

# **EU Legislation on legal certainty of securities holding and dispositions**

## **Consultation document DG MARKT**

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# SLD: Background (1)

- **Book-entry securities instead of paper-based securities (immobilisation and dematerialisation)**
- **Securities no longer transferred in paper form but through securities accounts kept by account providers acting on behalf of account holders**
- **Cross-border holding = different applicable laws**
- **Securities held through securities accounts across border:**
  - Legal uncertainty, not clear what an investor owns;
  - Ineffective;
  - Does not allow/enable investors to exercise rights attached to these securities without major obstacles.

## SLD: Background (2)

- **Giovannini Reports (2001 and 2003): 3 spheres of difficulties and 15 specific obstacles within the post trading sector re:**
  - technical requirements and industry practices;
  - taxation, and
  - legal certainty.
- **EU Commission: Legal Certainty Group to advise on the dismantling of the Giovannini barriers connected to legal issues**  
**→ *Advice on Solutions to Legal Barriers related to Post-Trading within the EU (2008):***
  - called for EU-wide harmonisation of certain areas of law and the preparation of EU legislation in this field;
  - endorsed by Commissioner McCreevy and the ECOFIN Council:
  - *"EU legislation is needed in this area providing for a more harmonised legal framework for intermediated securities and a better protection of investors' rights enshrined in their securities".*

# SLD: Content general

- **SLD corresponds to the Swiss Federal Act on Book-entry securities (BEG), with some exceptions and particularities**
- **SLD interacts with Shareholder Rights Directive, MiFID, Settlement Finality Directive, Financial Collateral Directive**
- **SLD is expected to address three issues:**
  - the legal framework of holding and disposition of securities held in securities accounts, covering aspects belonging to the sphere of substantive law as well as conflict-of-laws;
  - the legal framework governing the exercise of investor's rights flowing from securities through a "chain" of intermediaries, in particular in cross-border situations;
  - the submission of any activity of safekeeping and administration of securities under an appropriate supervisory regime, notably MiFID.

# SLD: Content details (1)

- **Selected principles:**

- Shared functions:

- Member states may provide that a person other than the account provider (e.g. “account operators” which are not account providers) is responsible for the performance of certain, but not all, functions of an account provider

- Account-held securities:

- Confer upon the account holder at least the following rights: (a) exercise/receive rights attached to the securities if ultimate account holder or provided for by the applicable company law; (b) effect a disposition under one of the harmonised methods; (c) instruct the account provider to hold the securities with another account provider;
- Account holder acting in the capacity as account provider for a third person: act in accordance with third person’s instructions;
- Functional approach

# SLD: Content details (2)

- **Selected principles (cont'd):**
  - **Methods for acquisition and disposition:**
    - Acquisitions/dispositions of account-held securities by way of crediting/debiting an account (= book-entry);
    - Account provider must hold a corresponding number of securities of same description when crediting an account;
    - National law may in addition provide for: (a) earmarking securities or account and removing earmarking (= book-entry methods); (b) concluding control agreement (= non-book-entry method); (c) concluding agreement in favour of an account provider (= non-book-entry method).
  - **Legal effectiveness of acquisitions and dispositions:**
    - No further steps required for effectiveness of acquisition/disposition between account holder and account provider and against third parties;
    - Effectiveness does not determine whom an issuer has to recognise as legal holder of its securities.
  - **Effectiveness in insolvency:**
    - Acquisitions/dispositions that are effective under SLD are equally effective against the insolvency administrator/creditors of e.g. the account-provider.

# SLD: Content details (3)

- **Selected principles (cont'd):**

- Reversal:

- Circumstances allowing national law to provide for reversal of effective book-entry positions: (a) account holder's consent to reversal; (b) erroneous crediting without account holder's authorisation; (c) debiting without account holder's authorisation; (d) earmarking without account holder's authorisation; (e) removal of earmarking without authorisation by person in whose favour it was made.

- Protection of acquirers against reversal:

- If person against whom the reversal takes effect knew or ought to have known that the initial crediting/ earmarking should not have been made.

- Priority:

- Earmarking amongst themselves: chronological order;
- Control agreement/agreement in favour of account provider amongst themselves: chronological order;
- Earmarking has priority over control agreement/agreement in favour of account provider;
- Acquisition/disposition methods under SLD = priority over any other method permitted by national law;
- Parties may deviate by agreement, but this cannot affect third party's rights.

