



Brussels, 13 November 2007
Markt/G2/PP D(2007)

LCG-16

*Legal Certainty Group
Subject 3 ("location of securities")
First working draft, November 2007*

| | | |
|----------|---|----------|
| 1 | BACKGROUND ANALYSIS | 2 |
| 1.1 | Practical significance of choosing the location | 2 |
| 1.2 | Location of securities | 2 |
| 1.2.1 | Initial issuance | 2 |
| 1.2.2 | Shift to a different location | 3 |
| 1.3 | Legal considerations | 3 |
| 1.3.1 | Shares | 3 |
| 1.3.2 | Corporate and Government debt | 4 |
| 1.4 | Existing restrictions of choice of location | 4 |
| 1.4.1 | Overview | 4 |
| 1.4.2 | Classification of restrictions | 4 |
| 1.4.2.1 | Private debt | 4 |
| 1.4.2.2 | Public debt | 4 |
| 1.4.2.3 | Shares | 4 |
| 1.5 | Effect of other measures addressing the issue | 5 |
| 1.5.1 | Articles 34 and 46 MiFID | 5 |
| 1.5.2 | Code of Conduct | 5 |
| 1.6 | Justification of certain restrictions? | 5 |
| 1.7 | Result: relevant restrictions | 5 |
| 2 | PROPOSALS FOR REMOVING RESTRICTIONS | 5 |

Introduction

The Giovannini Group identified restrictions regarding the location of securities as limitation to the choice of investors and issuers and as contrary to the principles underlying the internal market for financial services. These national restrictions reflected the evolution of historically efficient national structures but were difficult to justify in the context of an integrated EU financial system¹.

Two types of restrictions could be found: (a) requirements that issues in listed securities be deposited exclusively in the local settlement systems; and, (b) listing on a regulated market requires registration with a local registrar.

Such restrictions came in the form of either market rules or national law. The Second Giovannini report made furthermore clear that restriction of the location of securities entailed equally impediments to the free choice of the location of clearing and settlement of securities, as the logic in restricting the location of clearing and settlement derived from restrictions on the location of securities².

In its 2006 Advice, the LCG came to the result that the restrictions depicted by the Giovannini Reports indeed existed and established a compendium of all restrictions falling under Barrier 9 and found in the EU Member States³.

1 Background analysis

1.1 Practical significance of choosing the location

It is mostly aspects related to the market structure and market potential that influence an issuer's choice of a specific location of securities:

- the liquidity of the market
- efficiency of infrastructure
- reputation of the market
- suitable network of distributors which reach the targeted investors
- regulatory framework
- transparency and efficiency of the legal framework

1.2 Location of securities

1.2.1 Initial issuance

¹ First Giovannini Report, p. 49 *et seq.*; Commission 2004 Communication, p. 25. We understand the terminology used by the Giovannini Report, *i.e.* location of securities, as referring to the location of the securities settlement system where the securities are initially issued. It is important to note that this concept does not refer to the location of the securities or the place where the securities account is maintained for the sake of determining applicable law, pursuant to the PRIMA principle.

² Second Giovannini Report, p. 18 *et seq.*

³ 2006 Advice, p. 2; Comparative Survey/Questionnaire, 24.04.2006, Question 38, pp. 424-438.

There are basically three methods by which securities (shares, bonds, etc) are issued into a securities settlement system:

- Depositing a physical certificate (representing the securities) with a depository (for example, a CSD);
- Registering the securities with a registrar;
- Recording the securities with the depository under the form of a book-entry (dematerialised securities).

In all cases, before the securities are capable of being transferred in the securities settlement system, they must be placed in the SSS, by the creation of an initial book-entry at the top-tier of the system.

It appears that both steps are regularly tied to each other, i.e. that the both the depositing in a CSD/registering with a registrar and the initial book entry in the settlement system occur simultaneously and are governed by the same law. For dematerialised securities, those steps are even completely mingled. In so far, for purposes of the present paper, both steps are regarded as one single act determining the "location" of securities.

1.2.2 Shift to a different location

Against the background of the aims of Barrier 9, the scope of this analysis is probably not limited to guaranteeing the free choice of location for the initial issuance of securities. In order to enhance competition and transparency, issuers should have the possibility to move the issue to a different location and a different top-tier custodian, in particular in cases where the new solution offers more favourable terms than the earlier one⁴.

In such scenario, there might be additional legal/operational issues to be taken into account, in particular whether the ISIN number remains unchanged or not.

