central custodian or delivered to a securities settlement system for financial instruments[6]; or (ii) where the securities settlement system delivers the financial securities on the basis of continuous irrevocable settlement. The draft order also moves the rules relating to compensation and transfers of claims and to the guarantee of financial obligations into Book II of the Code[7].

1.4. The provisions of the Code on financial instruments are reorganised around a new classification of financial instruments differentiating between financial securities (*titres financiers*) and financial futures (*contrats financiers*). The reason for introducing the concept of financial securities is to regroup within one legal category those instruments that present identical formal characteristics such as dematerialisation and registration and that are therefore subject to the same rules on holding of account, account-holders, tradability, etc.[8]. As regards voluntary or forced public auctions, this results in a broadening of the scope of the relevant provision to cover financial securities[9], which also include negotiable debt securities. The draft order therefore includes a reference to the Banque de France in the list of persons and entities entitled to hold voluntary or forced public auctions of financial securities, with the exception of auctions involving securities of public debt carried out for the account of the State which fall outside the scope of this provision of the Code.

1.5. Moreover, the reform also entails the introduction of new principles governing financial securities. The draft order introduces the general principle according to which financial securities are deemed to belong to the account holder[10]. The draft order also contains a provision introducing in the Code

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3 The draft order also abrogates the reference to such instruments in Article L. 112-3 of the Monetary and Financial Code which allows indexing to the general level of prices by derogation to the general principle of prohibition (Article L. 112-1 and Article L. 112-2, first paragraph, of the Code).

4 Article L. 112-3-1 of the Code, as proposed by the draft order.

5 Article L. 211-17 of the Code, as proposed by the draft order. The rules governing the transfer of ownership of financial instruments are currently part of Book IV of the Code (Article L. 431-2 of the Code).

6 Referred to in Article L. 330-1 of the Code.

7 Articles L. 211-36 to L. 211-40 of the Code, as proposed by the draft order. These provisions are currently part of Book IV of the Code (Articles L.431-7 to L.431-7-5 (and Article D. 211-1A(II)).

8 See the explanatory memorandum to the draft order relating to L.211-1, p. 2.

9 Article L. 211-21 of the Code, as proposed by the draft order.

10 Article L. 211-4 of the Code, as proposed by the draft order.

the protection of an account holder's right of ownership where financial securities have been acquired in good faith[11]. Further, the draft order introduces in the Code a provision pursuant to which the custody-account keeper may, subject to the conditions set out in the General Regulation of the Financial Markets Authority, allocate to a third party all or some of the tasks linked to its activity of custody-account keeping for financial securities[12]. As regards negotiable debt securities, the draft order ends the requirement for a fixed term[13].

1.6. The draft order[14] clarifies and broadens the list of entities qualifying as participants in an interbank settlement system or a securities settlement system for financial instruments (hereinafter 'participants') so as to include, *inter alia*, the central securities depositories and the operators of a securities settlement system for financial instruments.

2. General observations

2.1. The ECB welcomes the draft order's aim[15] of improving the coherence and readability of the law on financial instruments, thereby enhancing the legal certainty and clarity of French law in this area.

2.2. The draft order reflects the work that has been done at the level of the European Union (Legal Certainty Group)[16] and at the global level (Unidroit)[17] aiming to promote future legislative action to address the legal effects of book entries in securities accounts for the purpose of the acquisition, disposal and creation of security interests over securities, and related aspects, thereby complementing a range of other EU and non-EU initiatives. The introduction of clear concepts, such as financial securities and securities accounts, relating to both individual accounts and 'omnibus accounts', as well as a clear description of the position of an account holder as owner of the securities is welcomed in this regard.

3. Specific comments

3.1. Protection of acquirers against reversal

The draft order introduces in the Code a provision regarding the protection of an account holder's right of ownership where financial securities have been acquired in good faith[18]. At the international level, concerns have been raised about the need for an account holder acquiring

11 Article L. 211-16 of the Code, as proposed by the draft order.

12 Article L. 211-8 of the Code, as proposed by the draft order.

13 Article L. 213-1 of the Code, as proposed by the draft order.

14 Article L. 330-1 of the Code, as proposed by the draft order.

15 See the explanatory memorandum to the draft order relating to Article 2 of the draft order.

16 See the Second Advice of the Legal Certainty Group entitled 'Solutions to Legal Barriers related to Post-Trading within the EU', August 2008 (available at: http://ec.europa.eu/internal_market/financial-markets/docs/certainty/2ndadvice_final_en.pdf).

