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Subject: Note to David Wright

Mission Report from the 1st Meeting of the LCG sub-group on 'core issues' held in Paris on 30 January 2006

Venue: European Parliament/COMM representation, 288 Blvd. St-Germain, Paris.

Attendees: I.Gomez-Sancha (GS); Dario Loiacono (DL); Max Ganado (MG); Diego Devos (DD); Agata Waclawik-Wejman (AW) and Antoine Maffei (AM).

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

Absent: J. Than, U. Bang-Pedersen¹.

The Legal certainty group sub group met to discuss in depth the issues that had been agreed at the 3rd LCG meeting on 13 Sept.2005 as constituting obstacles to a safe, efficient and integrated EU securities market and would therefore constitute the core of the LCG's report (envisaged by mid-2006) ("report"). The seven authors were asked to prepare draft papers as a basis for the discussion.

The purpose of the meeting was to brainstorm the issues and thereby to try to reach consensus on the main thrust of the report.

MS described work done to date (Questionnaire and horizontal analyses of national laws, previous meetings, etc.). MT recapitulated the principles that intermediated securities rights had to be as strong as direct holding rights and that these rights had to be kept strong regardless of any cross border element, all within a safe and efficient market.

Each author then presented his or her paper followed by a *tour de table* after each presentation.

¹ These authors sent draft papers *in absentia* on moment of transfer and priorities respectively.

IGS (on scope) stated that the report should concentrate not only on regulated markets but also on OTC transactions. He believed only those derivatives traded on a regulated market or if OTC only if subject to standardised agreements should be included. He considered that the 'cross border' scope should mean not only international but also indirect domestically settled transactions; if a transaction is settled outside the legally recognised book entry system in any member state a problem of legal certainty also arises in that state's market. Any solution would need to deal with the concerns of the issuer/debtor who had to know who to pay.

MG (on legal effects of book entry) stressed the current legal confusion and lack of transparency in this field. The various legal systems assign different legal effects to credits to securities account by intermediaries. The intermediaries also have multiple functions. A functional solution was needed; the starting point for which is to categorise intermediaries according to their basic function vis à vis the investor, and to correlate each function to a particular set of legal effects according to how that function impacts on the investor's legal position, i.e. a credit entry may be constitutive, it may create the root of title, it may be for custody purposes (i.e. holding only) or it may be to manage the securities (holding plus exercise of corporate rights). Once the function is chosen, however, it should be ensured that the legal effects are the same throughout EU.

DL (on recognition of indirect holdings) stated that the report should try to propose the best possible solution for EU. It could even propose a '*new legal asset*' for intermediated securities rights, departing from existing legal concepts, although it was not necessary to adopt the US model. The buyer had to have confidence of what exactly he was buying or what was being pledged. It had to be possible for the investor "to go over the dead body" (of the intermediary) if necessary. He agreed to elaborate this in a fuller draft paper.

AM, in his capacity as an observer, stressed the need to be pragmatic and propose only a realistic solution which has a chance of being accepted by the Member States.

DD (on transfer requirements) reported that there were no transfer requirements which constituted per se barriers to an integrated market. Book entry securities are not as rule subject to legal transfer requirements apart from credit and corresponding debit and need to act under a contract of transfer.

AW (on corporate actions and voting rights) stressed the need for transparency. There was a strong link between this project and the investor and issuer relationship. She informed the subgroup of contents of the COM proposal on shareholder rights. The proposal brought up issues that the LCG must take into account, e.g. information obligations of the issuer, problem of defining 'record date' for exercise of shareholder rights, electronic voting. The report would have to address how these rights impact on CSDs and other intermediaries. Issuers need to know who is entitled to exercise shareholder rights at the legally defined point in time.

MT summed up the conclusions from these papers, including briefly the paper submitted in absentia by J. Than (on 'moment of transfer'; conclusion: no need to define it in legislation). There was no time to go through the paper of U. Bang-Pedersen (on priorities), which attempts to formulate general principles for solution of priorities based conflicts.

It was agreed that there would need to be at least two more meetings of the sub group before the next LCG meeting at end April 2006. The next sub group meeting would probably take place just before the Unidroit plenary session in Rome on 5-6 March.

The secretariat would distribute shortly (i) an outline structure of the report and (ii) a list of next steps to be taken.

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