

## Financial Markets Law Committee (“FMLC”)

### Banking Scoping Forum

Date: Monday 2 March 2020

Time: 2.00pm to 3.30pm

Location: Allen & Overy LLP, One Bishops Square, London, E1 6AD



#### **In Attendance:**

Dorothy Livingston (Chair)	Herbert Smith Freehills LLP
Jons Lehmann	Fried, Frank, Harris, Shriver & Jacobson (London) LLP
John McGrath	Dechert LLP
Monica Sah	Clifford Chance LLP
Julia Smithers Excell	White & Case LLP
Ferdisha Snagg	Cleary Gottlieb Steen & Hamilton LLP
Chhavi Sinha	FMLC Secretariat
Katja Trela-Larsen	FMLC Secretariat

#### **Regrets:**

Clare Dawson	Loan Market Association
James Bresslaw	Simmons & Simmons LLP
Thomas Donegan	Shearman & Sterling LLP
Simon Hills	UK Finance
Ian Jameson	Sumitomo Mitsui Banking Corporation Europe Limited
Mark Kalderon	Freshfields Bruckhaus Deringer LLP
Etay Katz	Allen & Overy LLP
Mitja Sirai	FIA
Jeremy Stokeld	Linklaters LLP
Stuart Willey	White & Case LLP

**Registered Charity Number: 1164902.**

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## Minutes:

### 1. Introductions

- 1.1. The Chair opened the meeting and members introduced themselves.

### 2. Linking in with the FMLC (Katja Trela-Larsen)

- 2.1. Ms Trela-Larsen provided an overview of a few non-pecuniary ways in which Forum members, or their institutions, could contribute to the work of the FMLC.<sup>1</sup> These include contributing to its research, hosting meetings and events and seconding lawyers to the Secretariat.

### 3. The Investment Firm Regulation: proposed changes to Article 46 of MiFIR (Dorothy Livingston)

- 3.1. Ms Livingston explained that the Regulation (EU) 2019/2033 on the prudential requirements of investment firms (the “**Investment Firms Regulation**” or the “**IFR**”) amends Article 46 of Regulation (EU) 600/2014 on markets in financial instruments (the “**Markets in Financial Instruments Regulation**” or “**MiFIR**”). Article 46 of MiFIR concerns the Third Country regime for investment services—it allows Third Country firms to provide investment services and activities to eligible counterparties and per se professional clients across the Union if they are registered by the European Securities and Markets Authority (“**ESMA**”) in its register of Third Country firms (the “**ESMA register**”) in accordance with Article 48 of MiFIR. The IFR revises Article 46 to include new, annual reporting requirements for Third Country firms and grants ESMA the power to ask Third Country firms in the ESMA register to provide data relating to all orders and all transactions in the E.U., whether on own account or on behalf of a client, for a period of five years.
- 3.2. Ms Livingston pointed out that the changes to Article 46 entered into force in December 2019 and will come into effect in June 2021. She stated that if the new Third Country regime is more onerous than the regime for E.U. regulated bodies it could be in breach of World Trade Organisation (“**WTO**”) rules.
  - 3.2.1. Members commented that the U.K. would soon be a Third Country and it was still to be decided whether the U.K. would be granted equivalence by the E.U. Members noted that the political declaration aims for an agreement on provision for financial services to

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<sup>1</sup> Please see presentation at Appendix I

be reached by end of June. A member observed that registration with ESMA can take around six months so any delay in reaching an equivalence decision is likely to create uncertainty for investment firms. Members suggested that the FMLC consider writing a letter suggesting a decision on equivalence should ideally be on the basis of the new rules.

**4. ESMA Consultation Paper on Draft Technical Standards on the provision of Investment Services and Activities in the Union by Third Country Firms under MiFID II/MiFIR<sup>2</sup> (Dorothy Livingston)**

4.1. Members agreed the provisions within the Consultation Paper are largely technical, and agreed the Consultation Paper did not bring up issues of legal uncertainty. A member suggested that U.K. Finance or the Association for Financial Markets in Europe (“AFME”) would be better placed to respond to this Consultation Paper.

**5. Bank for International Settlements Discussion Paper: Designing a prudential treatment for cryptoassets<sup>3</sup> (Dorothy Livingston)**

5.1. Ms Livingston pointed out that the Bank for International Settlements (“BIS”) Discussion Paper on designing a prudential treatment for cryptoassets focuses on prudential regulation, whereas the European Commission has published a separate consultation on an E.U. regulatory framework for cryptoassets.<sup>4</sup> One attempt to regulate cryptoassets has been through Directive (EU) 2018/843 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (“5MLD”) although the application of other financial markets regulation to cryptoassets remains undecided. Ms Livingston observed that Germany, in its implementation of 5MLD, has brought cryptoassets within the scope of the national law which implemented Directive 2014/65/EU on markets in financial instruments (“MiFID II”).