17 See the Draft UNIDROIT Convention on substantive rules regarding intermediated securities, 12.9.2008 (available at: http://www.unidroit.org/).

18 Article L. 211-16 of the Code, as proposed by the draft order.

financial instruments to be able to rely on a credit on his account and for a harmonised protective rule in this regard. The abovementioned provision introduced in the Code suggests that a reversal can only be requested in the case of the account holder's bad faith. In addition, the relevant provision of the draft order links the protection of the holder of the securities to the crediting of the book-entry securities to the acquirer's securities account. The ECB assumes that the application of the provision introduced by the draft order[19] will result in an adequate level of protection for the acquirer of book-entry securities and considers that flexibility should be maintained with respect to a possible further harmonisation that could result from the ongoing work in this area at the European and international level. The ECB therefore welcomes the new provision proposed by the draft order[20] as a first step in this direction.

3.2. List of participants

The draft order extends the list of entities qualifying as participants to include, *inter alia*, the central securities depositories and the operators of a securities settlement system for financial instruments[21]. The draft order therefore clarifies in a legislative provision that central securities depositories qualify as participants, even though they are not credit institutions, thereby increasing legal certainty. With regard to the inclusion of the operators of a securities settlement system for financial instruments as participants, the ECB notes that the draft order anticipates the expected changes[22] to Directive 98/26/EC on settlement finality in payment and securities settlement systems[23] (hereinafter the 'SFD'). Moreover the list of entities qualifying as participants corresponds to a large extent to the definition of participant as provided for in the SFD. In this regard, the ECB suggests examining whether reference to 'members of a clearing house'[24], should be broadened to 'clearing house', as is the case in the SFD[25], as such change may be of relevance with regard to foreign clearing houses.

3.3. Access to a securities settlement system for financial instruments

The Code[26] provides that a securities settlement system for financial instruments may refuse, on legitimate commercial grounds, access by credit institutions and investment companies with their registered office or, otherwise, their effective headquarters in another member state of the European Community or in another state that is a member of the European Economic Area. Against this background, the ECB draws attention to the draft ESCB/CESR recommendations for securities

19 Article L. 211-16 of the Code, as proposed by the draft order.

20 Article L. 211-16 of the Code, as proposed by the draft order.

21 Article L. 330-1.II of the Code, as proposed by the draft order.

22 See in this respect the revised Presidency Compromise on a Proposal for a directive of the European Parliament and of the Council amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims (available at: http://register.consilium.europa.eu/pdf/en/08/st11/st11968-re02.en08.pdf) (Article 2).

23 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998, OJ L 166, 11.6.1998, p. 45 (Article 2).

24 Article L. 330-1.II, first paragraph, point.3 of the Code, as proposed by the draft order.

25 Clearing houses are covered by the definition of participant in a system (Article 2(f) of the SFD).

26 Article L. 330-1.I, fourth paragraph, of the Code; Article L.330-1.II. third paragraph, of the Code, as proposed by the draft order.

settlement systems, which invite public authorities to ensure that central securities depositories, including the securities settlement systems operated by these entities, expressly limit rules and requirements restricting access to those aimed at controlling risk[27]. Although an amendment of the abovementioned provision would go beyond the scope of the draft order, the ECB considers that, in the context of a reform of the law applicable to market infrastructures, it could be useful to amend the rules governing access to a securities settlement system for financial instruments accordingly.

3.4. Outsourcing the activity of central securities depositories

The draft order provides that a custody-account keeper may allocate to a third party all or some of the tasks related to its activity of custody-account keeping for financial securities[28]. The ECB understands that no specific rules currently apply to the outsourcing by a French central securities depository of all or part of its operations to another entity. In this respect, although this would go beyond the scope of the draft order, the ECB would like to point out that it could be useful from the point of view of promoting further integration of European securities infrastructures to introduce requirements in respect of outsourcing to third parties the activities of the central securities depositories conducting settlement functions.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 8 December 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET

27 See the draft ESCB/CESR recommendations for securities settlement systems and draft recommendations for central counterparties, CESR/ESCB consultation paper, CESR/08-749, October 2008 and more particularly Recommendation 14 on access (Part 1, Recommendations for securities settlement systems, pp. 64-66. (available at http://www.ecb.int/paym/cons/html/escb-cesr.en.html or http://www.cesr-eu.org/index.php?page=contenu_hearings_details&id=91).

28 Article L. 211-8 of the Code, as proposed by the draft order.