Original Article

EU financial collateral arrangements and re-hypothecation in the shadow of 'shadow banking': To further regulate or not?

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ABSTRACT The purpose of this study is to analyze the shadow banking issues related to financial collaterals in the form of book-entry securities, as defined in EU under the Financial Collateral Directive (Directive 2002/47/EC, as in force), the so-called 'FCD'. It examines different legal approaches related to the activities of securities reuse or re-hypothecation that financial intermediaries, mainly as collateral takers, conduct in modern markets. Despite its positive aspects, it is beyond any doubt that re-hypothecation poses risks to the markets. The collapse of too large both in number and size entities in recent times that negatively affected investors properties in securities pointed out that the 'too big to fail' myth is not rather real. To this end, further measures have to be taken in addressing these risks. The study points out the following as areas on which EU regulation should focus in this respect: (a) Collaterals reuse and re-hypothecation should not be regarded as a pure contractual choice but as a specific service or activity that should be subject to further EU regulation and supervision for its provision by the intermediaries. In achieving this goal, it would be appropriate for a reform of the custody activities to be accelerated for the purposes of distinguishing from a prudential regulatory perspective any 'non-banking type of safekeeping services', that is, the custody activities that by definition do not include any securities reuse, from the 'banking type of safekeeping services', that is, the custody activities that as banking-like credit intermediation activities may include such a reuse. (b) There should be a clear definition of 'who owns what' that should operate as a uniform substantive law rule. This definition should cover the need of proprietary aspects and rights in book-entry securities to be recognized on an EU level regardless of the legal nature of the chains of the securities holding systems and intermediaries involved, that is, regardless of the definition of 'who holds what'. The 'who owns what' definition would be appropriate to be based not on the existing 'securities account' approach, as adopted by FCD, which in concept reflects the 'PRIMA' ('Place of the Relevant Intermediary Approach') principles, but on an approach able to accommodate the ownership and the other proprietary aspects in book-entry securities more accurately from a legal perspective. This approach should take seriously into account the concepts of the 'law under which the securities are constituted' as an aspect of the *lex societatis* rule. In this regard and for the purposes of establishing proprietary rights in book-entry securities, the actual owners (shareholders) should be registered as such in the official registrars of the country of the securities constitution. (c) Furthermore and in terms of addressing the issues of cross-border securities holdings, there should be a clear conflict of laws rule in determining the applicable law for all the

proprietary aspects in such securities. This rule should be based on the above 'who owns what' substantive law definition. In this regard, the applicable law that should define the proprietary rights in securities should be the law under which the securities are constituted. Therefore, any investor registered, for example as a shareholder, under the registry system applicable in accordance with the law under which the relevant securities are constituted, shall be considered as the owner of the securities regardless of the systems and chains of intermediaries to which the investor entrusted their property in such securities to be held. The study considers all these parameters as of extreme importance in addressing the 'shadow banking' issues in the securities and collaterals sector and, to this regard, in achieving a real protection for the markets and the investors in EU.
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INTRODUCTION

Financial collaterals are of main importance for the proper and efficient functioning of capital markets.[1] As modern markets are collateral-based, any turbulence to the collateral system may be detrimental for the market as a whole. The collapse of Lehman Brothers and other relevant default cases pointed out the need of more legislative effort on an EU level in order to solve any 'shadow banking' issues related to the use of the collaterals by the intermediaries.

In modern practice intermediaries use collaterals in securities for securities financing purposes, mainly related to stock lending or repo transactions, which in turn contribute to market liquidity. However, and despite the fact that this intermediation is similar to the banking one, it is not adequately regulated within the EU framework. Usually, this intermediation is called re-hypothecation of client securities.

In US markets re-hypothecation, as a concept of securities reuse, is generally prohibited, since it entails shadow banking risks. Under the EU current approach, which is different from the US one, re-hypothecation is regarded as a commercial issue and, hence, as a matter of negotiations between the intermediary and their clients. Considering this asymmetry, the study examines whether financial collateral regime should be further regulated on an EU level or not in terms of addressing the shadow banking risks inherent in such collateral activities.

Specifically, the next section of the study presents the main concepts of the financial collaterals, as they have been regulated on an EU level by the Directive 2002/47/EC on financial collateral arrangements, as in force,[2] the so-called 'Financial Collateral Directive' (FCD). The subsequent section focuses on the characteristics of such collaterals that opened discussions from a shadow banking perspective, mainly with regard to the 'right of use' that can be contractually granted to the collateral taker by the collateral giver on the basis of the collateral arrangement. Any relevant aspect of EU laws permitting such collaterals use and re-hypothecation is also examined and compared with the US model, which prohibits such use and re-hypothecation. The issue of 'shadow banking' is analyzed in the latter section, where the concept of securities 'commingling' is examined from an EU and US law perspective.

Under the fifth section answers are given to the dilemma 'to further regulate or not'. In this section why non-regulation is not a proper EU answer to the above question is analyzed. Furthermore, this section includes suggestions on possible regulative measures that could be appropriate on an EU level in solving the issue of shadow banking in the securities intermediation and, respectively, the 'who owns what' issues related to the proprietary aspects in securities and its conflict of laws parameters.

The penultimate section describes the relevant EU initiatives relating mainly to the Communication from the Commission to the Council and the European Parliament 'Shadow Banking – Addressing New Sources of Risk in the Financial Sector'[3] and the task force launched by the Commission in harmonizing the securities law field, the so-called 'Securities Law Legislation' (SLL). The recent Proposal for a Regulation of the European Parliament and of the Council on reporting and transparency of the securities financing transactions[4] can be considered genuine regulatory reaction on shadow banking in this field, which is analyzed in this section as well. Its provisions are also compared with the provisions of the Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions related to undertakings for collective investment in transferable securities (UCITS) regarding depositary functions, remuneration policies and sanctions,[5] the so-called UCITS V, for its inclusion of rather interesting rules on securities segregation in the UCITS field.

Last but not least, the recent Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholders engagement and the Directive 2013/34/EU as regards certain elements of the corporate government statement[6] is examined, which,among others, aims at introducing a more transparent EU environment in the securities and shareholding field.

Concluding and policy remarks are given in the final section.

THE FINANCIAL COLLATERAL DIRECTIVE – MAIN CONCEPTS

Financial collateral arrangements, as a means of securing the discharge of financial obligations, became a legal reality in the European Union (EU) by FCD. Under its aim to contribute to the integration and cost-efficiency of the financial market as well as to the stability of the financial system in the EU,[7] FCD created a new law area with simplified legal formalities[8] for collaterals, in cash[9] or financial instruments,[10] mainly in the form of book-entry securities,[11] and with exemptions from insolvency rules in serving collaterals protection from insolvency risk, to which the collateral taker is exposed in relation to the collateral giver and vice versa.[12]

In this regard, and in facilitating effectiveness and legal certainty in the use of collaterals, FCD recognizes two different forms of collaterals, that is, the security financial collateral[13] and the title transfer financial collateral.[14]

Before examining the definitional details of both collateral forms, crucial is to underline their conceptual difference from the traditional collateral status related to their simplified legal formalities and the exemptions from insolvency proceedings.

In terms of their formalities it is notable that such collaterals are subject to rather simplified procedures as evident in their creation, validity, perfection, enforceability and admissibility. FCD points out that the collateral is established once it is provided to the collateral taker; such provision is effected under the sole condition that the collateral, as well as the financial collateral arrangement from which the collateral arises, are evident in writing. It is notable that this writing form includes, based on the FCD's meaning, any recording by electronic means and any other durable medium.[15]

Focusing on cash and securities as collateral, FCD further defines that it is sufficient to prove, in terms of evidencing collateral, that the book-entry securities collateral has been credited to, or forms a credit in, the relevant account and that the cash collateral has been credited to, or forms a credit in, a designated account.[16] It is therefore apparent that FCD, considering the electronic status of securities and cash-banking systems, confines the relevant formalities in effecting collaterals to the very basic evidencing requirements by simply pointing out the 'account' through which the relevant credit of cash or securities is affected.

In the same context FCD stipulates that the collateral shall not be dependent on the performance of any formal act. In view of these provisions, it is far from clear that any formal requirements provided by national laws of EU member states in relation to collaterals (pledges, transfer outrights and so on), referring for example to any notary, court or other public registration formalities, are not applicable to the case of the FCD's collaterals.

The 'provision' of collateral is also defined in such a similar simplified manner. FCD accepts all possible circumstances under which traceability of collateral may appear in practice as such provision. Specifically, it recognizes as provision, the delivery, the transfer, the holding or the registry of collateral, as well as any other designation to be in the possession or under the control of the collateral taker or of a person acting on their behalf.

It is notable that all these alternative means of establishing collateral render its function rather flexible and permits its provision to be effected by credit to an account, regardless of the particular account structure that may appear in practice.

In terms of securities provided as collateral, such broad definitional approach by the FCD is rather crucial since it renders collateral flexible and operational in any form of securities holdings that may be involved. As cash deposits and relevant collaterals fall into the definition of banking regulations, the analysis in this study focuses mainly on securities collaterals that in relation to their nature of book-entry securities are yet of main EU legal and policy concern.

In respect of securities, the establishment of the collateral is closely related to the holding system or, put in the intermediaries' glossary, to the custody relationship[17] under which the securities are held. For example, when the securities are held by a custodian for their client directly in a Central Securities Depository (CSD)[18] under the concept of the individual segregated account, that is, when they are held directly for the client in an account in the client's name in the books of the CSD, then it is reasonable to consider that the relevant CSD should be typically involved in perfecting the collateral. Normally, in this case the CSD may be under the legal duty to monitor the blocking of the securities held as collateral, in the name of the collateral taker, in order to ensure the latter's rights and the broadest publicity of the collateral and, in this respect, to safeguard the priority in its use in favor of the collateral taker.[19]

On the other hand, the situation differs when securities are held indirectly for the custodian's clients in an omnibus account in a CSD (or on a lower level through other intermediaries) within the framework of the multi-tier chain of intermediaries that creates indirect holding concepts for securities. In this case, as the client, for which the securities are indirectly held by the custodian with the CSD, does not appear in the CSDs books, any collateral that the client may want to establish in such securities will follow the same indirect route, that is, it will have to be established on a lower level in the books of the custodian who is keeping the relevant account for the client. These indirect concepts of collateral holding may, however, raise concerns as the top-tier levels of accounts in the books of the CSD are not informed of the collateral. Such concerns relate mainly to the fact that securities posted as collateral in this indirect holding manner may not be prohibited from being used by the custodian or the other intermediaries through which they are kept in the multi-tier chain and thus the securities and the relevant collateral may be vulnerable in case of the custodian's default.[20]

The above different direct and indirect holding concepts appear more complex when systems interact with each other in the context of the cross-border EU markets. As securities are used as collaterals from one system to the other, it is rather difficult in praxis to identify which system's law applies for securities holdings and collaterals. From a legal perspective, this is regarded as an issue of conflict of laws.

Moreover, such interaction is not merely an issue of conflict of laws. It is also an issue of custody risk. As different custody law systems interact, commonly as a mixture of direct and indirect holdings, it is crucial in this cross-border context to identify which custody law applies and defines the operation of the system. Considering the importance of the above issues for the proper function and effectiveness of EU collaterals, they are further analyzed below in the section 'To further regulate or not?'.

In respect of the FCD's collateral formalities crucial is to underline that the main concept of simplification covers also the enforcement of collaterals.[21] In underpinning the same goal of ensuring effectiveness and legal certainty in the use of collaterals, FCD recognizes the collateral taker's right to realize the collateral by simply using the cash or sell the securities provided as collateral and, hence, without being subject to any other formal procedures under the EU national laws (for example, to prior notices or court approvals for the realization of collateral or to public auctions in terms of its selling and so on). To this end, it is apparent that any national specificity related to the enforcement and realization of collateral cannot be applicable in case of collaterals posted in accordance with FCD.

Such simplified formalities with respect to the creation-perfection and enforceability of the FCD collaterals are tightly connected to their profile as 'financial' collaterals. This relates to the fact that they are applicable to a specific scope of persons, as collateral givers or collateral takers, and to specific obligations that the collateral intends to secure.

As far as its scope of persons is concerned, it is notable that such collateral can be established only between financial actors other than natural persons according to the FCD's definitions. In interpreting the exclusion of natural persons from the FCD's scope, it is reasonable to consider that the FCD's intention, based on its general goals of safeguarding the stability of the financial system as a core aspect of the EU integration, is to regulate the collateral relationships of persons that are involved in the financial system and may therefore pose risks to it.

Specifically, FCD is applicable under its scope[22] to persons mainly referring to the public sector, when intervening in the management of public debt or holding customers' accounts, the central banks, the European Central Bank (ECB), the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and other relevant bodies, the post-trading infrastructures, mainly referring to central counterparties (CCPs) and CSDs, the financial institutions, for example, credit institutions, investment firms and undertakings for collective investment in transferable securities (UCITS), relevant management companies, as well as persons related to the legal financial system.

In terms of such definitional approach natural persons, mainly related to retail end-investors, are excluded from the scope of FCD. However, it seems reasonable for such exclusion to be further examined mainly in cases where natural persons are active players in the financial markets and therefore become a non-negligible source of risk for the markets concerned. Reasonable is also for the FCD to be updated in order to reflect any relevant EU legislative changes. From this point of view, its scope of collateral givers or collateral takers should reflect not only on the traditional forms of funds under the Directive 2009/65/EC, the so-called UCITS IV Directive (UCITS: Undertakings for Collective Investment in Transferable Securities), but also on the more recent concept of the alternative investment funds, as recognized on an EU level by the Directive 2011/61/EC, the so-called AIFMD (Alternative Investment Fund Managers Directive).

In concluding its definitional aspects, it should also be pointed out that the FCD's collateral relates only to 'financial obligations'. Collateral is designated solely for the discharge of obligations that give a right to cash settlement or delivery of financial instruments,an obligation closely connected to the financial system.[23]

Considering these elaborations and mainly the need to protect the financial system from any insolvency risk and the triggering of systemic risks, FCD includes also provisions aiming to protect collaterals and close-outs from the insolvency proceedings, that is, the winding-up proceedings or reorganization measures that may commence in relation to the involved parties. In this regard it adopts a set of rules based on the main principle that such insolvency may not have any 'retroactive effect' with regard to the collateral. Additionally, it recognizes the right of applying close-out netting notwithstanding the commencement of such proceedings and measures.[24] The rationale behind these provisions is that the parties in the collateral arrangement should be in a position to manage and limit their credit risk exposures by using collateral or applying close-out netting without facing any voidance or reversal risks related to insolvencies.

It should be underlined that, conceptually, these measures aim to protect not only the collateral taker from the default of the collateral giver, but also the collateral giver from the default of the collateral taker. Therefore, if the collateral taker defaults, the collateral giver will be entitled to close-out immediately any outstanding transactions and enforce its collateral in discharge of the collateral taker's relevant obligations. In this regard and to the extent of the close-out effect, the collateral giver is not rendered as an unsecured creditor of the defaulting collateral taker. The collateral giver is legally protected by FCD to use the collateral as a kind of security for the leg of the collateral taker's obligations and, to the extent of the relevant offsetting, to mitigate its exposure to the latter.

In view of these main concepts, it is far from clear that the financial collateral under FCD is subject to rather favorable provisions in terms of perfection, enforcement and protection against insolvency risks that undoubtedly encourage such collaterals' use in the financial sector. However, concerns are raised, mainly in the recent financial crisis era, due to the fact that the collateral taker is permitted, as analyzed below, to use the collateral from the first moment of its creation and not only in case of default.

COLLATERALS CHARACTERISTICS THAT OPENED DISCUSSIONS

The so-called 'right of use' that FCD recognizes sets in the heart of the financial collaterals. In legal terms this right operates as a pre-default right, that is, as a right under which the collateral taker is entitled to use the collateral posted by the collateral giver before the occurrence of the default that the collateral intends to cover.[25]

In its essence this right reflects mainly on the collateral taker's right to deal with the collateral and, in case of securities provided as collateral, to sell such securities freely at a pre-default stage.[26] The specific aspects of exercising such right are closely connected to the two main forms of the FCD's collaterals, that is, the 'title transfer financial collateral' and the 'security financial collateral', both operating in the context of an 'arrangement'.