5.2. A discussion followed on the nature of cryptoassets, the treatment of cryptoassets as property in the U.K. Courts, and whether they should be treated in the same way as a

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<sup>2</sup> ESMA, *Consultation Paper: Draft technical standards on the provision of investment services and activities in the Union by third-country firms under MiFID II and MiFIR* (31 January 2020), available at: [https://www.esma.europa.eu/sites/default/files/library/esma35-43-2131\\_cp\\_on\\_provision\\_of\\_services\\_by\\_tcfs.pdf](https://www.esma.europa.eu/sites/default/files/library/esma35-43-2131_cp_on_provision_of_services_by_tcfs.pdf)

<sup>3</sup> BIS Basel Committee on Banking Supervision, *Discussion paper: Designing a prudential treatment for crypto-assets* (13 March 2020), available at <https://www.bis.org/bcbs/publ/d490.pdf>

<sup>4</sup> European Commission, *Consultation document: An EU framework for markets in crypto-assets* (19 December 2019), available at: [https://ec.europa.eu/info/files/2019-crypto-assets-consultation-document\\_en](https://ec.europa.eu/info/files/2019-crypto-assets-consultation-document_en)

financial instrument. Members expressed an interest in reading the FMLC’s response to the European Commission’s Consultation.

5.3. A member commented that the BIS Discussion Paper does not distinguish between the risk level associated with different types of cryptoassets, for example bitcoin and stablecoins, and that not all cryptoassets would necessarily not qualify for good treatment in the banking book. Ms Livingston stressed that any risk weighting would need to be calculated on the basis of the risk which would be held by the bank. Members largely agreed with the general approach taken to the prudential regulatory treatment of cryptoassets in the Discussion Paper and therefore did not recommend the FMLC respond to the paper.

6. **Law Commission Consultation on Intermediated Securities—issues in relation to debt securities (Dorothy Livingston)<sup>5</sup>**

6.1. Ms Livingston gave a brief overview of the structure of intermediation for equity and debt securities. She explained that English law understands the intermediary chain as a series of trusts and each level in chain down to ultimate investor has a beneficial interest in the securities. She further explained that for equities only those with direct relationship with CREST/Corporate Registrar level have a legal interest. For bonds the legal interest lies at level of custodian of the global bond (an investor cannot be a legal owner).

6.2. Ms Livingston highlighted that the “no look through” principle, applied in English law (and in most other legal systems), prevents ultimate investors or intermediated level holders asserting property or other claims at higher levels in chain or against the issuer in most circumstances. As a result, a dispute at any level of the chain can be resolved without involving parties at other levels.

6.3. Ms Livingston stated that Law Commission had published a Consultation on intermediated securities in August 2019.<sup>6</sup> Ms Livingston explained that the Consultation questioned the value of the “no look through” principle and appeared to reflect concerns of small “active” shareholders about exercise of voting and other rights against the issuer. She noted the Consultation did not cover bonds and predates the judgment in *SL Claimants v Tesco Plc* in which the court held that ultimate investors could

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<sup>5</sup> Please see presentation at Appendix II

<sup>6</sup> U.K. Law Commission, *Intermediated securities Call for evidence* (August 2019) available at: [https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jxou24uy7q/uploads/2019/08/6.5925\\_LC\\_Intermediated-securities-call-for-evidence-web.pdf](https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jxou24uy7q/uploads/2019/08/6.5925_LC_Intermediated-securities-call-for-evidence-web.pdf)

be entitled to compensation from the issuer under Section 90A and Schedule 10 of the Financial Services and Markets Act 2000 (“FSMA”), as holders of interests in securities.<sup>7</sup> Agreeing with the judgment, Ms Livingston noted that a claimant cannot be awarded damages unless they have actually suffered them and intermediaries do not suffer loss as they have bare beneficial interest.

- 6.4. Ms Livingston outlined the response submitted by the City of London Law Society (“CLLS”) to the Law Commission Consultation. She explained that CLLS highlighted in its response the importance of the “no look through” principle as essential to the international securities markets as the principle is aligned with privity of contract and international best practice. According to CLLS, the “no look through” principle is not an obstacle to ultimate investors exercising voting rights where there is good practice and effective regulation and it does not prevent investors from having appropriate direct rights where they suffer economic loss.
- 6.5. Ms Livingston explained that there are measures to assist ultimate investors such as: education, including how to shorten chain for voting instructions for active investors; development and enforcement of rules on passing on notices of meetings and voting instructions, as well as on feedback on execution, including review of regulatory sanctions; review of where statutory rights against issuer may be appropriate—where they suffer economic loss from issuer action and intermediated chain does not; and extension of innocent purchaser/transferee protection to transfers of intermediated securities.
- 6.6. Ms Livingston stated that questions around the insolvency of intermediaries remain unresolved and the enforcement of separate rules in this context would improve the prospects of full recovery by investors, consistent with existing property rights.