- Protection of account holders in case of insolvency of account provider:

- Account-held securities should be unavailable for distribution to account provider's creditors;
- National law to provide mechanism governing the distribution of a shortage (insufficient number of securities being held by an insolvent account provider).

# SLD: Content details (4)

- **Selected principles (cont'd):**
  - Instructions:
    - Instructions to intermediaries only by account holder;
    - Exceptions: (a) by agreement; (b) instructions based on interest acquired by any other person; (c) judgement, award, order, decision by court/judicial/administrative authority; (d) rule of applicable law; (e) operator of a securities settlement system pursuant to applicable law.
  - Attachment by creditors of the account holder:
    - Only at the level of the account provider of that account holder.
  - Attachment by creditors of the account provider:
    - National law to prohibit that account provider's creditors attach securities credited to accounts opened in the name of that account provider with a second account provider, as far as those accounts are identified as containing securities belonging to the first account provider's customers.
  - Determination of the applicable law:
    - National law to determine that the national law of the country where the relevant securities account is maintained by the account provider (or the branch) shall be applicable with respect to the matters covered by the SLD;
    - Uniform conflict-of-laws rule



# SLD: Content details (5)

- **Selected principles (cont'd):**
  - Cross-border recognition of rights attached to securities:
    - National law not to discriminate against exercise of rights attached to securities on the sole grounds that the relevant securities are held in a specific manner (e.g. through a holding chain, through a nominee, in an omnibus account).
  - Passing on information:
    - National law to require account providers/holders to pass on information to their account holder (or to the ultimate account holder) as far as information is necessary for the exercise of rights and is directed to all legal holders of securities of that description → only ultimate account holder can opt-out;
    - Ultimate account holder's account provider to pass on information to issuer/following account provider as far as information is received from ultimate account holder in the course of the exercise of rights.
  - Facilitation of the ultimate account holder's position:
    - National law to require that ultimate account holder's account provider be bound to facilitate determination of exercise of rights as requested by ultimate account holder;
    - At least three alternative methods: (a) arrange for the ultimate account holder being the representative of the legal holder; (b) exercise the rights upon authorisation and instruction and for the benefit of the ultimate account holder; or (c) provide the ultimate account holder with evidence confirming its holdings;
    - Possibility of contractual agreement between ultimate account holder and its account provider is subject to restrictions for purposes of client protection.

# SLD: Content details (6)

- **Selected principles (cont'd):**
  - Non-discriminatory charges:
    - National law to ensure that costs charged by account provider to its account holders re duties to pass on information and facilitate ultimate account holder's position are not higher in cross-border holdings than in comparable domestic holdings (= similar to regulation re cross-border wire-transfer).
  - Holding in and through third countries:
    - Account provider to make reasonable and appropriate arrangements with its account holder/provider outside the EU facilitating the effective exercise of rights (= promote SLD principles abroad);
    - Duties on Swiss based account holders/providers?
  - Exercise by account provider on the basis of contract:
    - If ultimate account holder is able to exercise rights itself, but does not want to do so: its account provider may be obliged to exercise these rights upon its authorisation and instruction and based upon contractual agreement only.
  - Account provider status:
    - Safekeeping of securities under MiFID-rules should become an investment service, thus bringing all account providers under the authorisation and supervision pursuant to MiFID.

# SLD: Link to Swiss SPTC

“Standardisation plays a primordial role for the development of cross-border investment. Given that the consistent and timely processing of information heavily depends on the standardisation of operational procedures and key dates used by issuers and financial intermediaries, the Commission strongly encourages market led standardisation in this field. In order to streamline existing standardisation practices, future legislation may foresee a mechanism that would facilitate and monitor market-led standardisation and install a regulatory option should market-led standardisation fail.”

*(EU COM, Consultation document of DG MARKT re Legislation on legal certainty of securities holding and dispositions, p. 28)*

# SLD: timetable

- **April-June 2009: First public consultation**
- **January-June 2010: Discussion of the preliminary draft directive with Member States' experts**
- **November-December 2010: Second public consultation**
- **First semester 2011: Adoption by the Commission; transfer to the European legislator**
- **First semester 2012: Finalisation of the legislative procedure**
- **End-2013: Finalisation of transposition into Member States' law**