As title transfer financial collateral arrangement is concerned, FCD defines it as an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of the financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations.[27]

This type of collateral is in legal theory also referred as transfer outright due to the fact that the ownership of the assets, comprising the collateral (cash or securities), is transferred from the first moment of the collateral's creation to the collateral taker. From this first moment, no proprietary right over the transferred assets remain 'in the hands' of the collateral giver, but only a contractual right (or claim) to have equivalent collateral returned from the collateral taker when performance of the secured obligation takes place. Therefore, this type of collateral legalizes the collateral taker to use the collateral, from the very first moment of the collateral's establishment . The right of use is inherent in its nature.[28]

The other form of the FCD's collateral, that is, the security financial collateral arrangement, seems different in nature from a definitional point of view, as it relates to a security interest and not to a transfer outright. However, it may conceptually entail the same transfer outright effect following the exercise by the collateral taker of their right to use the collateral, as it can be provided by the relevant financial collateral arrangement.

Considering, firstly, its definitional nature, the security financial collateral arrangement is regulated by the FCD as the arrangement under which a collateral provider provides financial collateral by way of security in favor of, or to, a collateral taker, and where the full ownership of the financial collateral remains with the collateral provider when the security right is established. However, such collateral's nature as security interest (for example, similar to the traditional forms of pledge) is conceptually blurred due to the fact that FCD recognizes collateral taker's right to use the collateral as a parallel functional component of the collateral. Within this context the collateral taker is entitled to use and dispose of the collateral provided under a security financial collateral arrangement as the owner of it and in accordance with the terms of the arrangements.[29]

It is therefore reasonable to consider that to the extent that the collateral taker is entitled to use and dispose of as an owner the collateral under the relevant right of use, such collateral cannot be treated as one of having the nature of a genuine security interest. Despite the fact that the collateral giver retains its proprietary-ownership right of the collateral at the time of its establishment, the exercise by the collateral taker of its right of use acts as a legal means of transforming the collateral from a security interest to a transfer outright. Therefore, it seems reasonable from a legal point of view such collateral to be regarded as a 'functional equivalent' to the title transfer collateral.

Based on the above, it is obvious that the main difference between the title transfer financial collateral and the security financial collateral, combined with a collateral taker's right of use, is that in the former the full ownership of the collateral is transferred to the collateral taker from the first moment of delivery of the collateral, while in the latter at the moment when the right of use is exercised.

It is crucial to underline that the right of use according to the FCD is not subject to any requirements or conditions for its exercise and functioning, in general. In this regard, the collateral taker may freely exercise this right at a pre-default stage in the course of its own funding and business.

From a policy perspective, the rationale behind this approach is attributed to the fact that the use of collaterals makes markets more liquid and efficient.[30] Modern market practices encourage the use of collateral not only as a risk mitigant but also as a means of securing funding. A characteristic example can be considered the one in which a broker uses its client's securities collaterals for which it has a right of use in terms of facilitating its own funding (for example, in repo transactions).

The necessity of using the collateral as a means of increasing liquidity has been positively approached by the EU not only within the context of FCD but also of other legislative initiatives, mainly the Markets in Financial Instruments Directive (MiFID) and AIFMD.[31] As for MiFID, this is reflected in the general scope of its provisions permitting the use by the investment firm of client's assets. Specifically, article 13 par. 7 of MiFID defines that an investment firm shall, when holding financial instruments belonging to clients, make adequate arrangements in order to safeguard clients' ownership rights, especially in the event of the investment firm's insolvency, and to prevent the use of a client's instruments on own account 'except with the client's express consent'. Therefore, when the consent of the client is obtained, such use is freely permitted by MiFID and, notably, without any concern related to client protection. It has to be pointed out that the use of client's assets under MiFID is not limited to cases of client collaterals in line with FCD but rather broader covering any use by the investment firm of client assets in the context of the legal relationship of 'holding', including the safekeeping and other related custody relationships, that the investment firm can create with its clients.[32]

A similar concept has been adopted in the AIFMD. The relationship between an alternative investment fund (AIF) and the prime broker relevant to the one between the client and the investment firm appears in AIFMD. AIFMD provides that where the manager of an AIF (AIFM) on behalf of an AIF uses the services of a prime broker, the terms shall be set out in a written contract and the contract shall provide, among others, any possibility of 'reuse' of AIF assets, which has to be in compliance with its rules.[33] It is therefore apparent that AIFMD permits reuse of AIF's assets without imposing any prudential requirement to the prime broker that uses the assets, though the AIF is exposed to its risk related to the assets concerned.

Despite the economic value of this 'free-use' approach, it is fairly obvious that the use or reuse or re-hypothecation of clients' assets by the intermediaries may be detrimental for the interests of the clients and the financial market as a whole, mainly in case of the intermediaries default. As the client's assets become own property for the intermediary under the latter's right of use and are not segregated, when the intermediary becomes insolvent the client does not have any right to reclaim the particular assets or, otherwise, be treated as a 'secured' creditor in relation to them. It can only be regarded as an unsecured creditor having, in the best case scenario, a close-out netting right to limit its unsecured exposure. Specifically, in cases when the law permits a close-out, which is the main context of FCD, the obligation of the intermediary to return the assets to the client is given a cash value and forms part of a set off calculation against the amount the client owes to the intermediary.[34] But what will be the case when the client does not owe any amount to the intermediary or, otherwise, when the intermediary has used or re-hypothecated the client's assets in excess of the amount the intermediary owes? Undoubtedly in that case the client 'owns' nothing more in relation to the relevant used assets but its 'unsecured' position.

It is therefore apparent that in all these cases the client is outside of the scope of any investor protection, as set out on an EU level (for example, under MiFID related to the segregation principles). The intermediary, acting as a collateral taker (FCD), as an investment firm (MiFID) or as a prime broker (AIFMD), lacks any prudential obligation to have in place arrangements to protect its clients in relation to their held securities, by exercise of their right to use such securities. MiFID limits the scope of such an obligation only in cases when the client's assets, held directly or indirectly by the intermediary, continue to belong to the client as own property.

Regulatory concern of client protection is therefore limited on an EU level only to cases where the client's assets (for example, financial instruments) remain in the hands of the intermediary under a 'holding' concept (for example, safekeeping). In this regard, it is apparent that EU regulation does not provide any kind of protection when the intermediary uses its clients' assets in the context of a right of use. As the client protection under the EU regulation, related to the client property entrusted to an intermediary, aims at protecting the client in case of default of the intermediary, the absence of any protective measure when such property is used, which is definitely a more riskier situation than the pure holding cases, seems a real paradox.

Lack of any supervisory intervention in these 'free-use' scenarios, referring notably to securities, could be interpreted as a regulatory asymmetry, considering that securities in the modern holding patterns are treated like money and their holding in the books of the intermediary is regarded as an 'irregular deposit', which in most cases functions in an equivalent manner in relation to the banking cash deposit. In such cases, it is apparent that the intermediary, when holding the securities as a custodian, acquires an ownership of them. To this regard the client-depositor retains only a contractual right to have securities returned of the same quality and quantity upon request from the custodian. Therefore, in the event of insolvency of the intermediary, the client has nothing more but an unsecured position.

Conditions of 'free-use' scenarios in relation to collaterals or securities' deposits and holdings may undoubtedly pose risks to the markets. Within the era of recent financial crisis this can be very easily proved. Characteristic are in this respect the examples of failure of giant financial firms, such as of Bearn Stearns (2008), Lehman Brothers (2008) and MF Global (2011). In all these cases, 'free-use' or, as it is called, re-hypothecation caused financial stability problems to the markets. Market stress, as a reaction of the firm's collapse, led clients to massive securities withdrawal attempts, but such attempts remained unsuccessful. As clients' securities were used by the firm in the context of their reuse right, the latter was unable to return them to the clients. This inability created further systemic problems leading to a catastrophe for the client portfolios.

THE PROBLEM OF 'SHADOW BANKING' IN COLLATERALS AND RE-HYPOTHECATION

Owing to this unregulated right of use and its inherent risks, the shift to a collateral-based system made financial markets rather vulnerable. To this end, the relevant activities have been characterized as 'shadow banking' activities.

In its broad definition shadow banking, as an activity or a system, relates to any 'credit intermediation involving entities and activities outside the regular banking system'.[35]

In this context shadow banking activities have been regarded as bank-like financial activities that are conducted outside the traditional commercial banking system in an unregulated manner or slightly regulated. Respectively, entities that fall into the definition of shadow banks are mainly non-banks that exercise bank-like activities in the course of their financial business. Such activities it is expected to refer either to financial products and services ordinarily provided by traditional banks, or any other non-banking financial products and services.

In their effort to supervise shadow banking activities regulators in EU and internationally and related fora, a series of non-bank financial activities, including repo transactions and stock lending activities, securitization and also re-hypothecation activities have been identified as shadow banking activities.[36]

Re-hypothecation has been in this context defined as pledging of any kind by the intermediary (for example, custodian, broker-dealer) of client securities as collateral in other unrelated transactions, for example as a collateral used so that the intermediary obtains brokerage bank loans.[37] Moreover, re-hypothecation has been conceived as a general definition that covers any pre-default use of clients' collateral by an intermediary, who acts in this regard as a shadow bank, or any use of clients' securities (or other financial assets) held and used by such an intermediary, in both cases in serving the latter's funding purposes.

As a means of increasing liquidity, re-hypothecation became a common market practice mainly in EU countries. Both clients and intermediaries appear to have strong incentives to re-hypothecate. Intermediaries, when engaging re-hypothecation activities, can successfully increase their revenues as re-hypothecation permits them to develop repo and stock lending capacity.[38] In the course of their re-hypothecation business they can thus intermediate more actively in the securities markets in a similar way that banks do. This works in practice, on the one hand, by accepting securities from their clients as deposits or collaterals, based on the pools of securities they create, and by offering, on the other, lending (securities financing) opportunities to prospective borrowers. Thus it is reasonable to consider that when the intermediary re-hypothecates, their clients succeed better rates on the services that the intermediary provides as a result of the latter's re-hypothecation increased revenues.

It is notable that re-hypothecation has been encouraged in EU markets as a result of modern custody and securities holdings techniques. Securities are usually commingled[39] by the intermediaries when acting as custodians. Such commingling enables the intermediaries to develop the concept of securities 'pooling' more easily. It is apparent that the intermediary cannot re-hypothecate when they do not commingle but holds the securities in a segregated manner, that is, in separate individual client accounts. From this point of view, it is obvious that re-hypothecation presupposes that the intermediary who re-hypothecates is able to use its clients' property as own property. From a definitional perspective this normally cannot be reflected when such property remains 'in the hands' of the clients and is therefore held in segregated accounts. It is therefore reasonable for the intermediary to commingle the securities of each of their clients with the securities of its other clients or even with its own securities in terms of optimizing its re-hypothecation effect.

These commingling techniques do not contradict to the EU regulations, but are rather in line with them. Specifically, commingling is not prevented by the MiFID. To the contrary, article 19 of the Commission Directive 2006/73/EC,[40] which implements article 13 of MiFID, recognizes the right of the investment firm to enter into arrangements for securities financing transactions (for example, stock lending, repos and others) and in this regard to hold client's securities in 'omnibus accounts' on the only condition that its clients have given prior express consent. It is therefore apparent that MiFID permits commingling of clients financial instruments within the context of an omnibus account, which in turn enables the intermediary to use such instruments acting as owner in the scope of securities financing activities.[41]

It should be underlined that MiFID does not provide any prudential or other related requirements for investment firms when they exercise securities financing activities to this regard. Following its choice of 'light regulation', it limits its requirements only to relevant reporting. Specifically, under the mentioned article 19 par.2 last point it imposes the obligation to the investment firm, engaging in such activities, to keep records of clients' details, on whose instructions the use of the financial instruments has been effected, and of the number of financial instruments used belonging to each client, in order to enable the correct allocation of any loss. However, such reporting requirements can only be regarded as an administrative measure, which under MiFID can be used for allocating clients loss in case of the firm's default, and not as a measure that can make clients property 'revive'.

Following the economic crisis, the shadow banking problems became more acute. The failure of Lehman Brothers, for example, pointed out the riskiness of allowing re-hypothecation as hedge funds, since other clients, mainly of the UK affiliate of Lehman (LBIE-Lehman Brothers International Europe) were unable to withdraw or reclaim the assets they had placed with brokers and other intermediaries. This situation led to massive market losses and affected rather negatively hedge funds businesses.[42]

In light of all these crisis problems, it has been argued that re-hypothecation should not be permitted in markets as it exposes them to financial stability and systemic risks.[43]

Notable is that re-hypothecation is generally prohibited under the US law. More specifically, SEC (Securities Exchange Commission) Rule 15c2-1 prohibits brokers and dealers of hypothecating customer securities. Such prohibition covers commingling of customers' securities in any respect, that is, commingling the securities of several customers, commingling customer securities with those of the broker as well as pledging customer securities in an amount greater than the customer's debt to the broker.[44]

Furthermore, SEC Rule15c3-3, the so-called 'Customer Protection Rule', prevents brokers from using their customers' assets as collateral for the benefit of anybody aside the customer. Such Rule also imposes strict segregation requirements by obliging the broker to open a separate bank account for each of their customers, the so-called 'Special Reserve Account for the Exclusive Benefit of Customers', and to use such account exclusively for the benefit of the customer for whom the account has been opened.[45]

Such prohibition is also apparent in the more recent US regulation on cleared-swaps customer collateral, the so-called 'Legally Segregated Operationally Commingled' (LSOC) model. Specifically, Section 724(a) of Dodd-Frank Wall Street Reform and Consumer Protection Act ('Dodd-Frank'), which amends section 4d of the Commodity Exchange Act ('CEA'), requires that money, securities, and property of a swaps customer shall be separately accounted for and shall not be commingled with the funds of the futures commission merchant (FCM) or be used to margin, secure or guarantee any trades or contracts of any swaps customer or person other than the person for whom the same are held.[46]

In this regard the LSOC allows for the FCM and designated clearing organizations (DCO) to commingle all collaterals of the FCM's customer in one separate account though this commingling is of a pure technical or operational nature. Under this model, this separate account could not include or be commingled with any other types of funds, such as the DCO's or FCM's proprietary funds, the funds of the FCM's non-cleared swaps customers, or the FCM's other customer funds. However, the FCM is required according to the LSOC model to provide the DCO with information for the identity of each of its customers and the amount of cleared swap collateral held at the DCO attributable to each customer daily. Therefore, the account of cleared swaps customers' collateral together in an omnibus account kept by the FCM is only of an operational nature, as in the FCM's and DCO's books and records, while the customers' swaps and relevant collateral are accounted for individually.[47]

All these US laws and relevant practices, supporting segregation and individual account keeping of collaterals, point out the need of client protection and the regulatory concern of ensuring such protection.[48]

However, different is the case of UK laws and other EU countries that apparently reflect on MiFID's concepts under the scope of EU harmonization. In contrast to the US laws, UK broadly allows brokers and dealers to re-hypothecate the assets of their clients. In the same line with MiFID, the FCA (Financial Conduct Authority) Custody Rules (CASS 6.4) although prohibits a prime broker from pledging its client's assets as collateral in its own transactions, it reverts such prohibition rule and permits it in case the prime broker obtains an express prior written consent from the client.[49] As a result, these FCA rules are in essence identical to those of MiFID that permit the investment firm to use its client's financial instruments for securities financing purposes upon the latter's consent.

In Lehman's case, the differences between the UK commingling legal system and the US segregated one led inevitably to regulatory arbitrage conditions. Such conditions were, however, detrimental for the clients of the collapsed UK Lehman (LBIE), as their portfolios felt the full risk of commingling and re-hypothecation activities exercised by LBIE in accordance with the UK law. As securities and assets of LBIE's clients were commingled and re-hypothecated by LBIE, those clients were unable to reclaim their securities. Such regulatory arbitrage situation also caused misleading market conditions. Managers of hedge funds dealing with the New York office of Lehman stated that they were not aware of being subject to UK regulations as their accounts were opened and handled by US Lehman. Differences in laws and market models became thus detrimental for cross-border clients and activities. As a result, the clients of LBIE could not favor from US bankruptcy law in accordance with which clients of US Lehman reclaimed their segregated assets without facing any risk of re-hypothecation.[50]

Considering the collapse of Lehman and of other systemically important firms, it is apparent that all related client interests have not been adequately protected under the existing EU legislation. But what will be the proper degree of regulation in this regard and, more specifically, the proper balance between the need to have liquid markets, on the one hand, and client protection, on the other? In which way can therefore the shadow banking problem in this area be addressed, by further regulating the market or not?