1.3 Legal considerations

The choice by a company of a location of its securities might entail the risk of an encroachment of legal provisions originating in different jurisdictions, following the rules of private international law of both countries concerned:

1.3.1 Shares

In case of shares in a company, the point of reference is the applicable corporate law (*lex societatis*).

- The issuance of securities is governed by the *lex societatis* of the company's home jurisdiction. In case of the securities being issued in a jurisdiction different from the home jurisdiction, the *lex societatis* will interact with the host country's law. For instance, the home jurisdiction might require the issuance of a paper certificate whereas the host jurisdiction provides for a completely dematerialised framework.

⁴ Please note that such possibility would be subject to various constraints, including the protection of the account holders along the chain of holding. For instance, in the case of a shift from an SSS "X" to an SSS "Y", the upholding of the rights of the investors holding their securities through participants of "X" should of course be ensured when shifting to "Y".

- The law governing the rights flowing from the shares is equally the *lex societatis* of the home jurisdiction. Neither the draft reports on Subjects 1 and 2 of the LCG nor the Unidroit draft Convention attempt to alter this rule for the cross-border context.
- The law applicable to holding and disposition of shares in a cross-border scenario is determined by the relevant conflict-of-laws rule which is, depending on the jurisdiction, based on the *lex rei sitae*, the PRIMA-approach or a choice of law made by the account holder and the account provider.

1.3.2 Corporate and Government debt

- The issuance of corporate debt is governed by the terms of the issue and the *lex contractus*. In some cases, the issuance of public debt might be partly ruled by public law.
- The rights and obligations are governed by the terms of the issue and the *lex contractus*. Sometimes, there might be a certain influence by the *lex societatis* (which jurisdiction?) as for example concerns the holding of a bondholders' meeting.
- The law applicable to holding and disposition of debt instruments in a cross-border scenario is determined by the relevant conflict-of-laws rule which is, depending on the jurisdiction, based on the *lex rei sitae*, the PRIMA-approach or a choice of law made by the account holder and the account provider.

1.4 Existing restrictions of choice of location

The freedom of choice regarding the location generally varies following the type of security: (a) private debt securities normally allow the choice of the law governing the rights incorporated in the securities and also the location of the issuance; (b) public debt securities are regularly bound to the national law and tied to the local CSD, whereas (c) the issuance of shares is, in the vast majority of cases, tied to one specific jurisdiction.

1.4.1 Overview

[A presentation on the basis of the Questionnaire will be given at the occasion of the LCG meeting]

1.4.2 Classification of restrictions

1.4.2.1 Private debt

The issuer has regularly free choice of the law governing the rights granted by the instrument and the location of the securities issuance.

1.4.2.2 Public debt

Public debt securities are regularly bound to a CSD in the home market.

1.4.2.3 Shares

The case of shares appears to be more complicated: in principle (disregarding the restrictions which are object of Barrier 9), the issuer is free to choose the location of the securities. However, the company law (*lex societatis*), governing the rights incorporated

in the securities, and the law applicable to the certificate or book-entry, thus governing holding and transfer (*lex rei sitae*) might diverge in case the location of securities is not the jurisdiction where the company is incorporated.

The aim of Subject 3 of the LCG is to remove restrictions regarding the location of securities. I.e. ideally, every issuer in each of the 27 Member States of the EU would be entitled to issue securities in each of the 27 European jurisdictions. However, the law sets different requirements with respect to the issuance of securities in any of the 27 jurisdictions. For example, in some countries, the issuance of paper certificates is precondition for the issuance, whereas in other countries dematerialisation led to abolishing this principle.

1.5 Effect of other measures addressing the issue

Barrier 9 is closely related to Barrier 2, addressing restrictions on the location of clearing and settlement. The question is whether the barrier is partly resolved by other rules.

1.5.1 Articles 34 and 46 MiFID

These provisions grant to investment firms remote access to foreign Central Securities Depositories (CSDs) and Central Counterparties (CCPs).

[A presentation on the basis of the Questionnaire will be given at the occasion of the LCG meeting]

1.5.2 Code of Conduct

The Code of Conduct⁵ carries forward the scope of Articles 34 and 46 MiFID to cross-border access and interoperability amongst all post-trading infrastructures.

[A presentation on the basis of the Questionnaire will be given at the occasion of the LCG meeting]

1.6 Justification of certain restrictions?

[tbd]

1.7 Result: relevant restrictions

[tbd]

2 Proposals for removing restrictions

[tbd]

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⁵ European Code of Conduct for Clearing and Settlement, of 7 November 2006; Access and Interoperability Guideline, of 28 June 2007