Position paper on Settlement Finality Regulation

France Post-Marché

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(1) TECHNOLOGY NEUTRALITY
(2) INSOLVENCY AND CENTRAL DATABASE
(3) CONFLICT OF LAWS ON COLLATERAL
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Executive Summary

The MIS package is a major initiative aimed at achieving both regulatory and operational progress, building on the existing regulatory framework and the philosophy of the SIU, with a view to strengthening the European financial marketplace, improving the efficiency of processing chains, and encouraging long-term investment through favourable market conditions.

France Post-Marché (FPM), the association representing post-trade stakeholders in France and playing a significant role in the overall competitiveness of the European market, **welcomes the EC's initiatives aimed at strengthening the integration, competitiveness and efficiency of the Single Market for capital, while making several recommendations** to ensure the operational consistency of the reforms, regulatory stability and investor protection, **while preserving the objective of avoiding any unjustified increase in costs for all participants in the value chain and, by extension, for end clients.**

Regarding more specifically the amendment of Directive 98/26/EC on Settlement Finality, while the association welcomes the objectives of reducing fragmentation resulting from divergent transpositions and improving transparency through the centralized publication of information**, FPM does not consider the conversion of the Settlement Finality Directive into a regulation to be appropriate for the following reasons:**

- **The Directives generally strike a good balance between harmonization and flexibility left to the Member States**, as some national divergences (such as the timing of entry into the systems and the irrevocability of transfer orders) could be resolved through the collective agreement between central depositories and national central banks for the purposes of legal certainty in the development of T2S.
- **A Regulation does not consider the different legal environments of Member States in insolvency, company law or securities law**, for which full harmonization is not yet in place and which remain the competence of each Member State.

In addition to this position on the nature of the instrument, and to ensure that the objective of harmonization and reduction of systemic risk is effectively achieved, FPM recommends:

1. **Removing the insertions relating to technological neutrality/DLT:** without a complete legal anchor (liability, governance, participants, conflict of laws), they risk increasing uncertainty, to the detriment of the legal certainty that the Regulation intends to strengthen. At this stage, these amendments must be confined to the Pilot Regime Regulation.
2. **Allowing central securities depositories to have centralized and concurrent access to the information relating to the insolvency of one of its participants.**
3. **Limiting changes to the conflict-of-law rule provided for in Article 9 of the Finality Directive**, by specifying only the proposed connecting factor (taking account of the case of branches of the account-keeping institution).

1. Technology neutrality

The proposal aims at technological neutrality and explicitly includes DLT in structuring definitions (transfer order, book entry, guarantee).

FPM considers that, generally formulated at Level 1, these insertions are sometimes over-inclusive and do not guarantee the desired legal certainty, as they are not systematically accompanied by complete requirements on governance, identification of responsible actors, proof and enforceability, as well as the treatment of conflicts of laws when the location becomes uncertain (in particular in DLT). **In addition, it should be recalled that the European Commission itself called in 2023 to await the conclusion of the pilot scheme trials before any legislative developments.**

At this stage in the development of experiments under the Pilot Regime Regulation, it seems essential to us those developments related to DLT be limited and focused on the Pilot Regime Regulation, to the exclusion of any other text (and notably the draft SFR).

Furthermore, and without prejudice to the above, technological neutrality must remain functional (achievement of the objectives of finality/irrevocability/enforceability) **and not merely declarative** (addition of DLT terms)**, unless a complete legal anchoring is provided.** By way of example:

- **Transfer orders (Article 2(1)(20)):** The text defines the transfer order as including instructions requiring a cryptographic key or a digital signalling device/method, and refers to electronic registration in a register, with the express mention that the entry in account can be made via DLT and that the guarantee includes assets issued/registered via DLT (including tokenised). The addition of technical markers (cryptographic key/DLT) is not enough to legally secure the perimeter. **FPM recommends favouring a functional definition: attachment to a registration system whose legal effects (proof, enforceability, governance, etc.) are established.**
- **Book entry (Article 2(1)(22)):** The text defines book entry as an electronic record, evidencing any credit or debit or other change to that electronic record, in which the electronic record and any change to it may be made using distributed ledger technology. In essence, an entry in the accounting sense cannot be amended. **To include the possibility of modifying such an entry seems to us to be contrary to the principle of sincerity and integrity in the entry of the corresponding entries.**
- **Participants (Articles 2(15) et 7) – residual category "other entity":** The text includes, among the possible participants, a residual category 'an entity other than the listed entities'; **FPM has identified this point as ambiguous**. In the DLT context, this category may lead to the inclusion of technical actors (e.g. validation/consensus functions) without clarification of their status, supervision and responsibility. **FPM calls for normative clarification (criteria/examples) and explicit articulation with the admission and control conditions of Article 7.**
- **Governance and responsibility of the operator in a distributed environment (Article 5(1)l-m):** The text provides that, where the operator is a network of nodes, an undertaking must be legally responsible and, in the case of a consortium, joint and several liability. **These principles are a step in the right direction but remain insufficient without explicit minimum requirements on governance** (incident management, audit, change rules) and on the traceability of key finality moments, particularly in the case of complex technical mechanisms.
- **Purpose times (Articles s18, 20, 21) and RTS:** The proposal provides for a framework for the introduction, irrevocability and final settlement times, and provides for technical standards (ESMA/EBA, with ESCB) that may specify these times, including for systems based on DLT. **FPM recommends maintaining a "principles + rules of the system" approach to avoid over-regulation to the detriment of flexibility.**
- **Conflict of law rule (Article 25):** see below, point 3.