TO FURTHER REGULATE OR NOT?

This question seems rather difficult to be answered. The two possible scenarios that the question includes, that is, the one 'to regulate' and the other 'not to regulate', represent two different market cultures and models that are in fact based on diametrically opposite theoretical approaches.

The one approach, that is, 'to regulate', apparently reflects on the US model. Under this approach clients' assets cannot be used or be commingled for re-hypothecation purposes. They shall have to be segregated on a client level. Such segregation covers all possible holding levels, therefore preventing commingling of the securities of each of the intermediary's client with the securities of their other clients or with their own.

This approach stems from the fact that segregation of client securities reduces systemic risk in the markets and, therefore, makes them safer and more efficient. In this regard, clients are encouraged to feel more confident about the level of credit or custody risk they accept. Supporters of such an approach claim that the more deleveraged the markets, the safer the conditions of the financial system. However, the main disadvantage in following such approach is that prohibition of re-hypothecation may make the markets less liquid, as it eliminates the securities financing capacity (stock lending, repo, sell buy back and so on) of the intermediaries and increases the cost of credit.

The complete opposite direction is the re-hypothecation one. This approach, which is conceptually encouraged by the EU regulation, supports the advantages of re-hypothecation as a means of contributing to market liquidity and borrowing cost reduction. This approach, as already mentioned, has been endorsed by MiFID, FCD and, more recently, by AIFMD.

In relation to the alternative investment funds the relevant expert group reported characteristically to the European Commission the following: '[T]he commercial driver behind re-hypothecation is the fact that prime brokers lend cash and securities to hedge funds and that capital to support these activities has itself to be raised. In simple economic terms, the use of hedge fund assets by prime brokers is a key factor in reducing borrowing costs, thereby increasing returns, for hedge funds …. the more assets a prime broker is able to use, the lower overall cost of funding that hedge funds have to pay'.[51]

Supporters of such an approach held that the degree of client protection and re-hypothecation will have to be a 'client choice'. The client should have to decide whether they permit the intermediary to re-hypothecate assets or not. In this approach, re-hypothecation is regarded as a matter of negotiations among the transacting parties, that is, the client and the intermediary (broker-dealer, custodian and so on), and not a regulatory intervention. It is notable that this approach is in line with MiFID, which permits an investment firm to use its client's securities upon the latter's consent, as well as with FCD where the collateral giver is entitled to negotiate whether it will grant or not to the collateral taker a right of use on the basis of the terms of their relevant collateral arrangement.

In support to the 'client choice' approach, the expert group on alternative investment funds argued that the cost of protecting the investor against the risk of default of the prime broker must be balanced against the other needs and the sophistication of the investor. In this regard the Group recommended that neither the Member States nor the Commission should impose any regulatory restrictions upon re-hypothecation limits for European hedge funds and that such matters be regarded as commercial terms of business to be negotiated between the fund and the prime broker.[52]

But what are the pros and cons of the above diametrically opposite approaches? Which one is 'better' and has to be followed? As already highlighted, the answer to this question is not an easy task. No doubt that such an answer presupposes a rather comprehensive analysis, which has to consider all necessary parameters as well as the current market conditions following the financial crisis and the pathologies that the collapse of too many systemically important firms have created.

It should be beyond any doubt that an 'appropriate' approach would be the one that considers all key parameters of the current market functioning and, hence, all related needs, including mainly:

- the need of liquid markets
- the need of financial stability
- the need to facilitate cross-border activities and transactions
- the need to respect the investor choice
- the need to have an appropriate degree of investor protection and, hence,
- the need of an appropriate prudential regulation in place so as to safeguard the satisfaction of the above needs.

In this regard the approach of prohibiting re-hypothecation, although safe in its essence, seems to be rather restrictive for securities intermediation. In our view by providing an absolute prohibition on re-hypothecation the markets will miss any opportunity of taking advantage of its positive sides. Its prohibition will inevitably limit the scope of the securities financing market and increase the cost of funding. Specifically, prevention of commingling of clients' securities will negatively affect the ability of the intermediaries to provide securities financing services. This stems from the fact that securities financing products are based on the ability of intermediaries to create pools of securities that presuppose commingling and re-hypothecation.

Therefore, if the intermediaries are not permitted to commingle or re-hypothecate, it will be rather difficult for them to create market conditions for securities financing (for example, stock lending or repo or other related). Considering, however, that securities financing is rendered a cornerstone for capital markets, since it covers a series of market needs for short sellers, market makers, risk hedgers, cases of failed settlement and so on, any negative impact to its function will definitely result in market inefficiencies and malfunctions.

On the other hand, the approach of 'client choice', although appropriate in its essence, does not ensure a proper degree of client protection from a securities marketability perspective. Considering the crisis problems and pathologies, this approach should be further elaborated and be subject to stricter EU regulation and supervision.

More specifically, further regulatory initiatives should be taken on an EU level focusing on the following points.

(a) Re-hypothecation: Why not a regulated activity?

Considering the risks that re-hypothecation poses, it is in our opinion important not be regarded as a pure contractual choice but as a specific service or activity being subject to further EU regulation and supervision for its provision by the intermediaries.

It should be from a conceptual perspective important to distinguish securities custody cases that include a right of use or re-hypothecation for the intermediary-custodian from those that do not. This distinction is rather important as custodians that re-hypothecate act in a similar manner to banks. Moreover, it should be appropriate this distinction to be clearly reflected on an EU regulatory level, mainly related to MiFID, where custody services in the form of safekeeping and administration of financial instruments for clients are provided. This distinction will create a better level playing field between market factors activating in the 'use' and 'non-use' sector respectively, while it will at the same time promote investor protection and transparency to the markets.

In this context, MiFID could elaborate a concept of distinguishing the securities custody services in two different categories. The first category could refer to custody services that operate as non-banking type of safekeeping services. In such services the right of use or re-hypothecation should by definition be excluded. The other category could define a scope of banking type of safekeeping services, in which apart from the safekeeping characteristic, an *ab initio* right of use or re-hypothecation could be recognized.[53]

From a conceptual perspective, as the reuse or re-hypothecation relates to the securities financing, it could be appropriate the banking type of safekeeping services to be more specifically defined so that they stipulate their particular meaning, as services permitting the custodian to use client securities for securities lending or other similar credit intermediation purposes.

These definitional distinctions of securities custody services should also be reflected upon the prudential requirements related to their provision. Specifically, regulation should distinguish the prudential requirements for non-banking from banking type of safekeeping services concerning their different risk profile. Relevant aspects of EU laws to which possible changes may refer, relate to the capital requirements regulations as well as to the investor compensation scheme regulations.[54] Relevant limits to the ability of re-hypothecating, for example caps on the amount of client securities that could be permitted to be re-hypothecated by the custodian could be also examined in this context.[55]

The custody approach as suggested herein seems also rather compatible to the existing EU regulation relating to the 'client choice' approach, as already elaborated under the scope of MiFID, FCD and AIFMD. Clients that may not wish their securities to be re-hypothecated will be free to choose an investment firm that provides solely non-banking type of safekeeping services. To this end, clients with less risk appetite will not be exposed to disproportionate custody or insolvency risks. On the other hand, when the client wishes to choose an investment firm that provides banking type of safekeeping services, they should have to consider the exposure to the relevant custody risks, unless pure safekeeping services are opted.

The concept of this custody approach is apparently not a new one in the securities sector. It has been reflected on the recent EU initiatives to regulate CSDs and their activities. More specifically, the Proposal for a regulation on improving securities settlement in the European Union and on central securities depositories, that is, the upcoming and so-called CSDR (Central Securities Depositories Regulation) Proposal,[56] reflects generally on the same concept in relation to the CSDs activities. In its list of the CSD services CSDR distinguishes between the typical CSD activities, related mainly to settlement services, notary services and so on, including non-banking type of ancillary services (for example, collateral management), from the 'banking type of ancillary services' that, among others, relate to the services of lending securities to CSD's participants and holders of securities accounts that may be provided by CSDs on the condition that they fulfill specific banking requirements (CSDR, Annex – List of Services, Section C – Banking type of ancillary services).

It is notable that the custody approach, as suggested in this study, could also impact on the functioning of the FCD's financial collaterals. The collateral taker would be able to have a right of use or to take collateral of a title transfer kind, provided that the appropriate 'custody' profile will be obtained. In this context, an investment firm could be able to re-hypothecate securities collateral only when it will be authorized to provide banking type of safekeeping services. In this regard the scope of collateral takers in case of security collaterals, accompanied with a right of use or of title transfer collaterals, should be limited only to entities entitled to re-hypothecate on a license-based concept, including such banks or investment firms having such custody profile. It would be reasonable for a relevant concept to be elaborated in other areas of re-hypothecation, including mainly UCITS or other forms of funds, using the vehicle of securities reuse as a means of ensuring funding or securities financing (infra section 'EU legislative initiatives in addressing shadow banking in securities collaterals', para d)).

To this end, it is rather questionable whether the upcoming and so-called 'MiFID-2', that is, the EU initiative of recasting MiFID,[57] is adequate of addressing re-hypothecation problems on an EU level. As it is apparent from the new drafting of its provisions under the relevant EU Proposal, the concern of MiFID-2 on client protection is not related to 'who provides the service' but to 'whom the service is provided'.

Specifically, with regard to the 'free-use' approach that MiFID adopted, MiFID-2 limits its re-hypothecation provisions by laying down that '[A]n investment firm shall not conclude title transfer collateral arrangements with retail clients for the purpose of securing or covering clients' present or future, actual or contingent or prospective obligations'.

Considering that the main goal in the post-crisis era is not to limit the scope of users of the financial services but to strengthen the financial stability of the markets for the benefit of the users, it is rather questionable whether the new MiFID-2 approach is rather accurate in achieving this goal.

Furthermore, the proposed in this study custody approach would be considered appropriate to be supplemented by a set of new reporting obligations that will correspond to the different profile of the safekeeping services related to their banking or non-banking type. More specifically, it would be appropriate for such report to be rather detailed in case of banking type of safekeeping services so that the client or, in case of collaterals, the collateral giver to be in a position to manage the exposures from their securities re-hypothecation. These reported obligations should also be a matter of supervision by regulators.

In light of the above, EU regulation should be further reviewed so that it ensures an appropriate degree of supervision on re-hypothecation and defines the relevant shadow banking regime in an efficient manner. In achieving this goal a set of prudential regulation should be introduced and affect all relevant aspects, focusing on the FCD's financial collaterals to which the relevant reuse is based.

(b) 'Who owns what' regardless of 'who holds what'

Another key parameter in addressing shadow banking and re-hypothecation in the securities sector should be the definition of 'who owns what'. This definition, which by nature reflects on substantive law concepts, should be tailored to cover the need of proprietary aspects and rights in book-entry securities to be recognized in EU regardless the kind of the securities holding systems involved.

It is of main EU concern the 'who owns what' problem to be solved on a pan-European level as a basic part of the securities markets integration. As has been pointed out earlier in the second section, due to

- the cross-border interactions among securities holding systems;
- the functional and legal differences among those systems, mainly acting directly or indirectly;
- the nature of securities as book-entry securities and
- the consequent multi-tier chain of intermediaries across EU

it is undoubtedly difficult to answer the 'who owns what' question.

This question mainly relates to the fact that registered, for example, as shareholders in national registrars or depository systems of EU member states are commonly not the real investors but the intermediaries, acting on their behalf. In modern markets intermediaries are indeed permitted to hold clients securities indirectly, to create pools of securities or omnibus accounts in the course of their business, to use such securities as owners, and, as a reflection of this ownership, to act as shareholders in the official registrars or depositary systems.

This study does not focus on the 'who owns what' issue *per se*. However, considering its relation to the financial collaterals, the following should be observed.

Proprietary aspects and rights on securities should be clearly defined on an EU level in order to address the issue of 'who owns what'. Put differently, regardless of the securities holding patterns, either direct or indirect, the investor should have the right and the respective protection not to lose its legal status as owner of the securities held through intermediaries. It should be an unconditional right of the investor to be the one registered as owner and, respectively, as a shareholder in the official registrar and not the intermediary, acting on its behalf. Even in cases when the intermediaries hold securities indirectly in omnibus accounts, that is, in a commingled manner for their clients, there should be a clear EU rule that will protect investors and mainly their choice to be registered as the owners of such securities. In this regard, such 'investor's direct identification right' should be recognized as an unconditional investor right regardless of any other parallel rights that may be attributed, for example, to the issuers of the securities to identify the real investors for transparency reasons.[58] Therefore, such right should be regarded as an essential constituent of the securities 'substance', mainly from a proprietary and thus investor protection perspective and not only as a means of enhancing transparency in the securities field.

Additionally, intermediaries not entitled to offer banking type of safekeeping services under the aforementioned custody approach should not be permitted to be registered as owners of the securities, as in this case they will not be legalized to use the securities in any manner. Intermediaries, acting in a non-banking type custody status, should be thus under the obligation to identify their clients as owners of the securities even in cases where such securities are held by them in a commingled or omnibus manner. Paradigms as one of the US model (LSOC) could be a valuable guide for the respective legal identification purposes.

With regard to collaterals, this custody approach will be very important in identifying the owner of the securities either at a pre-use or at post-use basis, that is, the collateral giver (and not for example its custodian) as owner before the exercise of the right of use by the collateral taker (and not its custodian under the same example) or before the establishment of the title transfer collateral or the collateral taker after this exercise or establishment takes place.

A clear rule on the securities ownership status could also be important for ensuring proper reporting of securities positions on an EU level for the purposes either of client protection, that is, in order to manage the exposures to the intermediary, or of the market protection, that is, in order such positions and changes thereof to be reported to a trade repository in the context of their supervision from a risk or market integrity perspective.

The need to create a transparent securities ownership model becomes an even more exacting task for EU regulators considering also that under the upcoming CSDR the CSDs there will not be an obligation to operate a securities ownership system for the securities held. Specifically, CSDR does not adopt a mandatory rule of segregation of securities on an investor level. Instead, it permits the participants of the CSD to offer either omnibus or individual client segregation accounts.[59]

Moreover, it should be underlined that the provisions of article 46 of the CSDR Proposal on applicable law to proprietary aspects have been removed[60] from the text of CSDR. Therefore, CSDR will not be able to provide any fundamental basis either from a substantive law or conflict of laws perspective for the establishment of proprietary rights in securities. Notable is that under the final texts of CSDR and specifically under recital 51 of its preamble the following have been defined: 'In view of the increasing cross-border holdings and transfers of securities enhanced by this Regulation, it is of utmost importance to establish clear rules on the law applicable to proprietary aspects in relation to securities held in the accounts maintained by CSDs. Nevertheless, this is a horizontal issue which goes beyond the scope of this Regulation and could be dealt with in future Union legislation'. Even if the implicit intention of the above provisions is to accelerate this future Union legislation, possibly known as SLL, it is far from clear that such provisions confirm the lack of EU legislation and respectively the lack of legal certainty in this cross-border field.

As a consequence of those non-regulated fields, segregation on a client level will be an option for CSDs and not an obligation. In the same context, CSDs will not be obliged to serve the need of mandatory client segregation even from a registry point of view. This stems from the fact that under CSDR, CSDs are not and cannot by definition be regarded as registry systems for securities. Registry activities, as defined by CSDR, are ancillary services for CSDs (*see* Annex – List of Services, Section B par. 2 (a) of CSDR) and therefore services, which as optional, cannot form the CSD's core profile. In result, any mandatory rule of segregation in this respect, as may appear on a national law level either from a depository or registry point of view, should be abandoned.

In view of the above, securities accounts on CSDs level should not be regarded *per se* as a legal means of proving securities ownership in EU. This concern relates, however, not only to CSDs accounts (top tier accounts) but, in general, to all kind of accounts that the intermediaries hold in the context of the indirect securities holdings (lower tier accounts). Owing to the indirect concept of such holdings, in which the intermediaries do not hold accounts directly for the investors but indirectly for others, acting directly or indirectly for the investors, and, respectively, due to the different nature of such accounts as omnibus or trustee and not as individually segregated, the investor cannot be reflected as the real owner of the securities to the account.