## **7. European Commission review of the regulatory framework for investment firms and market operators (Dorothy Livingston)**

- 7.1. Members agreed to defer discussion on this topic to a future meeting owing to lack of time.

## **8. Any other business**

- 8.1. No other business was raised.

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<sup>7</sup> [2019] EWHC 2858 (Ch)

# Linking into the work of the FMLC

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**Katja Trela-Larsen**  
**Forums Coordinator**

**Registered Charity Number: 1164902.**

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# Non-pecuniary involvement with the FMLC

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The FMLC's work in furthering legal certainty in the wholesale financial markets, addressing legal risk, and providing impartial analysis is vitally important at this time when so much is happening.

The FMLC appreciates your support through participation in this Scoping Forum. Do you know other ways you can engage with and contribute to the FMLC, aside from a monetary donation?

# Engaging with the FMLC

Alerting the FMLC Secretariat to issues of legal uncertainty

Participation in FMLC scoping forums, either as a member or a guest speaker

Joining FMLC working groups, contributing legal expertise and drafting chapters of papers

Participation in FMLC events, either as a attendee or guest speaker

# Supporting FMLC Events

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Your organisation can host FMLC events and/or provide logistical support for events, such as printing.

For example:

- Judicial Seminar
- Quadrilateral Conference
- Spring and Autumn Seminars
- Patrons' Dinner, and
- Festive drinks reception

# FMLC Secondment Programme

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Law firms can supply lawyers on secondment to the FMLC Secretariat, in the role of Legal Analyst.

The secondment provides an opportunity to conduct detailed research on specific issues and will hone key skills such as drafting, legal research and stakeholder relationships.

Each secondment typically lasts for a period of 6 months. Recent secondees have included trainee solicitors and associates at NQ level, as well as associates who are one year or more PQE.

# Supporting the FMLC

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If you wish to find out more about the FMLC secondment programme and how your organisation can participate, please contact Emma McClean ([operations@fmlc.org](mailto:operations@fmlc.org))

If you wish to find out more about upcoming FMLC events and the ways you can offer support, please contact Rachel Toon ([executivesupport@fmlc.org](mailto:executivesupport@fmlc.org))

If you have an issue of legal uncertainty you would like to raise with the FMLC, or if you or your organisation would like to contribute to the FMLC's work via a Scoping Forum or Working Group, please contact Venessa Parekh ([research@fmlc.org](mailto:research@fmlc.org)) or Katja Trela-Larsen ([forums@fmlc.org](mailto:forums@fmlc.org))



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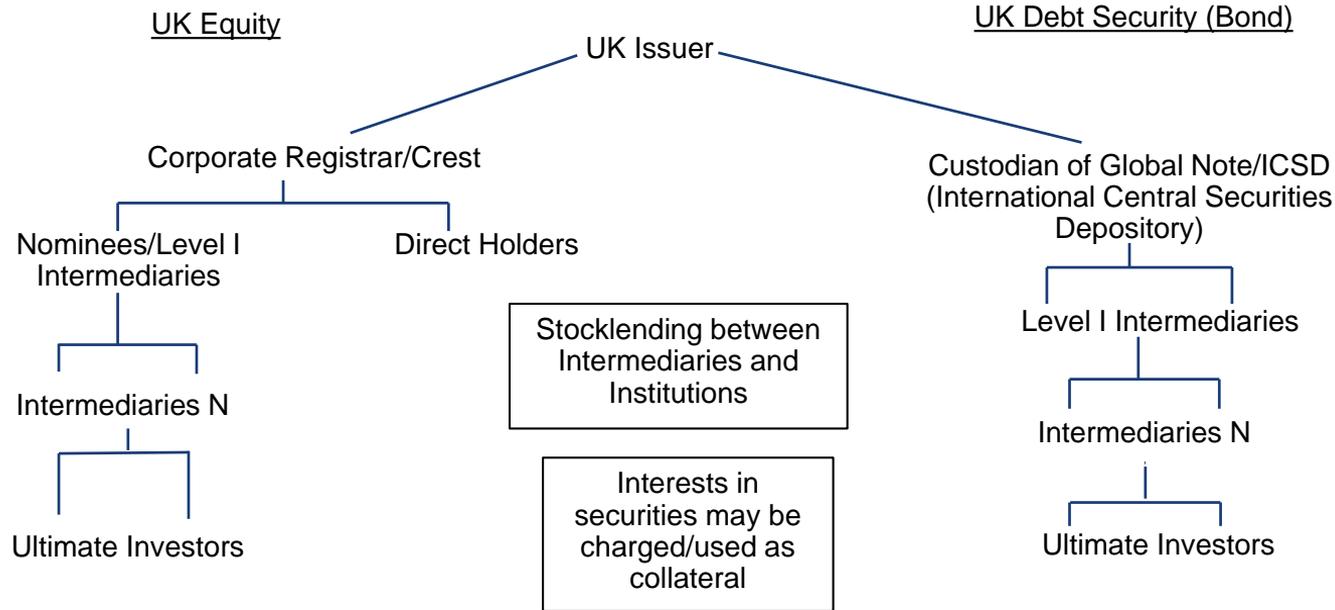
# INTERMEDIATED SECURITIES