2. INSOLVENCY AND CENTRALE DATABASE

Articles 22 and 26

The text sets out the moment of opening of insolvency proceedings (moment of decision) and establishes a central database for the exchange of relevant information and documents.

However, it is foreseen that CSDs must feed into this database but do not necessarily have access to the insolvency information of their participants. **FPM calls for clarification of the notification channel, access rights (need-to-know), and standardization (format/time stamp) of the insolvency event, so that all stakeholders (notably central securities depositories) are informed at the same time of the insolvency in question.** Such concurrent information of central securities depositories is essential to ensure the validity of a transfer order entered a system by a participant in bankruptcy, particularly where it is a participant in more than one system.

3. CONFLICT OF LAWS ON COLLATERAL

Article 25

The European acquis in securities/collateral is based on a logic of connection of the location of the account: it is a simple, objectiveable and "anti-forum shopping" rule, designed to secure intermediation chains and insolvency.

This European acquis derives from Articles 9 of the Finality Directive and the Collateral Directive, and from Article 25 of the Resolution Directive: the question of the property consequences of the entries in securities accounts, including securities guarantees, are covered by the abovementioned Directives, even if the general case of holding securities is however not covered by these texts. Indeed, there is no conflict-of-law rule at European level to settle the question of the property consequences of book-entry of securities, other than in the case of the liquidation of a credit institution.

As a European acquis, amending the conflict-of-law rule of the Finality Directive may lead to other side effects beyond the scope of that directive (determination of the law applicable to collateral submitted in payment, settlement or clearing systems).

Indeed, the question of the law applicable to the effects of book-entry of securities makes it possible to determine the extent of the rights in rem of the account holder (client of an account-keeping intermediary). It has been discussed at length several times at European and national levels with an approach that is agreed: **in a securities intermediation chain, the law that determines the type and extent of the account holder's rights in securities is the law of the country where each relevant securities account in the chain is located.**

- **An intermediation chain is made up of links.** Each link comprises an account holder and an account holder, respectively, the account holder being himself, except for the final beneficiary, an account holder of another account holder located at the lower link.
- **Each link in this chain is represented by a relevant account.** There are as many relevant accounts as there are links in the intermediation chain. In other words, in an intermediation chain, there is no single relevant account (for example, that of the final beneficiary of the securities) that would determine the law applicable to the entire intermediation chain. Relevant account means an account, a register or any other medium recognized by the law of a State, intended to record the entries, accounting entries or records representative of each security.
- **However, the exercise of the rights of the final beneficiary of the securities may be called into question or affected by the law or laws applicable to each level of the securities intermediation chain.** Moreover, it seems important to assume that ownership or rights in those securities is entirely based on the replication of the accounting entry representative of each security, as recorded at each successive link in the chain of ownership of the security.

The "new rule" (Article 25), as described, shifts the location criterion to the account holder's registered office (even if the account is maintained through a branch) and adds a "fallback" rule based on the law of the settlement system or interoperability agreement when the account cannot be located.

This dual development weakens rather than enhances legal certainty because:

- **it ignores the operational reality of branches and "local" management:** the lex rei sitae remains "in the first instance", but its connecting factor is clarified by referring to the place of the registered office of the account holder. Consequence: if the account holder is a branch of an entity with its head office in another Member State, the applicable law switches to the head office State, even if the branch maintains a local system, and
- **it reintroduces a quasi-contractual logic** (reference to the law applicable to the interoperability agreement, where applicable) which is precisely problematic in European history (Hague Convention on the Law Applicable to Intermediated Securities, rejected by the European Union).

Thus, it would be necessary to:

- **As regards the criterion for determining the location of the relevant account, a material criterion (and in no case consensual / contractual) should be used to determine the location of the account.** The criterion to be used is the location of the institution with which the account is opened, namely the place of the registered office (as proposed in the draft Finality Regulation) or, where appropriate, the location of the branch of that institution when the account is opened with a branch located in a different State.
- **To remove any fallback rule**, as the rule of principle always allows the location of the relevant account to be determined.

4. TRANSITIONAL PROVISIONS

Article 28

FPM considers that the grandfathering clause as envisaged in Article 28 is insufficiently calibrated and risks re-creating fragmentation, instead of securing the legal and operational continuity sought by the transformation of the SFD into a regulation.

The clause is identified as a critical point because of the procedural burden it would impose, in practice, through state-by-state re-recognition of systems, after a transitional period (mentioned as limited to 5 years). The transitional mechanism should ensure continuity without creating a "cliff effect" at the end of the transitional period, creating a significant procedural burden and a risk of fragmentation incompatible with the harmonization objective pursued by a Regulation).

FPM recommends revising Article 28 to streamline this mechanism, through a coordinated approach (single file/single window type) to avoid multiple national decisions for the same system. Systems already designated at the date of the Regulation should at least benefit from a lighter procedure to the extent strictly necessary.