For example, when the intermediary A keeps an omnibus account on a CSD level for the intermediary B, which in turn keeps an omnibus account in its own books for the intermediary C, which acts for two investors, D and E, neither the top-tier account in the CSD nor the lower tier account in the books of the intermediary B could be regarded as a proof of ownership for D and E. Considering the indirect nature of their securities holdings, D and E will not be regarded as owners of the securities that are held for them through C, B and CSD A, but as mere creditors of C in relation to their securities, having in most cases, nothing more but a contractual right (or entitlement) under the relevant applicable law.

This is the so-called 'PRIMA' approach ('Place of the Relevant Intermediary Approach'), upon which, it is notable to refer that the Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary (Hague Convention), as well as the Unidroit Convention on substantive rules for intermediated securities (Geneva Convention), are based.[61]

As it is apparent, PRIMA seeks to capture the proprietary aspects of securities transactions on an international level. It stems from the fact that due to the dematerialized and generally book-entry nature of securities and the globalized network of intermediaries, the law upon which proprietary aspects in securities are established cannot be the law of the 'location of the securities' based on the traditional approach of the *lex rei sitae* rule, but the law of the relevant intermediary, that is, the intermediary that maintains the securities account for the accountholder.[62] From this point of view, PRIMA could be regarded as a legal reflection of the indirect securities holding patterns.

However, the securities account concept that PRIMA elaborates seems to be rather inaccurate for the purposes of addressing the 'who owns what' issue. As already mentioned, this securities account cannot by definition be regarded to reflect an ownership status for investors, but only a 'holding' status of the securities concerned, which relates rather to 'who holds what' than to 'who owns what'. Furthermore, as securities in book-entry form are located in a very specific manner, that is, in CSDs or other securities holding systems, it is apparent that the holding of securities by intermediaries through the chain does not relate to the location of the securities themselves but to the 'location' of the relevant account as such is agreed between the intermediary and their client. To this end, it is clear that the location of the account is purely a contractual choice under PRIMA and not necessarily a matter of securities substance. In this regard, it seems rather questionable whether PRIMA would be able to address the discussed 'who owns what' issue, since this issue by definition (who 'owns') relates to the securities substance and not to contractual choices.

In light of the above and in terms of addressing this problem, it is in our view important to have a clear rule that will define ownership and other proprietary rights in securities on an EU level. In relation to such ownership status the following example is worthy to mention.

Investor S of country C1 sells 10 shares of issuer A registered in country C2, which are held by the intermediary B in the CSD C located in country C3 through an omnibus account held by D, which is a participant in the CSD C. The 10 shares are bought by the investor E of country C4, the securities of which are also held indirectly through an omnibus account held by F, which is a participant of the CSD C. The question that arises in this example is how the ownership status could work. According to the very definition of 'ownership', ownership rights for the investor E cannot be simply established by a debit and credit of the shares from the omnibus account of the participant D to the omnibus account of the participant F.

Considering the nature of the involved securities accounts as omnibus accounts, the relevant book-entries in the accounts reflect nothing more but a change in the holding status of the securities and do not confer *per se* a 'title of ownership' from the investor S to the investor E. To this end and in terms of establishing a transfer of such title, it is far from clear that a relevant definition should be introduced.

But how could this transfer be conceptually defined? And, moreover, how can it be accommodated in a cross-border securities markets environment?

The answer to this question cannot disregard the nature of securities as assets whose constitution is determined by the law of their issuer, that is, the entity that issues the securities. From a legal perspective, the law of the issuer is defined as the law of the corporation of the company (Anglo-American system) or of the seat of the company (civil law systems), which in generally relates to the corporate law under which the securities are constituted.[63] In the above example, such law is the law of C2, as the law of the issuer A who issued the securities.

It is notable that the concept of the 'securities constitution law' is endorsed broadly by CSDR. This law is clearly defined within the CSDR's preamble (recital 50), as the corporate law that governs the relationship between the issuer and holders (of securities) and their respective rights and duties attached to the securities such as voting rights, dividends and corporate actions. In this respect, CSDR, within the context of the 'issuance freedom' that establishes, that is, the freedom for issuers to arrange for their securities trading on trading venues (regulated markets, multilateral trading facilities (MTFs) and others) to be recorded in any CSD of Member States (article 49 of CSDR), clearly defines in its preamble (recital 50) that (1) harmonization of national corporate laws is beyond this scope and (2) such national corporate laws or other similar laws 'under which the securities are constituted' should continue to apply and arrangements should be made to ensure that the requirements of such national corporate and other similar laws can be met where the right of choice (by the issuer) of CSD is exercised.

Moreover, article 49 of CSDR explicitly recognizes that the 'law under which the securities are constituted' shall continue to apply in all these issuance freedom cases. In the same context, where a CSD exercises its freedom rights under article 23 of CSDR, that is, its rights to provide for example notary services to issuers of other Member States ('CSD passport'), it is obliged to pass the 'assessment test' and notify the competent authorities, that is, the test proving that the CSD has measures in place allowing its users to comply with the national law of this Member State, which as defined relates notably to the 'law under which the securities are constituted' (article 23 par. 3 (e) and article 49 par.1 of CSDR).

In light of the above, the securities constitution law could reasonably be regarded as 'safe harbor' for the securities substance, rendering their corporate profile perspectively unaffected, since this law will derive from a CSDR, therefore securities holding. To this end, it can be held that this law is absolutely appropriate for the purposes of accommodating both the ownership and the shareholding aspects in securities.

More specifically, considering that the 'ownership right' and the 'shareholding right' or, in general, other corporate-related rights in securities constitute the 'two sides of the same coin', such rights not to be subject to the same law, should cause a legal paradox. In this respect, as the law of the securities constitution determines the corporate rights in all matters, that is, the one side of the coin, it should reasonably be expected to define and the other aspect, that is, the ownership rights in securities. Therefore, somebody cannot be regarded as a shareholder if they are not the owner of its shares and vice versa. In the above example this law is the law of country C2. Therefore, in terms of establishing ownership for E according to the example there should be a holding transfer that has to be based on the law of country C3, that governs the relevant CSD's securities holdings, and a transfer of the title of ownership under the law of country C2, the one of the securities constitution.

This rule of securities ownership definition should not be left outside the EU harmonization scope. In terms of effecting integration in the EU securities markets, there should be a general concept of registering the real owners-securities holders, at least for listed securities, that could enable the ownership-securities holding status to be traced easily on an EU level.[64] The main advantage of this registration function is that regardless of the location of securities in one or more CSDs or securities accounts or, otherwise, regardless of the securities holding patterns involved (direct/indirect), investors, mainly those that are using the non-banking type of safekeeping services in practice, will be fully protected from any default or insolvency risk not only in relation to the intermediaries that keep their securities accounts but also in relation to any other intermediary involved in the chain of their securities holdings that, in most cases, crosses borders.

In terms of facilitating the above goals, registration of ownership status should be regarded as a key parameter in finalizing any securities transactions or changes in the proprietary rights in securities. In the above example, the buyer E should not be regarded as the owner of the bought securities under the laws of country C2, if the participant or intermediary acting on its behalf will not proceed to its registration. On the other hand and in compliance with the proposed custody model as analyzed above, the intermediary acting for the client should be under the obligation to proceed to the investor's ownership registration. This registration should be definitely a task when the intermediary is entitled to provide only non-banking type of safekeeping services and, in any case, when this reflects its client's choice, that is, when the client does not allow their 'banking type' intermediary to use their securities in any manner.

For the purposes of EU market effectiveness this registration could be operated centrally by each EU member state or, more preferably, by the EU for all the member states. Technology could facilitate this goal by underpinning automated forms of registration on a centralized registry level and optimize its positive results for EU. It should be important to have an EU mechanism in order to enhance legal certainty, as well as financial stability in the securities markets, on the one hand, without sacrificing market effectiveness, on the other. This could be easily achieved considering that an EU securities mechanism related to 'who owns what' could be adopted by the markets regardless of the securities holding pattern that each market operates ,without affecting existing holding regimes.

The need for having an EU rule on securities ownership status relates also to the fact that the upcoming CSDR will drastically impact on the function of the securities law. More specifically, the recognition by CSDR of a passport to each Member State's CSD to provide services to issuers of other Member States and respectively the recognition of issuer's right/freedom to arrange for its securities to be recorded in a CSD established in another Member State,[65] will inevitably lead to a legal situation under which the ownership rights on the one and the shareholding (securities holding) rights on the other, which are, as already mentioned, the 'two sides of the same coin', may be subject to different laws. For example, when the CSD of Member State A is the issuer CSD for a company of Member State B, that is, the CSD is responsible for the initial recording of the shares of such company in a book-entry form in Member State A (the so-called 'notary service' under Section A of the Annex of the CSDR), it would be questionable under the upcoming CSDR which will be the applicable law related to proprietary rights on securities.The law of Member State A, possibly under a concept similar to the *lex rei sitae* doctrine, or of the Member State B, related to the *lex societatis* one? As mentioned above, this question will not be answered by the CSDR.

With respect to the proposed in this study securities ownership approach, it is notable that, apart from the ownership rights, any other proprietary right in securities and thus the securities collaterals, fall as well in its scope. Therefore, by adopting this approach it is apparent that the subject matter of collaterals in securities will not be limited to rights or entitlements. The securities 'substance' will revive under this approach, as a result of the recognition of a proprietary effect to the rights in securities (*erga omnes* effect), any collateral over them will (have to) be regarded as a collateral not in simple contractual rights related to securities (for example, under the concept of PRIMA) but as a collateral in the securities themselves. Respectively, the collateral giver will be entitled to provide collateral in such securities provided that the registration points them out as the owner of them based on the law of their constitution.

However, this direct investor registration concept for securities and collaterals should not and cannot be regarded as a mandatory rule when the intermediary provides banking type of safekeeping services and the investor as a user of such services consents to the use of their securities by the intermediary. In these cases (or possibly in cases of trust law, where there is by definition a legal ownership in securities for the intermediary who acts as a trustee), the investor will not be the one registered as an owner in the relevant registry system but the intermediary. In such cases it is therefore reasonable to consider that the investor does not retain an ownership right in securities but solely a contractual right, possibly similar to the one under PRIMA, as this will reflect the investor choice and, under the above custody approach will be also in compliance with prudential regulations similar to the banking ones.

(c) One law – One 'proprietary location' for securities: The law under which the securities are constituted

In terms of effecting a real EU integration in the securities field, there should be also, in addition to the points under paras (a) and (b) above, a clear conflict of laws rule for all proprietary matters related to securities. This rule should reasonably be based on the aforementioned 'who owns what' substantive law definition.

Specifically, considering the value of the proposed ownership approach analyzed above, it seems rather appropriate to adopt as an applicable law rule, in addressing any conflict of laws issues related to proprietary rights in securities, a law under which the securities are constituted. Put differently, the conflict of laws rule should be in line with the 'who owns what' rule and in this context should be based on the law that answers this question.

From an ownership perspective and in terms of effecting compatibility among different securities systems on an EU level, all securities holdings could be harmonized under this securities constitution law concept reflecting an already existing law field, that is, the issuer law (*lex societatis*) approach. Within this context the law applicable in case of securities of the same issuer will be the same for any relevant proprietary or corporate law matters regardless of whether the securities are held in omnibus or segregated accounts, opened in the same or different CSDs, or intermediaries operating in the same or different EU member states.

From a corporate law perspective, this may also result to a coherent securities regime,. The investor regardless of the location of the initial recording (under the 'issuer CSD' concept) or the subsequent holdings of its securities (for example, on the basis of the 'investor CSD' or the 'multi-tier intermediaries chain' concepts) will be able to consider that one law will be applicable to its securities investments, for all relevant proprietary and corporate matters, that is, the law under which the securities are constituted.[66]

This approach presupposes, however, that the doctrine of the 'securities account', as already recognized by EU, shall not be further elaborated and in essence be replaced by the doctrine of the law of the securities constitution. This review definitely relates not only to FCD but also to the Directive 98/26/EC, the so-called 'SFD' (Settlement Finality Directive),[67] as well as to the upcoming CSDR.

As far as FCD and SFD are concerned, the main issue relates to the applicable law for securities provided as collateral. In case of SFD this relates to collateral provided in relation to a settlement system, which has to operate within the 'finality' concept of SFD, while in case of FCD it relates to financial collaterals among 'financial actors', as pointed out above in the section 'The financial collateral directive – Main concepts'. Both cases, while adopting the 'account approach', recognize the law of the country in which the relevant account is maintained as applicable law in relation to collaterals in securities in a book-entry form.[68] To this end, changes to these Directives should be important.

As has already been mentioned, this account concept had been embedded also in the CSDR Proposal. In its aim to address the proprietary issues in securities, the CSDR Proposal introduced the account approach to the accounts that could be held at a CSD level (top tier account level). Since such approach has already been abandoned and article 46 of the CSDR Proposal has been removed, no proprietary aspects in securities are now reflected in the final text of the upcoming CSDR. This change in the context of the upcoming CSDR, further to its regulatory justification related to the 'horizontal' nature of the issues concerned (recital 51 of the CSDR's preamble), reasonably also reveals the EU concerns in adopting such account approach, and raises questions in this respect of the appropriateness of such approach for all cross-border matters related to securities holdings and CSDs.

It is important to highlight that the adoption of the proposed ownership/

registration approach under the securities constitution principle should not undermine the functioning of the multi-tier level of accounts and securities holdings. This stems from the fact that in terms of achieving a proper 'who owns what' definition, a 'who holds what' rule would also be necessary, mainly for ensuring legal safety of securities holdings and transfers (credits or debits) related not only to securities *per se*, but also to 'rights in securities' that intermediaries 'hold' for others.

Moreover, this 'who holds what' rule is rather important as it constitutes the legal precondition for the proper establishment of all related proprietary matters. Put it differently, such rule is important as a precondition in perfecting proprietary rights in securities, considering that any registration of securities ownership or collateral presupposes legally binding transfers of securities holdings from one account to the other. Such transfers of securities holdings should be reasonably subject to EU regulations in order to achieve a coherent securities law in this field. This stems mainly from the fact that due to their book entry nature, securities holdings are established through accounts in CSDs or intermediaries under a *jus cogens* concept. As a result such accounts may hold not only the securities themselves, but also simple contractual rights in securities (for example, in case the intermediary, being registered as a shareholder, acts on behalf of others[69] or re-hypothecates).

For these reasons the 'account model', that is, the concept that contractual rights in securities can be traceable on the basis of the relevant securities accounts, and the respective applicable law rule as well, that is, the rule which relates to the law of the country where the account is maintained, should continue to be applicable on an EU level. However, its application should not serve the need of defining conflict of laws related to the 'ownership' or 'shareholding' in securities but the need of defining the applicable law for securities holdings and relevant accounting matters.

By this twofold approach related to the proprietary rights in securities (clients protection/ownership status) on the one hand, and the contractual rights in securities (clients protection/re-hypothecation status), on the other, all positions in securities could be traceable from a legal and supervisory perspective at all levels, which in effect will enhance client protection and markets transparency.

As stressed out above, an appropriate prudential regulation for intermediaries should accompany such traceability, as a key component for the purposes of addressing the shadow banking risks in this credit intermediation field, related to securities, collaterals and their reuse or re-hypothecation (Table 1).

EU LEGISLATIVE INITIATIVES IN ADDRESSING SHADOW BANKING IN SECURITIES COLLATERALS

It is apparent that EU intends to take serious legislative steps in addressing the shadow banking issues in the field of securities and collaterals that mainly include the following.

(a) The communication from the commission to the council and the European parliament 'shadow banking – Addressing new sources of risk in the financial sector' (2013)

Based on the international agenda and the relevant considerations in its Green Paper, the Commission issued the Communication on 'Shadow Banking – Addressing New Sources of Risk in the Financial Sector' (the 'Communication').[70] The Communication refers to a series of measures aiming at solving the open issues on shadow banking. It focuses among others on the risks associated with the securities financing transactions[71] and their impact to investment funds when using such financing.[72]

As such risks have a negative impact on the securities financing regime and the relevant activities of securities and collaterals reuse or re-hypothecation, the Commission

Table 1: main points of the proposed approaches of custody and ownership/registration status, as analysed in section 'To further regulate or not?'