## THE LAW COMMISSION PROJECT

**2 March 2020**

Dorothy Livingston, Herbert Smith Freehills LLP

# INTERMEDIATED SECURITIES STRUCTURE



Each level in chain may be governed by a different law. Equity chain could be wholly English law; debt will have Belgian or Luxembourg law between ICSD and level I intermediaries

# INTERMEDIATED SECURITIES

## THE NO LOOK THROUGH PRINCIPLE

- English law analyses the intermediary chain as a series of trusts
- Each level in chain down to ultimate investor has an interest in securities
- For equities only those with direct relationship at Crest/Corporate Registrar level have a legal interest – an ultimate investor may hold at this level
- For bonds the legal interest lies at level of custodian of the global bond answerable to the relevant ICSD (an investor cannot be a legal owner)
- Each level in chain is a separate relationship
- A level governed by a different law may be subject to a different analysis – e.g. intermediary record of property right may not be differentiated from right of holder in direct relationship with issuer
- No look through principle – applied in English Law (and most other legal systems) prevents ultimate investors or intermediated level holders asserting property or other claims at higher levels in chain or against issuer in most circumstances – a dispute at any level can be resolved without involving parties at other levels

# INTERMEDIATED SECURITIES

## LAW COMMISSION WORK

- 2019 scoping study consultation
- Questioned value of no look through principle
- Appeared to reflect concerns of small “active” shareholders about exercise of voting and other rights against the issuer
- Predated *SL Claimants v Tesco Plc* in which the court held that ultimate investors could be entitled to compensation from the issuer under FSMA s90A and Schedule 10, as holders of interests in securities
- Discussed various other issues related to dealings in intermediated securities

# INTERMEDIATED SECURITIES

## CITY OF LONDON LAW SOCIETY RESPONSE

- Joint working group of Financial, Company and Regulatory Law Committees
- Now joined by Insolvency Law Committee
- Prepared response to Law Commission scoping study available on CLLS website at relevant committee pages
- Working group will remain active throughout Law Commission project

# INTERMEDIATED SECURITIES

## NO LOOK THROUGH PRINCIPLE

- CLLS defended the principle as essential to international securities markets

*“The benefits of the no look through principle are structural and contribute the system and, to a large extent, to legal certainty”*

Goode and Gullifer on Legal Problems of Credit and Security  
(6th edition) at 6.21

- Aligned with privity of contract
- Aligned with international best practice
- Not an obstacle to ultimate investors exercising voting rights where there is good practice and effective regulation
- Does not prevent ultimate investors having appropriate direct rights where they suffer economic loss: see *FSMA s90A*
- Education of investors important

# INTERMEDIATED SECURITIES

## MEASURES TO ASSIST ULTIMATE INVESTORS

- Education, including how to shorten chain for voting instructions for active investors
- Regulation: development and enforcement of rules on passing on notices of meetings and voting instructions, as well as on feedback on execution, including review of regulatory sanctions
- No major company law changes but review headcount test under s899 CA 2006
- Review of where statutory rights against issuer may be appropriate – where they suffer economic loss from issuer action and intermediated chain does not
- Extension of innocent purchaser/transferee protection to transfers of intermediated securities
- **Contrast:** recognition that in debt markets it is the issuer who suffers because ultimate investors are uninterested - cannot get quorate meetings – again regulation may assist

# INTERMEDIATED SECURITIES

## INSOLVENCY OF INTERMEDIARIES

- Situation remains unsatisfactory
- Shortfall in securities of a particular description means no prompt transfer of assets held on trust causing hardship to chain below level of insolvent intermediary
- This could be remedied by SIPA style rules on pooling of available securities similar to those for client money – should “returned” stock loans be included?
- Enforcement of hold separate rules would improve prospects of full recovery – consistent with property rights of investors
- Review of FCSC threshold and risk advice for holders of portfolios valued above statutory compensation level

# INTERMEDIATED SECURITIES

## OTHER ISSUES

- Clarification that formality requirements such as those for “writing” contained in *LPA ss53(i)(c)* and *136* do not apply to electronic transfers of intermediated securities
- Replication of statutory protections for register integrity and limitations of liability for issuers/operators of relevant systems (Crest) under *s126 CA 2006* and *USRs Regs 23(3)* and *40(3)* to intermediaries regarding maintenance of securities accounts

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