



ARENDR & MEDERNACH

AVOCATS A LA COUR



How to eliminate legal inconsistencies in the cross-border settlement of book-entry securities

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EXISTING EU LEGISLATION



Post-Trade

- Finality Directive
- MiFID
- Code of conduct on clearing and settlement

Related Legislation

- Financial Collateral Directive
- Winding Up Directives
- Shareholders Rights Directive



RELATED INITIATIVES

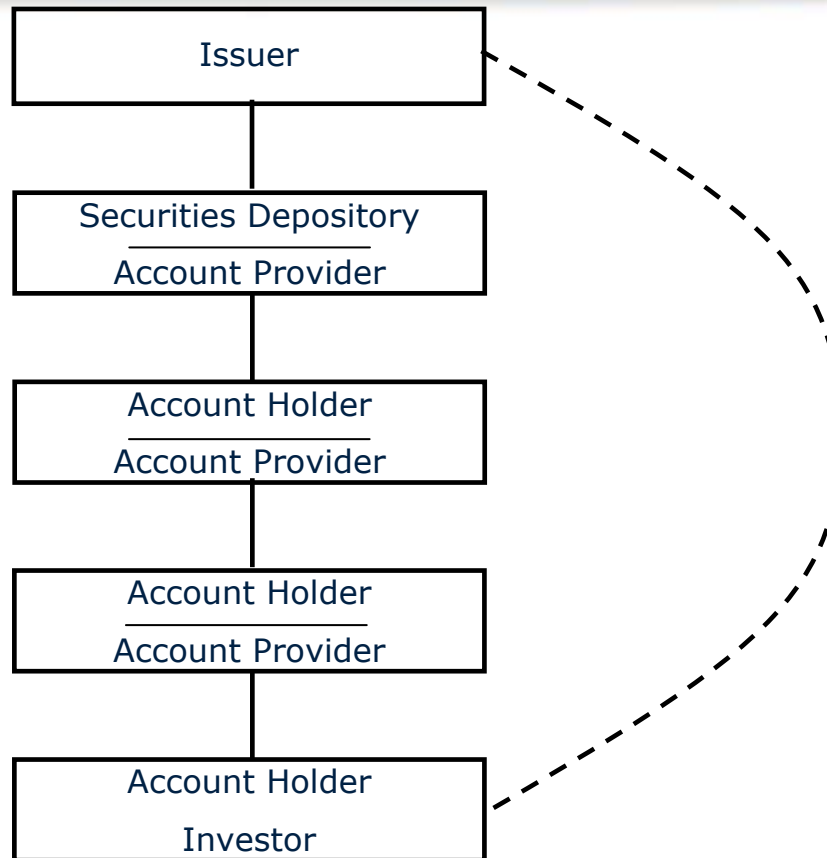


- Target 2 Securities
- ECB - CESR and CPPS – IOSCO recommendations
- Hague Securities Convention
- Draft Unidroit Convention on intermediated securities

KEY ACTORS AND ELEMENTS



- account provider
- account holder
- securities
- securities accounts
- transparent ><
non transparent systems

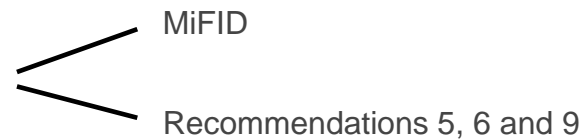


ACCOUNT PROVIDER

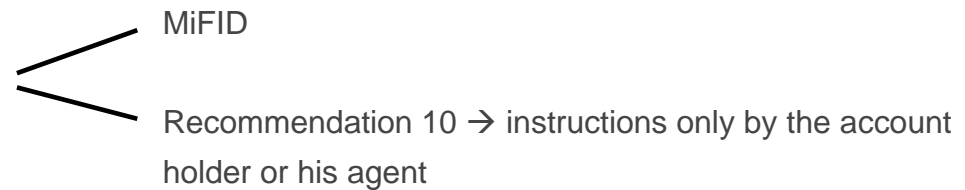


- pivotal role
- core duties:

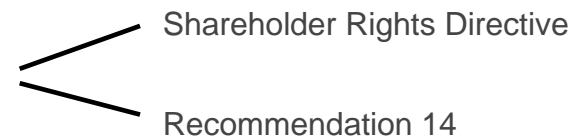
– safeguard securities



– follow instructions of the account holder



– exercise of rights flowing from the securities



– reporting duties



INTEGRITY OF ISSUE



- account provider should hold at all times hold sufficient securities to meet all customer rights in securities and to match its own holdings
 - imbalances should be avoided but can in practice not be entirely avoided
- rules to address shortfalls (reversals, buy-in, loss sharing)