Approaches	*Regulatory issues*		
	(a) Service	*(b) 'Who owns what'*	*(c) Cross-border holdings*
Proposed	approach	Distinction of the activity of custody services from a prudential regulation perspective to: • Non-banking type of securities safekeeping services (no securities re-use) • Banking type of securities safekeeping services (securities reuse)	1. Adoption of a new criterion based not on the existing 'account approach' (PRIMA) but on the 'securities registration' approach under which ownership (shareholding) would be traceable regardless of the securities holding pattern (direct/indirect) involved. 2. Limitation of the scope of the 'registered intermediaries' mainly to cases of banking type of securities safekeeping services 3. Limitation of the PRIMA rule in EU mainly to cases of banking type of securities safekeeping services
Adoption of a new	'applicable law' rule based not on the 'lex rei sitae' principle and PRIMA but on the 'law under which the securities are constituted' This would be in line with the 'who owns what' rule under (b).		
	Reform of MiFID-MiFID2, FCD, SFD, accordingly.	Reform of MiFID-MiFID2, FCD, SFD, CSDR, adoption of a new EU legislation (SLL?) for the implementation of the above rule.	Reform of FCD, SFD, CSDR, adoption of a new EU legislation (SLL?) for the implementation of the above rule.
Current EU status	One type of custody services, no regulatory distinction of the two types – the use of each type (non-reuse or reuse) is simply a 'client choice', under MiFID. Unregulated 'right of use' under FCD.	Not clear, different national laws in EU, reflecting both PRIMA, that is, the 'account location approach', and 'lex rei sitae' rule, that is, the 'securities location approach'.	Not clear, different cross-border rules in EU depending on whether securities rights are defined as proprietary rights (in rem) or contractual rights (in persona), that is, under PRIMA related rules and 'lex rei sitae' rules, as applicable respectively.

acknowledges the need of taking measures to address the problem. In this regard, the Communication highlights the impact of the securities financing to the excessive level of indebtedness in the financial sector and points out how and why financial intermediaries use security (collateral). As it is explained, such use became the basis for intermediaries to obtain financing in the markets, which includes also all relevant scenarios of reuse of collaterals by them as lenders. Important observations are based on the fact that while such collateral takes the form of securities, it cannot be re-invested in cash as is the case of logging collaterals.

In this respect the Commission argues that 'the reuse or re-hypothecation of securities generates dynamic collateral chains in which the same security is lent several times, often involving actors from the shadow banking system. This mechanism can contribute to an increase in leverage and strengthen the pro-cyclical nature of the financial system, which then becomes vulnerable to bank runs and sudden deleveraging'.[73]

Focusing on the property aspects of securities, the Communication stresses out that the lack of transparency in these markets 'makes it difficult to identify property rights (who owns what?) and to monitor risk concentration as well as identify counterparties (who is exposed to who?)'.[74] Moreover, it points out that the Commission is considering a legislative proposal regarding 'securities law', the so-called SLL. Another main concern that is stressed out by the Commission is the securities financings issue and notably the use of such financing by investment funds, mainly when connected to the banking system.

(b) Workshops on SLL: The commission's legal certainty group (2005)

It is notable that as a reflection of its intention to further regulate securities under the scope of the so-called SLL, the Commission has already established, since 2005, an expert group, the Legal Certainty Group,[75] which is called for the harmonization of certain areas of law and the preparation of EU legislation in securities.

The rationale behind this initiative has been underlined as follows: '(…) in the wake of the financial crisis, significant efforts have been undertaken by EU regulators to ensure a more stable financial system in the future. As collateral in the EU is normally given in the form of securities, these efforts rely on the fact that the securities collateral is legally safe and available to be enforced in the event of a default. The legal uncertainty coupled with stability risks poses significant barriers to the safe and efficient functioning of the Single Market, restricting cross-border activity, reducing clarity and certainty, as well as limiting opportunities for businesses and compromising investor protection'.[76]

Based on these observations the Member States Working Group in their relevant meetings[77] underlined the following as of main concern:

- the issues of addressing re-hypothecation and reuse, mainly by enhancing transparency and reporting;
- the issues of ensuring investor protection by focusing on the interrelation between the SLL and the Invertor Compensation Scheme Directive Recast (ICSD);[78]
- the issue of introducing clear rules on 'who owns what', by focusing on the 'chain of titles' and the interrelation between SLL and the so-called 'EMIR', that is, the Regulation (EU) 648/2012/EC on OTC derivatives, central counterparties and trade repositories;[79]
- the repos/securities lending and maturity transformation products, by focusing on trade repositories as are developing in the EU financial markets.[80]

Notable also are the discussions of the Group on the issue of using conflict of laws to determine location of ownership under which the following are considered as options on the law criterion: (a) the law of the country of the CSD; (b) the law of the account of the end-investor; (c) the law of the country where the issuer was seated at the moment of the issue.

Further discussions of the Member States Group are also related to the concepts and interactions between direct and indirect holding systems regulated on a CSD level by the forthcoming CSDR,[81] the concerns of regulating the ownership models in securities considering their functional differences among Member States, the need to have more transparency in the securities lending and repurchase agreements field, as well as the relevance of PRIMA or Hague Convention[82] to this securities law initiative.

Considering that SLL remains at present an issue of discussion among Member States and that its drafting has been postponed, it is clear that it could be rather premature to make any assessment on it. However, as a piece of legislation aiming at addressing the 'who owns what' issue in securities, SLL should definitely be regarded as a milestone for the EU capital markets integration.

In this regard, the one law – one 'proprietary location for securities' approach, as discussed above in the previous section, under its parameters on ownership/direct registration status in securities (Section 'To further regulate or not?' para b) and applicable law rule on the basis of the law under which the securities are constituted (Section 'To further regulate or not?' para c), should be taken seriously into consideration in terms of introducing a uniform substantive and conflict of laws field in EU for all related proprietary rights in securities, for the benefit of both local and cross-border investors.

(c) The proposal for a regulation of the European parliament and of the council on reporting and transparency of the securities financing transactions (2014)

Recently, the Commission adopted a Proposal for a Regulation of the European Parliament and of the Council on reporting and transparency of the securities financing transactions.[83] The Proposal introduces a bundle of measures aiming to address the shadow banking issues in the securities sector related to the activities of the securities financing transactions.

As has been pointed out by the relevant results of consultations with the interested parties and the impact assessments, the main problems that have been identified in respect of the securities financing transactions (SFTs) relate to the following:[84]

- the regulators are unable to effectively monitor the use of SFTs;
- there are risks that SFTs are being used at the detriment of fund investors and
- re-hypothecation shifts the legal and economic risks in the market.

The absence of comprehensive (frequent and granular) data on them and the conflicts of interest that SFTs create between fund managers and fund investors are also added in the Explanatory Memorandum of the Proposal, as main problems of the SFTs.

In this concern, the reporting of SFTs to the trade repositories, the disclosure on the use of SFTs to fund investors and the need for prior consent to re-hypothecation of the financial instruments have been identified as measures of addressing shadow banking problems in this field . Another measure of great importance would also be these instruments to be transferred to an account opened in the name of the receiving counterparty before re-hypothecation takes place.[85]

The main purpose of the measures concerned is ensuring that the shadow banking activity of using SFTs will be properly supervised and regulated. In the same line it is stressed out in the Explanatory Memorandum that the Proposal does not aim to prohibit or limit the use of SFTs by the imposition of specific restrictions but to introduce a more transparent field in the use of SFTs.

In this respect, the Proposal is not expected to create structural impacts on the SFT market. As it is underlined, despite the fact that the retained options will increase the reporting costs for the counterparties, this increase will be outweighed by the benefits of having greater transparency for the competent authorities, clients, investors and society at large.[86]

In this regard and in addressing the reporting issues in this field, the Proposal introduces three sets of measures. The first set refers to transparency of SFTs, including registration and supervision of trade repositories under the Chapters II and III of the Proposal. The second set includes the measures of transparency towards the investor, as they are defined in Chapter IV of the Proposal, while the third one relates to the measures that contribute to transparency of re-hypothecation based on the stipulations of Chapter V of the Proposal.

More specifically, the first set of measures imposes reporting requirements that include the registration of the details of SFTs to trade repositories and their relevant supervision. It is apparent from the Proposal's scope that such reporting requirements reflect on the relevant pre-existing trade repositories concepts, as mainly included in EMIR, that is, the Regulation (EU) 648/2012/EC on OTC derivatives, central counterparties and trade repositories.[87]

Under the proposed harmonization regime of the 'registered trade repositories', defined in articles 5-11 of the Proposal, the counterparties to SFTs are subject to obligations of reporting the details of the SFTs no later than the working day following the conclusion, modification or termination of the transaction in accordance with the specific provisions of article 4 of the Proposal. Based on these transparency concepts data,[88] a trade repository is obliged under article 12 of the Proposal to publish regularly, and in an easily accessible way, aggregate positions by type of SFTs reported. Furthermore, it shall collect and maintain the details of SFTs and shall ensure pursuant to the provisions of article 12 of the Proposal, that all centrally stored information will be easily and directly accessible to the relevant authorities, such as ESMA, ESRB, the ESCB, for the purposes of identification and monitoring of financial stability risks entailed by these SFT activities of financial and non-financial counterparties, as are defined in article 3 par. 2 of the Proposal.[89]

The second set of measures aims at serving transparency towards the investors. The Proposal considers that SFTs are used extensively by fund managers for the purposes of efficient portfolio management. Apart from other financing structures (for example, swaps, collateral swaps and so on), they can be used either to fulfill investment objectives or to enhance returns that fund managers adopt and that by definition aim at exposing managers to certain strategies or enhancing their returns.[90] The transparency measures in this regard are reflected in Chapter IV of the Proposal, namely in articles 13 and 14.

Considering their close link to the Directives 2009/65/EC[91] and 2011/61/EU,[92] such measures are regarded as a supplement to the provisions of the mentioned Directives.[93] Specifically, according to article 13 of the Proposal, all fund managers related to the management companies of UCITS, UCITS investment companies and AIFMs are subject to periodical reporting requirements under which they are obliged to inform their investors of the use they make on SFTs and to include such information in the official reports they publish (annual, half-year) under their respective UCITS and AIFM obligations.

The measures also include reporting obligations at a pre-investment stage. Under article 14 of the Proposal the respective fund managers shall disclose obligations of the SFT and other financing structures authorized to use and include a clear statement that these techniques are used, in the relevant pre-investment documents that they issue under their respective UCITS and AIFM.

Last but not least, the third set of measures relates to re-hypothecation under article 3 par. 7 of the Proposal, which is defined as the use of financial instruments received as collateral in its own name and for its own account or for the account of another counterparty by a receiving counterparty.

It should be underlined that the Proposal constitutes the first legislative step in harmonizing re-hypothecation on an EU level. The need for its definition is clearly reflected on the Explanatory Memorandum of the Proposal and in its preamble, as well. Under the Explanatory Memorandum counterparties engaging in re-hypothecation should be subject to contractual and operational transparency minimum information requirements. Such requirements are further stipulated as relevant obligations of the counterparties receiving financial instruments as collateral, to re-hypothecate them only with the express consent of the providing counterparty and only after having transferred such collaterals to their own accounts.[94]

More specific elaborations on re-hypothecation are included in the preamble of the Proposal. Under the recital 18 of the preamble re-hypothecation is recognized as a means of providing liquidity and enabling counterparties to reduce funding costs. Under the same recital it is further underlined that re-hypothecation creates complex collateral chains between traditional banking and shadow banking, posing financial stability risks. To this end, the lack of transparency to the extent of which financial instruments provided as collateral have been re-hypothecated and the respective risks in case of bankruptcy that can undermine confidence in counterparties and magnify risks to financial stability are stressed out as main disadvantages of re-hypothecation.

Despite the fact that re-hypothecation is considered a source of bankruptcy risks, notable is that the Proposal does not introduce any prudential measures for the protection of investors from relevant re-hypothecation exposures. As it is apparent from its article 15 under which re-hypothecation measures are defined, the Proposal limits its scope in establishing reporting rules only. In this context, it does not introduce any restrictions on the use of re-hypothecation by the counterparties engaging such activities in the field of collaterals.

Moreover, it introduces obligations that, as pointed out in recital 19 of the preamble of the Proposal, are based on the following considerations:

1. As it is provided, the reporting rules of the Proposal should not prejudice the application of sectorial rules adapted to specific actors, structures and situations. It is specified in recital 19 that the rules on re-hypothecation provided in the Regulation should apply, for example, to funds and depositories only insofar as there are no more stringent rules on re-use foreseen within the framework for investment funds constituting a *lex specialis* and taking precedence over the rules contained in the Regulation.
2. The application of the referred reporting rules to the involved counterparties presupposes re-hypothecation to be permitted for the counterparties concerned.

As it is apparent from its wording, the Proposal's aim is not to introduce a general permission of re-hypothecation. Its scope is confined exclusively to the establishment of particular reporting rules on re-hypothecation that presuppose re-hypothecation to be permitted under the relevant applicable laws. In this regard, recital 19 points out that the Regulation should be without prejudice to any rule restricting the ability of counterparties to engage in re-hypothecation of financial instruments that are provided as collateral by counterparties or persons other than counterparties.

Further to these explanatory points, the re-hypothecation rules are specifically defined in article 15 of the Proposal. In particular, in paragraph 1 of this article it is stipulated that re-hypothecation can take place where at least all the following conditions are fulfilled:

(a) The providing counterparty has been duly informed in writing by the receiving counterparty of the risks that may be involved in granting consent in particular the potential risks in the event of the default of the receiving counterparty.
(b) The providing counterparty has granted their prior express consent as evidenced by the signature of the providing counterparty to a written agreement or an equivalent alternative mechanism.

Furthermore, under paragraph 2 of the same article it is defined that counterparties shall exercise their right to re-hypothecation, provided that re-hypothecation is undertaken in accordance with the terms specified in the aforementioned agreement and the financial instruments received as collateral are transferred to an account opened in the name of the receiving counterparty. The article concludes by also making reference to the UCITS IV and AIFMD and stipulates that it is without prejudice to the provisions of the aforementioned Directives and in general to stricter sectoral legislation.

As it is apparent, the above-mentioned provisions reflect on the existing EU approach on securities use, reuse and hence re-hypothecation, which is conceived simply as a contractual choice, already defined in FCD under the concept of the 'right of use', or in MiFID under the concept of the 'investor consent', that is, the concept under which the intermediary is entitled to use the investor' securities upon the latter's prior consent.

However, as it has been pointed out earlier in the sections 'Collaterals characteristics that opened discussions' and 'The problem of "shadow banking" in collaterals and re-hypothecation', re-hypothecation puts the client and, according to the wording of the mentioned article 15 of the SFTs Proposal, the providing counterparty to a risk, as its ownership right in the re-hypothecated securities is replaced by a simple contractual right to return of equivalent securities.

This issue is not addressed by the SFTs Proposal. To this end, the position of the providing counterparty, commonly in practice of the investor of the re-hypothecated securities, remains vulnerable in case of default (for example, bankruptcy) of the receiving counterparty. In this respect the contractual protection that article 15 of the Proposal provides for the providing counterparty, that is, to have agreed on re-hypothecation or to be aware of the securities transferred to a different account in the name of the receiving counterparty, could not easily be considered as an adequate solution in addressing the relevant 'open issues'.

Considering that article 15 of the Proposal limits its scope in relation to the re-hypothecation risks, in introducing only a requirement to the receiving counterparty to inform the providing one of the risks involved, rather than establishing measures in mitigating the relevant default risks[95] (arising either from the custody activities concerned or from other activities, for example, from fund management activities), it is apparent that re-hypothecation remains yet an open issue in EU from all relevant perspectives (prudential regulation, investor protection, insolvency, transparency in shareholdings).

(d) The proposal for a directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with regards to depositary functions, remuneration policies and sanctions, the so-called 'UCITS V' (2012)

Rather important in relation to re-hypothecation is the upcoming UCITS V[96] and mainly its 'depositary rules', as are introduced for the protection of UCITS assets towards the depositaries that hold such assets.

