



EUROPEAN COMMISSION

Internal Market and Services DG

FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS
Financial markets infrastructure

Brussels, 3 March 2006
G2/MS D (2006)

Subject: Note to David Wright

Mission Report from the 2nd Meeting of the LCG sub-group on 'core issues' held in London on 28 February 2006

Venue: Clifford Chance, 4 Coleman Street, London.

Attendees: Ignacio Gomez-Sancha (IGS); Dario Loiacono (DL); Diego Devos (DD); Habib Motani (HM), Antoine Maffei (AM), Juergen Than (JT), J.C. Kobbach (JK), P. Langlet (PL), Eva Micheler.

Commission: Martin Thomas (Secretary LCG/ G2) (MT), Marek Svoboda (Secretariat LCG/ G2) (MS)

Absent, but joining via tel.conf. link-up. U. Bang-Pedersen (BP), K. Wallin-Norman (KWN), Janne Laune (JL), K. Loeber (KL), Pablo Maris, D. Tsibanoulis. Absent: Max Ganado; A. Waclawik-Wejman.

The purpose of the meeting was to discuss the secretariat's 'core principles' paper and the issues raised by expert reports on the seven core issues.

HB recapped that the rights created upon credit entry to an account could be either "stand alone" or "representative" proprietary rights. If they were to be "stand alone", as MG preferred, this would require careful attention as it would have significant implications in other areas, (e.g. the EU prospectus directive). JK wanted to know what such "proprietary" right was transferring exactly.

IGS was concerned that the group concentrate on the methodology agreed by solving specifically identified problems relating to cross border legal uncertainty; it should not attempt to regulate intermediated securities relationships and their markets as such.

DL summarised his paper. In book entry transfers, there is confusion as to the precise identity of the asset being transferred and this legal uncertainty arises from the 'derivative' nature of the account holder's right. The existing fragmentation with respect to characterisation of the nature of the rights arising from book entry in an account creates legally uncertainty but is not a legal barrier to integration per se. It would nevertheless be beneficial to introduce EU legislation on "derivative holdings" such as securities entitlements arising upon a credit entry, as this helps to remove the legal

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uncertainty. Second, as regards transfer of the securities themselves cross border, there is currently legal uncertainty as to what the transferee is getting, which also represents a legal barrier. Legislation is required to harmonise the characterisation of securities when transferred cross border so that the object of the title transfer shall be the financial asset itself.

DD recalled that transfer requirements are not legal barriers and may be left to the various systems' rules. The group should not attempt to harmonise rules in a maximalist way, but instead try to remove barriers to building legally certain "bridges" between systems. There was broad consensus on this. The report should not recommend a new asset form, and not try to reorganise the legal basis of intermediated markets as such, but instead focus on harmonising the effects of a credit entry (DD, KW, BP, JL, JT, PL, JK).

AM stressed that the Unidroit draft convention should form the basis for the group's work; a concept needs to be devised where both "securities entitlement" and "ownership" can co-exist and to find sufficient common principles in Unidroit to allow that co-existence.

JT recalled that the moment of transfer is a matter of operational technique and not of legal provisions. All systems make the credit entry give effect to the transfer, but the rules of some systems (e.g. Germany, France) make the moment of transfer (of legal title to the ultimate account holder) effectively conditional on the account provider (system participant) being first credited, which only happens at T+2. An account provider may agree to transfer securities to another via a third party but there was consensus that such transfers should not be part of any legislative solution. Several experts thought there should be a minimum level of harmonisation to establish the elements of a transfer and of a credit entry. BP thought there may also need to be a closer look at how the German system operates, as in theory it allows transfers to be reversed.

Conclusion: The meeting revealed broad consensus on key points: (i) credits to accounts have legal effects in that they create rights for account holders; (ii) no need to intrude into national law as regards domestic transfers, as there is sufficient legal certainty; (iii) as regards cross border credit entries, the 'package' of core rights that are 'acquired' upon credit entry needs to be sufficiently identified to remove uncertainty as to the legal nature of what the account holder is acquiring (i.e. his title). The characterisation of these core or 'load bearing' rights should be harmonised. By doing, legally sound 'bridges' will be built between systems and intermediaries when they trade book entry securities cross border.

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