LINKS BETWEEN RECOMMENDATIONS

Recommendations are very closely linked

- what rights do the credit of securities to a securities account confer upon the account holder
- how do you acquire or dispose of book-entry securities
- when can your right to book-entry securities be reversed
- protection of certain persons against reversal
- priority among competing interests

→ Creation of a harmonized framework for the acquisition and disposition of book-entry securities

BOOK-ENTRY SECURITIES



securities credited to an account with an account provider should confer upon the account holder a minimum set of rights = book-entry securities

- right to receive and exercise rights attached to the securities (e.g. dividends, voting rights)
- right to dispose of the securities or create an interest therein (sale, pledge, usufruct)
- right to hold securities in a different manner (transfer, retrieval)



ACQUISITION AND DISPOSITION OF BOOK ENTRY SECURITIES - 1

6 methods which must be recognised in all Member States

- Book-entry methods
 - crediting account (title transfer, security interest, limited interest)
 - debiting account
 - earmarking (security interest, title transfer)
 - removing an earmarking

ACQUISITION AND DISPOSITION OF BOOK ENTRY SECURITIES - 2



Non book-entry methods

- control agreement
- agreement with and in favour of the account provider

Other methods

- may differ per country
- impact on priorities

Priorities

- earmarking prevails over control agreement and agreement in favour of account provider
- 6 recognised methods prevail over other methods

EFFECTIVENESS



- The recognised book-entry and non book-entry methods are immediately effective against the account provider and third parties
- Member States' laws may not impose any additional steps to render acquisition or disposition effective (e.g. notarization, filing)

REVERSALS



Concept: \neq unwinding of a securities transactions between parties

= securities account adjustments in one account

Conditions:

- 1) Consent of the account holder
- 2) Erroneous crediting
- 3) Unauthorised debiting or crediting

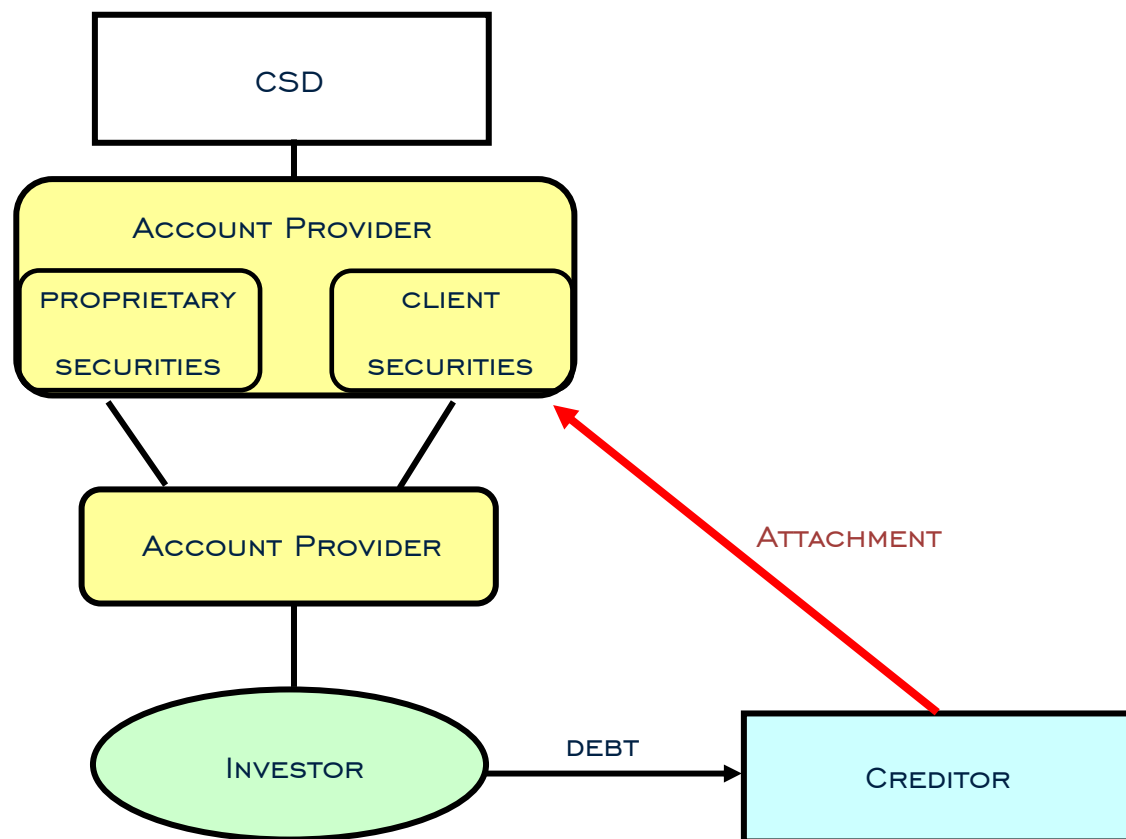
Effective time of reversal: at the time the reversal is made \rightarrow no retroactive effect