Focusing on the need of adopting additional rules in relation to the Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), the so-called 'UCITS IV', for the purposes of defining the tasks and duties of depositaries, of designating the legal entities that may be appointed as depositaries and of clarifying the liability of depositaries in cases UCITS assets are lost in custody or in case of the depositaries' improper performance of their oversight duties,[97] UCITS V amends, among others, article 22 of the UCITS IV for the purposes of introducing the following main rules:[98]

(a) Under article 22 of UCITS IV, amended under the upcoming UCITS V, a clear limitation on the re-use right of a depositary is introduced for the purposes of protecting the assets of UCITS. Specifically, it is defined that 'the assets held in custody by the depositary shall not be reused by the depositary or by any third party to whom the custody function has been delegated for their own account. Reuse comprises any transaction of assets held in custody including, but not limited to, transferring, pledging, selling and lending'.

(b) It is further defined in the amended article 22 that 'The assets held in custody by the depositary are only allowed to be reused provided that the reuse of the assets is executed for the account of the UCITS, the depositary is carrying out the instructions of the management company on behalf of the UCITS, the reuse is for the benefit of the UCITS and the interest of the unit-holders and the transaction is covered by high quality and liquid collateral received by the UCITS under a title transfer arrangement. The market value of the collateral at all times has to amount to at least the market value of the reused assets plus a premium'.
    It is apparent that under these new provisions the reuse of UCITS assets from the depositaries as custodians is prohibited for the purposes of protecting UCITS assets from any indebtedness of the relevant depositaries. However, considering the necessity of the reuse or re-hypothecation in terms of enhancing markets' liquidity and reducing the cost of funding, UCITS assets are not prohibited from reuse under the new provisions, when this is for the benefit of the UCITS and the unit-holders.
(c) Rather compatible to this new prohibition of reuse for the depositaries are the special insolvency rules that are introduced by the amended article 22.

As it is laid down, 'Member States shall ensure that in the event of insolvency of the depositary and/or any third party located in the EU to whom custody of UCITS assets has been delegated, the assets of a UCITS held in custody are unavailable for distribution among or realization for the benefit of creditors of such depositary and/or such third party'.

Considering that the depositary is not permitted under the new prohibition of reuse to provide any credit intermediation services with regard to the UCITS assets, the new insolvency rules are rather reasonable being absolutely compatible to the nature of the relevant custody business. Specifically, such business can easily be regarded as being based not on 'irregular deposit' concepts, which are legally applicable in case of reuse rights (banking-like rights), but on the 'regular deposit', which generally relates to situations in which the custodian is only entitled to the course of its business to exercise pure safekeeping activities that do not by definition entail any such reuse. In this respect, the custody profile reflected in these new provisions can be considered to be exclusively referring to the traditional securities custody business under which the custodian (for example, depository) is entitled to hold assets (for example, UCITS assets) for administration purposes only and not for the purposes of intermediating in the securities field (that is, for banking-like purposes).

The question however is whether this limitation of reuse is solely a UCITS issue or it should also be considered as a choice entitled to each investor? Put differently, is the prohibition of the securities reuse a reasonable regulatory choice only for UCITS 'property' or it would be appropriate to cover any other piece of securities property regardless of the type of its owner, that is, either in case when such owner is an institutional investor, which is for example the case of UCITS, or in case when such owner is any other investor (private, professional and so on) seeking prudential protection of the same kind and level.

As it is supported in this study, the scope of the users of this protection should be broader in order to encompass all cases in which the intermediary (custodian) is not from a prudential regulatory view in a position to offer intermediation services to their clients, that is, the so-called under this study banking type of safekeeping services, but only the safekeeping ones, that is, the so-called in this study non-banking type of safekeeping services. Therefore, such limitations should be regarded as a prudential policy issue and thus as an issue of defining or re-defining the services and activities in the financial sector for the benefit of the investors and the markets concerned.

Furthermore, the aforementioned provisions reflect strict segregation principles with regard to the assets (financial instruments) to which re-hypothecation may relate. These principles, when related to securities and mainly to shares are rather important not only from an ownership perspective, that is, in relation to the question of 'who owns what', but also from a shareholding perspective, which relates to 'who the shareholder is'. From this point of view it should be reasonable that any reuse scenario is accompanied by appropriate corporate law rules in order to properly reflect on all aspects of shareholding rights that are also a key parameter in the field of securities and collaterals.

The particular kind of rules that would be appropriate to be introduced on an EU level in addressing this issue have been elaborated in our earlier work titled as 'Cross-border shareholding in EU: Is indirect holding appropriate in achieving EU integration?'[99] As analysed in this work but also highlighted above as well (Sections 'Collaterals characteristics that opened discussions', 'The problem of "shadow banking" in collaterals and re-hypothecation' and 'To further regulate or not?'), there has to be a clear rule on securities ownership and, respectively, on shareholding that it will cover the necessary proprietary aspects and relevant corporate rights in such securities to be respected in EU regardless of the nature of the securities holding systems and intermediaries chains involved. The need to adopt such rules is, as highlighted earlier, urgent considering that the upcoming CSDR will not accommodate ownership or shareholding aspects of securities but simply holding and segregation aspects that do not reflect on 'what the investor owns' but simply 'what the intermediary holds' for the investor.

Therefore and to this respect a more transparent level of segregation, ownership and related rights (corporate rights) should be elaborated on an EU level andto be inspired, where appropriate, from the upcoming UCITS V provisions on segregation and prohibition of reuse.

(e) The proposal for a directive of the European Parliament and of the Council amending Directive 2007/36/EC with regards to the encouragement of long-term shareholder engagement and the Directive 2013/34/EU with regards to certain elements of the corporate governance statement (2014)

The need for achieving a more transparent environment in the shareholding field is one of the main issues underlined in this recently issued Proposal,[100] which amends the Directive 2013/34/EU and also the Directive 2007/36/EC, the so-called 'SHRD'.[101]

Considering the need of shareholding activism as a key parameter in achieving proper corporate governance conditions, the new SHRD (namely the provisions of this Proposal amending the SHRD), introduces, among others, rules on the shareholding identification that are expected to contribute to the transparency on all proprietary aspects of securities and thus to the collaterals, as well.

Specifically, the new SHRD acknowledges among others that the exercise of rights of investors flowing from securities is difficult and costly. This is attributable mainly to the fact that securities are held by a chain of intermediaries in terms of cross-border transactions and engagement that render the identification of the real shareholdings a difficult task.

To this end, the new SHRD introduces a series of provisions under its articles 3a–3d that aim to address such issues. More specifically, article 3a requires Member States to provide a right for listed companies to identify their shareholders. As it is pointed out under the detailed explanations of the Proposal,[102] the intermediaries should, upon request of such company, notify without undue delay of the name and contact details of the shareholders. In this regard, where there is more than one intermediary in a holding chain, the request of the company and the identity and contact details of the shareholders shall be transmitted among intermediaries without undue delay.

Further, it is stressed out that in order to fully protect the personal data of shareholders, intermediaries shall inform them that their name and contact details are to be transmitted for the purpose of the referred identification. Such information may only be used under the relevant provision of article 3a par. 3 of the Proposal for the facilitation of the exercise of the rights of the shareholder and therefore for no other reason. Rather relevant are also the provisions of article 3b of the Proposal, under which if a listed company chooses not to directly communicate with its shareholders, the relevant information shall be transmitted to them by the intermediary.

It is therefore clear and rather reasonable that the shareholding identification rule under the new SHRD is not related to the securities holding patterns involved. It is closely connected to, and aims at protecting the right of, the 'real' shareholder regardless of whether such right arises from a direct holding place or an indirect one, mainly reflecting and accommodating the cross-border aspects of the related securities transactions and the safekeeping/custody levels concerned.

This approach is definitely in line with our legal view reflected in this study and in our earlier work,[103] in which it has been supported that the 'proprietary rights' in securities have to be recognized in EU regardless of the securities holding systems involved (direct/indirect).[104] The rationale behind this approach stems from the fact that in case of securities held for the investors, such securities cannot be attributed either from an economic or a legal perspective, as an own property to the intermediaries carrying the relevant holding process. To this end, intermediaries shall not be considered as shareholders. Even in case of indirect holdings there has to be a legal room where the real investors are registered as shareholders and thus the real ownership is reflected and reconciled to all relevant corporate law aspects.

This transparency regime under the new SHRD will definitely contribute to the proper separation among the indirect holding aspects of securities, on the one hand, and the reuse or re-hypothecation cases, on the other.

Specifically, considering the new SHRD and mainly its investor identification concept, any indirect nature of the securities holdings will no longer justify *per se* the identification of the involved intermediaries as shareholders instead of the investors. On the contrary, the introduced under the new SHRD identification procedure will encourage the intermediaries to register as shareholders not themselves but the real investors. This can be attributed to the fact that such identification will be reasonable under the new provisions in terms of cost and risk.[105]

On the other hand, such identification has to cover also the reuse or re-hypothecation cases. Considering that re-hypothecation results to a transfer of ownership of the securities from the providing counterparty to the receiving one, that is, the one that re-hypothecates, it is far from clear that this transfer has to be reflected from a corporate law perspective as well. Such reflection could be supported by the new established rule under the SFTs Proposal on which the re-hypothecated securities have to be transferred to an account opened in the name of the receiving counterparty. From this point of view, the relevant account will and should reflect not only on the property rights of securities but also the respective corporate rights. Therefore, the re-hypothecation through this account will and should result to a change of the relevant shareholding position, where the receiving counterparty will be considered as a shareholder instead of the providing counterparty, under the terminology of the SFTs Proposal.

However, considering that it relates more to the factual issue of 'who owns what' than to the information status that the company chooses to introduce in its relationship with its shareholders, it is rather questionable whether such investor identification should be left at the disposal of the issuing company, according to the new SHRD elaborates.[106] Put it differently, the investor identification relates not only to information rules that support investors to be aware of the company's corporate and other related matters under the EU law (SHRD, Transparency Directive, that is, Directive 2004/109,[107] and so on) but also to the rules on how the shareholding right is established and thus to the legalization of the shareholders in terms of exercising all their relevant rights (for example, the right of participating in the general meetings, of cast voting and so on).

Therefore the investor identification should be regarded, from all perspectives, either the proprietary perspective as pointed out above in Section 'To further regulate or not?', or the corporate one as the new SHRD points it out, as a rule that should be applicable under the law of the securities constitution regardless of the information status that the company issuing the securities chooses to adopt in its relationship with its shareholders. This approach will definitely provide a more coherent and safe environment in the securities field since:

- it will bridge any gap between 'who owns what' and 'who holds what';
- it will facilitate the exercise of corporate rights of the securities owners; and, moreover,
- it will render the securities field more transparent without affecting the securities holding systems of the intermediaries, custodians and infrastructures involved and thus without jeopardizing the cross-border aspects of the EU securities markets that these holding systems intend to accommodate.

In this regard it is considered necessary for all these regulatory aspects of securities, as reflected in the SFTs Proposal, the upcoming UCITS V and the relevant depository function on segregation and prohibitions of reuse, the new SHRD, as well as all other present (CSDR) or future (SLL) legislative initiatives of harmonising the securities law field to take into account that the rule on securities should not only relate to pure reporting or transparency provisions but also to rather stable and coherent rules that will safeguard the investors rights in securities and will protect them from any 'banking like' risks, mainly the re-hypothecation risks that all relevant credit intermediation activities in securities entail.

CONCLUSIONS

This study examined the shadow banking issues related to the financial collaterals of FCD within their context as collaterals in securities held in book-entry forms in modern markets. It also examined this issue as a main part of the securities intermediation, which commonly results to re-hypothecation conditions that inevitably pose risks to client portfolios, as well as to the financial stability of the securities markets, in general.

The following could be considered as main observations and suggestions from the analysis of such issues:

1. There is definitely a shadow banking area in the securities sector related to the collaterals and securities holdings that has to be attributed to the 'unregulated' right of use or re-hypothecation by the intermediaries of the collaterals and, respectively, of the 'deposited' clients securities.
2. This right of use should not be prohibited but rather it should be subject to appropriate regulation on an EU level in order to hinder financial stability threats caused by the intermediaries' defaults and protect the investors' properties in securities. Therefore, the answer to the question 'to regulate or not' should be affirmative.
3. The new EU initiatives of the SFTs Proposal, the upcoming UCITS V, as well as the new SHRD can be seen as a step forward to this end, contributing to the introduction of a more transparent environment in the securities markets. However, many issues connected to the prudential supervision of the securities intermediaries related to the re-hypothecation activities as well as the

securities form as a kind of property, that is, a property that has to be able to be acquired easily and safely not only on a local level but also at a cross-border one, remain open in EU.

4. Suggestions on which could be the appropriate regulation should initiate from the fact that regulation should be proportionate and not discourage market players from exercising securities intermediation activities, at most securities financing activities, considering their importance for the markets. To this end, it should be appropriate under the study's suggestions for the custody concept to be further elaborated on an EU level so that it distinguishes non-banking of safekeeping services cases from the banking ones. While it is reasonable for the former services to be subject to a less stringent prudential regulation in which they do not pose to markets significant credit or custody risks, the latter should be regulated more strictly due to their similarity to the banking cash/credit intermediation. MiFID, FCD, SFD, AIFMD, the upcoming CSDR and other relevant EU legislative initiatives should take into serious consideration and render a priority issue, the need of such regulation in terms of effecting proper balance between financial stability, on the one hand, and markets effectiveness, on the other. The UCITS V provisions on depositaries and UCITS assets segregation rules should be considered as a characteristic paradigm in structuring similar segregation (non-banking type) concepts.
5. Furthermore, any EU intervention in the field of custody services should take seriously into account that a real protection for investors and an 'added value' for such services can only be achieved if the 'product', for which the relevant services are provided, is clearly defined. In this respect the 'who ones what' definition, which focuses on stipulating the securities substance as an 'asset' as well as the kind of rights that can be established therein, can be regarded as a *sine qua non* element and a necessary precondition for the proper regulation of the relevant custody services. However, as the legal environment in terms of securities is not yet clear on an EU level, considering that there is no particular answer on the question related to 'who owns what', the investor or the intermediary (?), the custody issues is difficult to be effectively addressed. A twofold EU rule, covering both the substantive law and conflict of laws aspects in securities, would be therefore necessary.
6. In this regard the study suggests a securities ownership status to be legally elaborated in EU, in order to safeguard all proprietary aspects in securities and respectively strengthen the client protection and the financial stability in the internal market. It is considered that, as this ownership status can be affected on a post-holding level and facilitated by the modern techniques of automation and technology, the adoption of such status does not presuppose any change to the securities holding systems and patterns concerned. On the contrary, it can be adopted regardless of such securities holdings nature as direct or indirect. The appropriateness of this approach is confirmed by the new SHRD that requires investor identification regardless of the direct or indirect chain of intermediaries involved.
7. A key component in this context relates also to the legal formula of such 'who owns what' substantive law rule as well as the relevant conflict of laws issues considering the globalized and, in concept, cross-border nature of securities markets. Answers to these questions presuppose an in-depth EU cost benefit analysis in order to estimate whether PRIMA rules and the function of the 'securities account approach' is appropriate and compatible to the new EU initiatives mainly the concept of investor identification under the new SHRD.

8. As the study proposes, such 'account approach', when relating to the proprietary aspects in securities, should be abandoned on an EU level (FCD, SFD, CSDR) and, more specifically, be replaced by an applicable law rule that will be more closely connected to this very nature of securities rights as proprietary rights. This aspect should be also aligned with the parallel definitions of contractual rights in securities that will serve the need of protecting investors' contractual rights in securities when such securities have been re-hypothecated.
9. In this regard, the 'law under which the securities are constituted' is proposed to be introduced as the applicable law. It should be underlined that this approach is closely aligned with the new SHRD in connection to its rule on the 'investor identification'. The rationale behind this proposed approach, that is, the securities constitution law approach, instead of the securities account law approach, stems from the fact that all proprietary aspects in relation to such securities will be subject to the same law, that is, to the law of the securities constitution regardless of:

   ○ the location of the securities (as a piece of property) or
   ○ the location of the securities' initial or subsequent recording and hence the location of the securities as a piece of property held in a book entry form or
   ○ the location of the CSDs or other holding systems operating securities holding and other related services or
   ○ the location of the intermediaries that hold securities account even indirectly or in a commingled or omnibus manner, acting within the context of the multi-tier intermediation profile of modern markets.

10. This approach will definitely facilitate EU regulators, in addressing all remaining and crucial for the EU integration securities law issues, towards improving prudential regulation for securities intermediation and also introducing more transparent conditions for the benefit of the investors, the markets and the financial system as a whole.

NOTES AND REFERENCES

1 A synopsis of this study has been presented by the author in the 'DTCC Systemic Risk Forum 2014' (Brussels, 27 March 2014). A previous version of this study has been presented in the international conference 'Banking, Finance, Money and Institutions: The Post Crisis Era' of the Centre for Money, Banking and Institutions (CMBI) of the University of Surrey and the Center of Research in the Contemporary Finance of the Fordham University, USA (Surrey, 2–3 November 2013).

2 [2002] O.J. L 168/43. FCD has been amended by the Directive 2009/44/EC 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 [2009] O.J. L 146/37.

3 COM (2013) 614.

4 COM (2014) 40.

5 COM (2012) 350.

6 COM (2014) 213.

7 *See* paras 3, 4 and 5 of the preamble of FCD. For an analysis of the FCD's objectives and other related issues, *see* Working Group of the Financial Law Committee of the City of London Law Society, EU Directive on Financial Collateral Arrangements: Replies of a Working Group of the City of London Law Society Financial Law Committee to the Questionnaire of February 2006 to the Private Sector from the European Commission for the Drafting of the Evaluation Report (2006) *Butterworths Journal of International Banking and Financial Law*, June, at 263 *et seq*.

8 *See* paras 9 and 10 of the preamble and article 3 of FCD.

9 Article 2 par. 1 (d) of FCD.

10 Article 2 par. 1 (e) of FCD.

11 Article 2 par. 1 (g) of FCD.

12 Paras 5, 14 and 15 of the preamble and articles 7 and 8 of FCD. For an analysis of the financial collaterals and the FCD financial collateral arrangements from an English law perspective, *see* among others Hughes, M. (2006) Legal principles in banking and structured finance, at 93 *et seq*., mainly at 101.

13 Article 2 par. 1 (c) of FCD.

14 Article 2 par. 1 (b) of FCD.

15 Article 2 par. 2 and 3 and article 3 of FCD.

16 Article 1 par. 5 of FCD.

17 From an EU perspective custody in securities has been defined as an ancillary service under the Directive 2004/39/EC on markets in financial instruments [2004] O.J. 145/1 (MiFID); *see* para 1 of Section B (Ancillary Services) of Annex I (List of services and activities and financial instruments) of MiFID, where the relevant service is defined as '(1) Safekeeping and administration of financial instruments

for the account of clients, including custodianship and related services such as cash/collateral management'; *see* also the section 'EU legislative initiatives in addressing shadow banking in securities collaterals' for our regulatory suggestions on custody in securities under the view of strengthening the transparency in the securities field. *See* also the EU initiatives of reviewing MiFID at http://ec.europa.eu/internal_market/securities/isd/mifid/index_en.htm and the references in Section 5, (a) and infra note, 58.

18 CSDs are systemically important entities in the financial sector as they provide main services for the proper functioning of the securities markets consisting of registration, safekeeping, settlement of securities in exchange for cash and others. For an EU definitional and regulatory approach of CSDs, *see* the Proposal for a Regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) COM(2012)73. *See* also at http://ec.europa.eu/internal_market/financial-markets/central_securities_depositories/index_en.htm, where the main importance of CSDs is underlined as follows: '*While securities markets traditionally relied on the physical exchange of papers, CSDs now assume a critical role to guarantee a safe and efficient transfer of securities that exist to a large extent only in book entry form. They have now become a central point of reference for an entire market. Furthermore, being located at the end of the post-trading process, CSDs witness all the settlement fails occurring during the settlement period. They are therefore a key element of any policy of settlement discipline. Given the systemic importance of CSDs and their strategic position at the end of the post-trading process, there is a strong need for an appropriate regulatory framework for CSDs*'.

19 For an analysis of this direct concept of securities holdings based on the 'individual client segregation' approach, see Kouretas, G.P. and Tarnanidou, Ch. (2014) 'Shareholding in EU: is "indirect holding" approach appropriate in achieving financial integration?' *Journal of Financial Regulation and Compliance*, 22(1) at 15–25. An earlier version of the above article has been presented at the International Conference on 'Improving Financial Institutions: The Proper Balance Between Regulation and Governance', Hanken School of Economics (Helsinki, 19 April 2012) and at the Conference on Research on Economic Theory and Econometrics (Milos, 11–15 July 2012).

20 For the direct and indirect holding systems and the relevant collateral approaches, *see* European Commission. Directorate General Internal Market and Services. Financial Markets Infrastructure, Summary of the Seventh Meeting of the Member States Working Group on the Securities Law Legislation (2013) Brussels, 24 May and Summary of the Meeting of the Member States Working Group on Securities Law Legislation (2012), Brussels, 19 Nov. at http://ec.europa.eu/internal_market/financial-markets/securities-law/index_en.htm. For a legal analysis of the open issues of securities holdings and collaterals at an international level (Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (5 July 2006), *see* at http://www.hcch.net/index_en.php?act=conventions.text&cid=72, 'Hague Securities Convention') and at an EU level, their aspects under the direct and indirect systems, their cross-border interactions and the relevant concerns on the conflict of laws rules, *see* Tarnanidou Ch.I. (2006) Derivatives Contracts of the Financial Sector. Legal and Practical Analysis (Greek edition), at 25–135 (for the book-entry nature of securities), 320–378 (for the collaterals in such securities provided as margin in derivatives contracts) and 393–420 (for the cross-border provision of such collaterals and the concepts of the 'Place of the Relevant Intermediary Approach' (PRIMA) under the Hague Convention and FCD), as well as the above book's relevant references mainly to Benjamin J. (2001), Easy of Transfer and Security of Transfer in the Securities Market. *Butterworths Journal of International Banking and Financial Law*, May, at 219 *et seq*.; (ibid) (2000) Immobilized Securities-Perfection of Security Interests, at 61 *et seq*., In: Hudson, Al. (ed.), *Modern Financial Techniques, Derivatives and Law*, (ibid) (2000) Interests in Securities. A Proprietary Analysis of the International Securities Markets; Bernasconi, Ch., Potok, R. and Morton, G. (2002) General Introduction: Legal nature of interests in indirectly held securities and resulting conflict of laws analysis, In: Potok, R. (ed.), *Cross Border Collateral: Legal Risk and the Conflict of Laws*,
at 7 *et seq*.; Guynn, R.D. (1996), Modernizing Securities Ownership, Transfer and Pledging Laws, Capital Markets Forum; Potok, R. (2001), The Hague Conference on Private International Law – An important step to legal certainty in relation to indirect-held securities, *Butterworths Journal of International Banking and Financial Law*, April, at 166 *et seq*. For an analysis of the indirect holding systems, FCD and Hague Convention – PRIMA, *see* also Alexander, K. (2003), Private Law Approaches to Enhancing Financial Stability: The Hague Convention on Indirectly Held Securities and European Union Collateral Directive, In: Andenas, M. and Avgerinos, Y. (eds.), *Financial Markets in Europe. Towards a Single Regulator*?, at 121 *et seq*., mainly at 126–127, 134–140. *See* also for more recent literature among others Mooney, Ch. W. (Rev. dr unif. 2010) Private Law and the Regulation of Securities in Intermediaries: Perspectives under the Securities Convention and United States Law, Private Law and the Regulation of Securities Intermediaries, at 801 *et seq*; Paech, Ph. (2013) Market needs as paradigm: breaking up the thinking on EU securities law, in Intermediated Securities. Conac, P.H., Segna, Ul. and Thevenoz, L. (eds.), *The Impact of Geneva Securities Convention and the Future European Legislation*, at 22 *et seq*., mainly at 48–49; Thevenoz Luc. (2007), Intermediated Securities, Legal Risk and the International Harmonization of Commercial Law (http://works.bepress.com/luc_thevenoz/1), at 1–69; Tarnanidou Ch. I. (2009) *Special Shareholders Rights in Listed Companies* (Greek edition, Sakkoulas publ.), at 178.

21 Article 4 of FCD. For an analysis of the implementation of FCD by the EU member states, *see* Löber, Kl. and Klima, E. (2006) The implementation of directive 2002/47 on financial collateral arrangements, *Journal of International Banking Law and Regulation*, 4, at 203 *et seq*. For a legal analysis of FCD's enforcement provisions based on the Greek laws, *see* Tarnanidou, Derivatives Contracts, *op. cit*. note 21, at 306 and 366, *et seq*.

22 Article 1 par. 2 of FCD.

23 Article 2 par. 1 (f) of FCD.

24 *See* mainly article 7 of the FCD for the recognition of close-out netting provisions and article 8 of FCD on the

disapplication of certain insolvency provisions. *See* also Benjamin, Interests in Securities …, *op. cit.* note 21, at 125–126; for comments on netting, (ibid) (2003) Overview of Post-Trade Infrastructure, Part 3, Butterworths Journal of *International Banking and Financial Law*, Jun., at 223 *et seq*., mainly at 225; Henderson, K. (1997) Termination Netting of Derivatives, at 4 *et seq*.; Dale, R. (1999) Risk Management in US Derivatives Clearing Houses in Issues in Derivative Instruments Swan ed. J. (ed.), at 101 *et seq.* (mainly at 105 and 122 *et seq*.); Hardig, M. (1986) Some practical and legal aspects of financial futures, *Journal of International Banking Law*, 1, at 30 *et seq*.; Löber – Klima, *op. cit.* note 22, at 210. For an analysis of FCD and the relevant close-out netting and insolvency provisions, *see* also Raffan, M. (2006) The Collateral Directive, in A Practitioner's Guide to EU Financial Services Directives, Raffan, M. (consultant ed.), at 222–224.

25 Articles 2 par. 1 (m) and 5 of FCD.

26 *See* Goode, R. (2003) Legal Problems of Credit and Security, at 232 *et seq*.; Turing, D. (2002) The EU Collateral Directive Butterworths Journal of International Banking and Financial Law, May, at 187; Keijer, Th. (2003) Introduction, (ibid), Dutch and German Law. The right of use based on a security interest as envisaged in the Collateral Directive, (ibid), Right of use under English law in Report on a 'Right of Use' or Collateral Takers and Custodians, July, Keijser, Th. (ed.), Researcher – Business and Law Research Centre, University of Nijmegen, The Netherlands, at 4, 31 *et seq*., 48 *et seq*., mainly at 56; Benjamin, Interests in Securities, *op. cit*., note 21, at 119 *et seq*.; Raffan, *op. cit.,* note 25, at 220–222; Tarnanidou, Derivatives Contracts …, *op. cit.* note 21, at 302–311 and 367–375. For an analysis of the two legal aspects of the collaterals, as pledge and title transfer, including the repurchase agreements, *see* Alexander, *op. cit*., note 21 at 124–125.

27 Articles 2 par. 1 (a), (b) and 6 of FCD; supra, note 27. *See* Hughes, *op. cit.* note 13, at 98–99.

28 *See*,Turing, *op. cit.,* note 27, at 187; Benjamin, Interests in Securities, *op. cit.* note 21 at 121; Alexander, *op. cit.,* note 21 at 31; Keijer, *op. cit.* note 27 at 3; Raffan, *op. cit,* note 25, at 220–222; Tarnanidou, Derivatives Contracts …, *op. cit.,* note 21, at 311–315 and 375–378.

29 Articles 2 par. 1(a), (c) and 5 of FCD. For a rather comprehensive analysis of the right of use and its impact to the collateral taker's legal position, mainly as an investor-user of custody services, *see* Keijer *op. cit.* note 27, at 4, 10, 53–59; Tarnanidou, *op. cit.*, note 21, at 303 *et seq.*

30 For a relevant analysis under the UK law and system, *see* Working Group of the Financial Law Committee of the City of London Law Society, *op. cit.* note 8, at 264. As the above Group notes, the right of use given for the collateral taker to use and dispose of financial collateral has had a beneficial effect both because it puts beyond doubt the legality of the grant of such right and also because the availability of such a right allows for greater flexibility in the structuring of transactions and increases liquidity in the collateral pool available for financial markets transactions. However, following the collapse of too many financial entities (Lehman, MF Global etc.) and the relevant 'collapse' of the 'too big to fail' myth, the aforementioned views on the right of use is reasonable to be reviewed. For these issues *see* also the analysis below in Section 5, (a).

31 For the references to MiFID, *see* supra, note 18. For AIFMD, *see* [2011] O.J. L 174/1 and for all other relevant EU regulations at http://ec.europa.eu/internal_market/investment/alternative_investments/index_en.htm.

32 Different is, however, the concept of the 'new MiFID' that prohibits title transfer collaterals when the collateral giver is a retail investor. For this prohibition, *see* below in Section 'To further regulate or not?' (a) of this study.

33 Article 4 par.1 (af) of AIFMD. For the AIFMD legislation, *see* at http://ec.europa.eu/internal_market/investment/alternative_investments/index_en.htm.

34 *See* article 4 of FCD. For a comprehensive analysis of close-out netting, its protection against insolvency risk and mainly the concerns on systemic repercussion related to its massive use, *see* European Parliament Directorate-General. For Internal Policies Policy Economic and Scientific Policy (2003) *Shadow Banking: Legal Issues of Collateral Assets and Insolvency Law* (author: Paech Ph.), at 7–12.

35 *See* Financial Stability Board (2011) Shadow Banking Scoping the Issues A Background Note of the Financial Stability Board, 12 April, at 2 *et seq*.; (ibid.) (2011) Shadow Banking Strengthening Oversight and Regulation Recommendations of Financial Stability Board, 28 October, at 3 *et seq*.; (ibid.) (2012) Securities Lending and Repos: Market Overview and Financial Stability Issues. Interim Report of the FSB Work Stream, 27 April, at 6, 8 *et seq*., 16 *et seq*.; (ibid.) (2012) Consultative Document Strengthening Oversight and Regulation on Shadow Banking An Integrated Overview of Policy Recommendations, 18 November, at 3 *et seq*.; European Commission, Green Paper Shadow Banking (Text with EEA relevance) COM(2012)102, at 3 and the Communication of the Commission to the Council and the European Parliament Shadow Banking – Addressing New Sources of Risk in the Financial Sector, COM (2013)(614), at 3 *et seq*., for which *see* also the analysis in Section 'EU legislative initiatives in addressing shadow banking in securities collaterals' (a); European Central Bank (2013) Enhancing the Monitoring of Shadow banking, Monthly Bulletin, February, at 89; *see* for relevant literature, among others, Adrian, T. and Ashcraft, A.B. (2012) Shadow Banking: A Review of the Literature. Federal Reserve Bank of New York Staff Reports, October, Staff Report No. 580, 2 and examples at 5 *et seq*.; Noeth, B.J. and Sengupta, R. (2011) Is Shadow Banking Really Banking? *Regional Economist*, October, at 8, 9 ('*Shadow banking comprises a chain of intermediaries that are engaged in the transfer of funds channeled upstream in exchange for securities and loan documents that are moving downstream*'.).

36 Supra note 36. For the definition of re-hypothecation from an English law perspective, *see* also Benjamin, Interests in Securities …, *op. cit*., note 21, at 94–95, 229 *et seq.* and 260 *et seq.* (shortfall risk); Hughes, *op. cit*., note 13, at 103.

37 For a relevant analysis, *see* Singh, M. and Aitken, J. (2009) Deleveraging after Lehman - Evidence from Reduced Re-hypothecation 1 (International Monetary Fund (IMF), Working Study No. 09/41; (ibid.) (2010) The (sizable) Role of Re-hypothecation in the Shadow Banking System, International Monetary Fund WP/10/172, at 4 *et seq*.; Gorton, G. and Metrick, A. (2009) The Run on Repo

and the Panic of 2007–2008, at 8; Benjamin, Interests in Securities, note 21, at 111–118 and 237–238, with conclusions on transfer outright as an appropriate route when the collateral taker uses the collateral; Turing, *op. cit.,* note 27.

38 *See* Schwarcz, St L. (2011–2012) Regulating shadow banking, inaugural address for the inaugural symposium of the review of banking and financial law, *Review of Banking and Financial Law* 31, at 619 *et seq*., mainly at 624; Deryugina, M. (2009) Standardization of securities regulation: Rehypothecation of securities commingling in the United States and the United Kingdom, *Review of Banking and Financial Law* 29, at 253 *et seq*., mainly at 257 and 261–262.