PROTECTION OF ACQUIRERS AGAINST REVERSALS

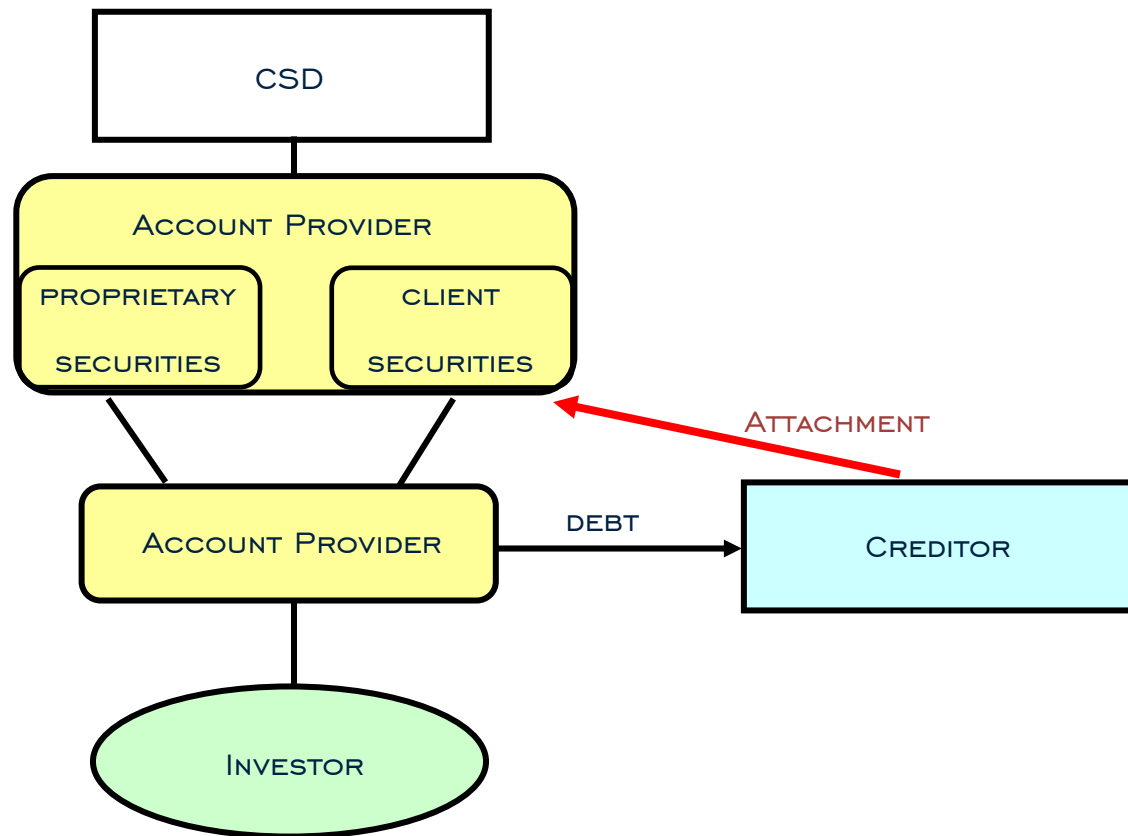


- Protection of *bona fide* acquirers
- Fundamental principle to ensure legal certainty in the market !
- Problem with traditional concepts
- Condition of protection: general protection unless beneficiary:
 - (i) knew; or
 - (ii) ought to have knownthat securities should not have been credited or earmarked

PROHIBITION OF UPPER TIER ATTACHMENT



PROHIBITION OF ATTACHMENT OF SEGREGATED CLIENT ACCOUNTS BY CREDITORS OF THE ACCOUNT PROVIDER





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