39 For the commingling and related consequences mainly under English law, *see* Benjamin, Interests in Securities …, *op. cit.,* notes 21 and 37. For an analysis of re-hypothecation, hypothecation, commingling and the resulting consequences mainly from a US law perspective, *see* Deryugina, *op. cit.* note 21 at 266–273. For an analysis of the indirect concepts and the related consequences in cross-border transactions and securities holdings, *see* also Thevenoz, *op. cit.* note 21; Paech, *op. cit.* note 21, at 39 *et seq*.; Deryugina, *op. cit.* note 21.

40 Commission Directive 2006/73/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive [2006] O.J. L 241/26.

41 For these issues, *see* also recital 27 of MiFID where the following are laid down '*(27) Where a client, in line with Community legislation and in particular Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, transfers full ownership of financial instruments or funds to an investment firm for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, such financial instruments or funds should likewise no longer be regarded as belonging to the client*'. Therefore, MiFID allows an investment firm to be a collateral taker with regard to its clients' obligation and in this context to obtain full title transfer of the financial instruments transferred by the client as collateral giver to cover relevant client's obligations to the investment firm. *See*, however, article 16(10) of MiFID's recast COM(2011) 656, where the scope of application of transfer outright in collaterals excludes retail investors as collateral givers in relation to the services provided by an investment firm to them. *See* also Section 'EU legislative initiatives in addressing shadow banking in securities collaterals', (a) of this study where the relevant approach under the new MiFID is analyzed.

42 *See* among others, Singh – Aitken, Deleveraging after Lehman …, *op. cit.* note 38, at 5 and 6; Schwarz, *op. cit.* note 39, at 625 (analysis on the systemic risk issues).

43 *See* Schwarz, Deryugina, *op. cit.* note 39.

44 For a relevant analysis, *see* Deryugina, *op. cit.,* note 39.

45 *See* 17 C.F.R. §240.15c3–3(e).

46 For a relevant analysis, *see* Architzel, P.M. and Walker, P.P. (2012), CFTC's rulemaking on the segregation of cleared swaps, customer collateral: LSOC and beyond, *Journal of Investment Compliance* 13 (3), at 36–45.

47 *See* also CFTC's consideration of the segregated models in Architzel – Walker, *op. cit.* note 47, at 39.

48 For the US approach, *see* Deryugina, *op. cit.* note 39.

49 *See* at http://fshandbook.info/FS/html/FCA/CASS/6/4.

50 *See* relevant references in European Commission, Directorate General Market and Services (2012) Legislation on Legal Certainty of Securities Holding and Dispositions, 6th meeting of the Member States Working Group (10th Discussion Study of the Services of the Directorate-General Internal Market and Services, Brussels, 16 October at 4–8; for an analysis of the US aspects, *see* Deryugina *op. cit.,* note 39.

51 For these elaborations, *see* European Commission Internal Market and Services DG, Report of the Alternative Investment Expert Group, Managing, Servicing and Marketing Hedge Funds in Europe (2006), July at 29 *et seq.* (http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/hedgefunds_en.pdf).

52 *See* supra, note 52.

53 However, it should be noted that re-hypothecation as a practice used by the intermediaries as clearing members to reuse the collateral pledged by their clients in discharge of margining obligations to central counterparties (CCPs) or other clearing houses related to such clients' positions, should not be prohibited to intermediaries when providing only non-banking type of safekeeping services as referred to above. In this case, re-hypothecation could be considered as an acceptable practice, as it purely relates to services that intermediaries provide within their agency activities and not for their own funding purposes. For the relevant rules under the US law, *see* 17 C.F.R. § 240.15c2–1(c)(2009) under which margin customer accounts are exempted from the general prohibition on hypothecation so long as the customers are notified of the exact terms of the hypothecation and commingling that the prime broker is engaging in. For relevant references and observations, *see* Deryugina, *op. cit.,* note 39, at 267–268.

54 This study does not focus on analyzing the capital and other relevant prudential requirements related to the proposed banking type of safekeeping services, as these issues go beyond its scope and nature. However, it should be important such issues to be further analyzed by regulators in terms of addressing the re-hypothecation shadow banking problem in an effective manner.

55 *See* European Commission, supra note 51. *See* also for relevant analysis in haircuts and circuit breakers as measures mitigating the risk of stock lending and repos, European Parliament (Paech), *op. cit.* note 35, at 12–20.

56 For the CSDR Proposal, *see* supra, note 19, and also below in paras (b) and (c) of the section 'To further regulate or not?'.

57 *See* mainly article 16 par. 10 of the Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council, COM(2011)656 (MiFID-2).

58 For the new EU initiatives in this area of investor identification and the need for more transparency, *see* the analysis on the 'new SHRD' in the section 'EU legislative initiatives in addressing shadow banking in securities collaterals' par. (e).

59 Worthy of note is that under the upcoming CSDR (*see* Council of the Union, Central Securities Depositories: Council confirms agreement with EP', Brussels, 26 February 2014, 7006/14 (OR. en) Press 100), and specifically

under its article 38 par. 4 point 3 the following have been laid down: '*However, a CSD and its participants shall provide individual client segregation for citizens and residents of and legal persons established in a Member State where this is required under the national law of the Member State under which the securities are constituted as it stands at … This obligation shall apply as long as the national law is not amended or repealed and its objectives are still valid*'. It should be noted that under the relevant references of the above CSDR text the date to which the above provisions refer will be the date of entry into force of CSDR (and alternatively, under the relevant drafting suggestion, 'nine months after its entry into force'). Considering the rationale behind these provisions, it should be noted that they were deemed to serve the need of 'neutrality' among CSDs' securities holding systems, that is, the need the harmonization not to affect such systems either acting as direct or indirect. In this respect, direct holding systems are included. However, the aforementioned provisions reflecting the 'direct holdings' should be considered as rather restrictive for CSDs as direct systems as they limit the application of individual client segregation only to such systems as 'existing systems' at the entry into force of CSDR and, moreover, only as long as they operate as such. To this end, under the drafting and meaning of said provisions CSDs will be prohibited to introduce a 'genuine direct holding' concept to their operations after the entry into force of CSDR. In view of the above, it should be highlighted that it is rather questionable whether CSDR is rather accurate in achieving its neutrality goals.

60 Article 46 (Applicable law to proprietary aspects) of the CSDR Proposal defined the following: '*1. Any question with respect to proprietary aspects in relation to financial instruments held by a CSD shall be governed by the law of the country where the account is maintained. 2. Where the account is used for settlement in a securities settlement system, the applicable law shall be the one governing that securities settlement system. 3. Where the account is not used for settlement in a securities settlement system, that account shall be presumed to be maintained at the place where the CSD has its habitual residence as determined by Article 19 of Regulation (EC) No 593/2008 of the European Parliament and the Council24. 4. The application of the law of any country specified in this Article shall comprise the application of the rules of law in force in that country other than its rules of private international law*'.

61 For the Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (5 July 2006), *see* at http://www.hcch.net/index_en.php?act=conventions.text&cid=72. For a relevant analysis of the Convention's concepts, *see* PRIMA Convention brings certainty to cross-border deals (Government representatives have agreed on an international convention governing which law applies to cross-border securities transactions. Christophe Bernasconi and Richard Potok, who have spearheaded the negotiations over the past two-and-a-half years, explain the need for the Convention and how it will benefit the securities industry (2003) International Financial Law Review, Jan., at 11 *et seq*., mainly at 12–13; Paech, *op, cit*. note 21, at 36 *et seq*. For the PRIMA's reflections in FCD, *see* also Pitt, C. (senior analyst, Market Infrastructure Division, Bank of England) (2003) Improving the legal basis for settlement finality, *Butterworths Journal of International Banking and Financial Law*, Oct., at 341 *et seq*., mainly at 344. For the account approach and the indirect holding elaborations before PRIMA, *see* Benjamin, *op. cit*. note 21, at 155 and 158 *et seq*. For the enunciation of PRIMA in FCD, *see* Raffan, *op. cit,* note 25, at 225–227. For an analysis of Hague Convention and the relevant opinion of the European Central Bank (ECB), *see* Alexander, *op. cit*. note 21, at 133 *et seq*. As Alexander notes, ECB criticized that the Hague Convention failed to make a clear distinction between contractual and property rights. ECB argued, among others and mainly in relation to the United States approach on interests (entitlements) in securities under art. 8 of the Uniform Commercial Code, that jurisdictions that have not adopted a complementary substantive law framework to accommodate the implementation of conflict of laws rules for determining ownership interests in property may suffer competitive disadvantages *vis-à-vis* jurisdictions like the United States that already have a comprehensive framework of substantive and choice of law rules to regulate securities holdings practices. For a relevant analysis related to the diversity of the substantive rules, *see* also Bourbon-Secret, Ch.(2005) Cross-border security interests in movable property: An attempt at rationalising the international patchwork: Part 1, *Journal of International Banking Law and Regulation* (9), at 419 *et seq*., mainly at 421. *See* also the Commission's withdrawal of the proposal for a Council Decision concerning the signing of the Hague Convention on the Law applicable to certain rights in respect of securities held with an intermediary, for which *see* at http://ec.europa.eu/internal_market/financial-markets/hague/index_en.htm. For the Geneva Securities Convention, *see* UNIDROIT Convention on Substantive Rules for Intermediated Securities ('Geneva Securities Convention') at unidroit.org/english/conventions/2009intermediatedsecurities/main.htm. For a comprehensive analysis of Geneva Convention, *see*, among others, Thevenoz, L. (2013) The geneva securities convention: objectives, history and guiding principles in intermediated securities: In: P.H. Conac, Ul. Segna and L. Thevenoz (eds.), *The impact of geneva securities convention and the future of the European legislation*, at 3 *et seq*.

62 *See* supra, note 62.

63 For a relevant definition in EU law, *see* the Directive 2007/36/EC, the so-called Shareholders Rights Directive (SHRD).

64 For a relevant analysis of this 'direct registration', *see* Kouretas – Tarnanidou, *op. cit*. note 20, mainly at 21 (section 'EU legislative initiatives in addressing shadow banking in securities collaterals' of the article). *See* also the EU initiatives on the new SHRD in section 'EU legislative initiatives in addressing shadow banking in securities collaterals' (e).

65 For these issues, *see* article 49 of the upcoming CSDR.

66 See Kouretas-Tarnanidou, *op. cit.,* note 20.

67 [1998] O.J. L 166/45. *See* also the amendment of SFD by the Directive 2009/44/EC, for which *see* also supra note 3.

68 Specifically, article 6 par. 2 of the SFD provides that: *'[W]here securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Member States or the future European central bank as described in paragraph 1, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded*

on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State.', while article 9 of the FCD provides that '*[A]ny question with respect to any of the matters specified in paragraph 2 arising in relation to book entry securities collateral shall be governed by the law of the country in which the relevant account is maintained*', where said paragraph 2 refers to all proprietary aspects in relation to book-entry securities, including its legal nature, its requirements of its perfection and provision and so on.

69 For the regulatory treatment of this approach from an EU law perspective, *see* article 13 of the Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies ([2007] O.J. L 184/17). For this Directive, the so-called SHRD, and its upcoming amendment *see* also in section 'EU legislative initiatives in addressing shadow banking in securities collaterals' (e).

70 For the Commission's Green Paper and the Communication, *see* supra, note 36.

71 *See* section 3.3 of the Communication.

72 *See* section 3.2 of the Communication.

73 Supra notes 71–73.

74 Supra, notes 71–73.

75 *See* European Commission Internal Market and Services DG, Mandate (2005), Jan., at http://ec.europa.eu/internal_market/financial-markets/clearing/certainty/index_en.htm#maincontentSec1. For a very comprehensive analysis of the securities issues and post-trading barriers, *see* Legal Certainty Group – LCG, Second Advice of the Legal Certainty Group. Solutions to Legal Barriers relating to Post-Trading within the EU at http://ec.europa.eu/internal_market/financial-markets/docs/certainty/2ndadvice_final_en.pdf.

76 *See* at http://ec.europa.eu/internal_market/financial-markets/securities-law/index_en.htm.

77 *See* supra, note 21 and also at http://ec.europa.eu/internal_market/financial-markets/docs/securities-law/index_en.htm.

78 For this EU recast initiative, *see* at http://ec.europa.eu/internal_market/securities/isd/investor/index_en.htm.

79 [2012] O.J. L 201/1. EMIR constitutes an EU law cornerstone for the establishment of harmonization in the field of central counterparties, that is, of the entities that carry out clearing by novation as central counterparties to the trades they clear. For EMIR and other related EU regulatory measures, *see* at http://ec.europa.eu/internal_-market/financial-markets/derivatives/index_en.htm.

80 For the trade repositories development under EMIR, *see* the EU page, supra, note 80.

81 *See* the analysis in section 'To further regulate or not?' paras (b) and (c).

82 For relevant references *see* supra notes 21 and 62, including the Commission's withdrawal of the proposal for a Council Decision concerning the signing of the Hague Convention.

83 COM (2014) 40.

84 *See* at Proposal at 4.

85 Supra note 85.

86 Supra note 85.

87 *See* for relevant references to EMIR, supra notes 80, 81.

88 For such concepts, *see* also recitals 6 to 10 of the preamble of the Proposal.

89 Based on the respective definitions of such counterparties under EMIR, the Proposal defines them in article 3 par. 2 as 'financial counterparties' and 'non-financial counterparties' as defined in points (8) and (9), respectively, of article 2 of EMIR (Regulation (EU) No 648/2012), as well as 'CCPs' as defined in point (1) of article 2 of EMIR. In this respect such 'financial counterparties' include any investment firm authorised in accordance with Directive 2004/39/EC, a credit institution authorized in accordance with Directive 2006/48/EC, an insurance undertaking authorized in accordance with Directive 73/239/EEC, an assurance undertaking authorized in accordance with Directive 2002/83/EC, a reinsurance undertaking authorized in accordance with Directive 2005/68/EC, a UCITS and, where relevant, its management company, authorized in accordance with Directive 2009/65/EC, an institution for occupational retirement provision within the meaning of Article 6(a) of Directive 2003/41/EC and an alternative investment fund managed by AIFMs authorized or registered in accordance with Directive 2011/61/EU. Accordingly, as 'non-financial counterparties' are defined any undertakings established in the Union other than CCPs and financial counterparties.

90 For the use of SFTs by fund managers and the respective measures of the Proposal, *see* the analysis under the recitals 11 to 16 of the preamble of the Proposal.

91 [2009] O.J. L 302/32. This is the so-called 'UCITS IV'.

92 [2011] O.J. L 174/1. This is the so-called 'AIFMD'.

93 Recital 14 of the preamble of the Proposal.

94 Proposal, at 7.

95 A risk mitigant in this respect could be considered, for example, an introduction of a cap on the amount of securities collateral that could be permitted to be re-hypothecated, or an introduction of measures similar to those referred to in section 'To further regulate or not?' para (a) of this study, related to the distinction from a prudential perspective of non-banking type and banking type of safekeeping services. These prudential measures could be further supported by the reporting rules under the Proposal.

96 COM (2012) 350.

97 *See* recital 11 of the preamble of the upcoming UCITS V.

98 *See* article 1 par. (5) of UCITS V, as elaborated under the compromise texts of the Council of the European Union.

99 Kouretas-Tarnanidou, *op. cit.,* note 20.

100 COM (2014) 213.

101 [2007] O.J. L 184/17. For the EU perspectives on SHRD and corporate governance in general, *see* European Commission: The EU Single Market, Company Law and Corporate Governance at http://ec.europa.eu/internal_market/company/index_en.htm. *See* for an SHRD analysis, Tarnanidou, Special Shareholders Rights, *op. cit.,* note 21.

102 *See* the Proposal at 5, 6, 9 and 10.

103 Supra note 20.

104 *See* section 'To further regulate or not?' paras (a) to (c).

105 *See* article 3a par. 4 (no breach of disclosure information) and par. 5 of the Proposal and also article 14a par. 2 thereof (Commission's implementing acts on the relevant information transmission requirements).

106 Article 3a of the Proposal (new SHRD).

107 [2004] O.J. L 390/38.