

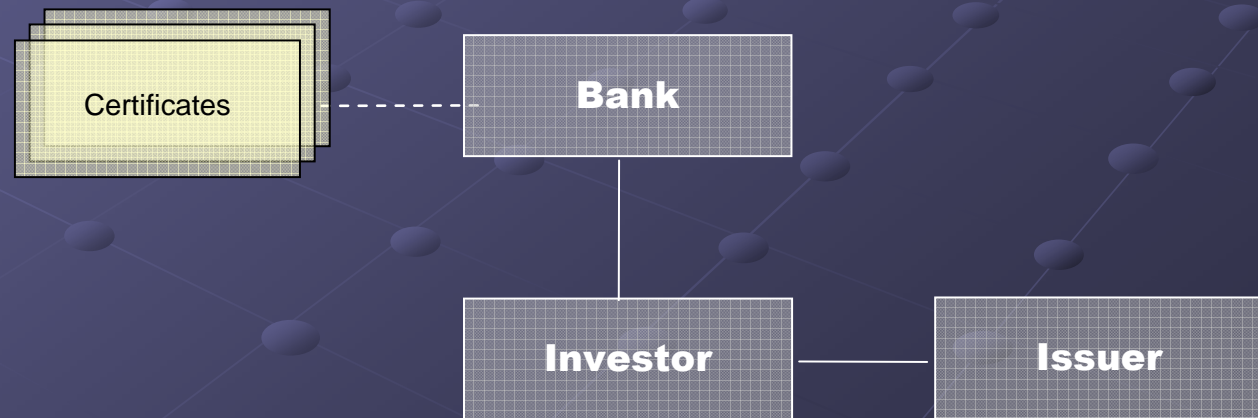
Intricacies of modern securities holding patterns

What happens to key notions in a cross-border context ?

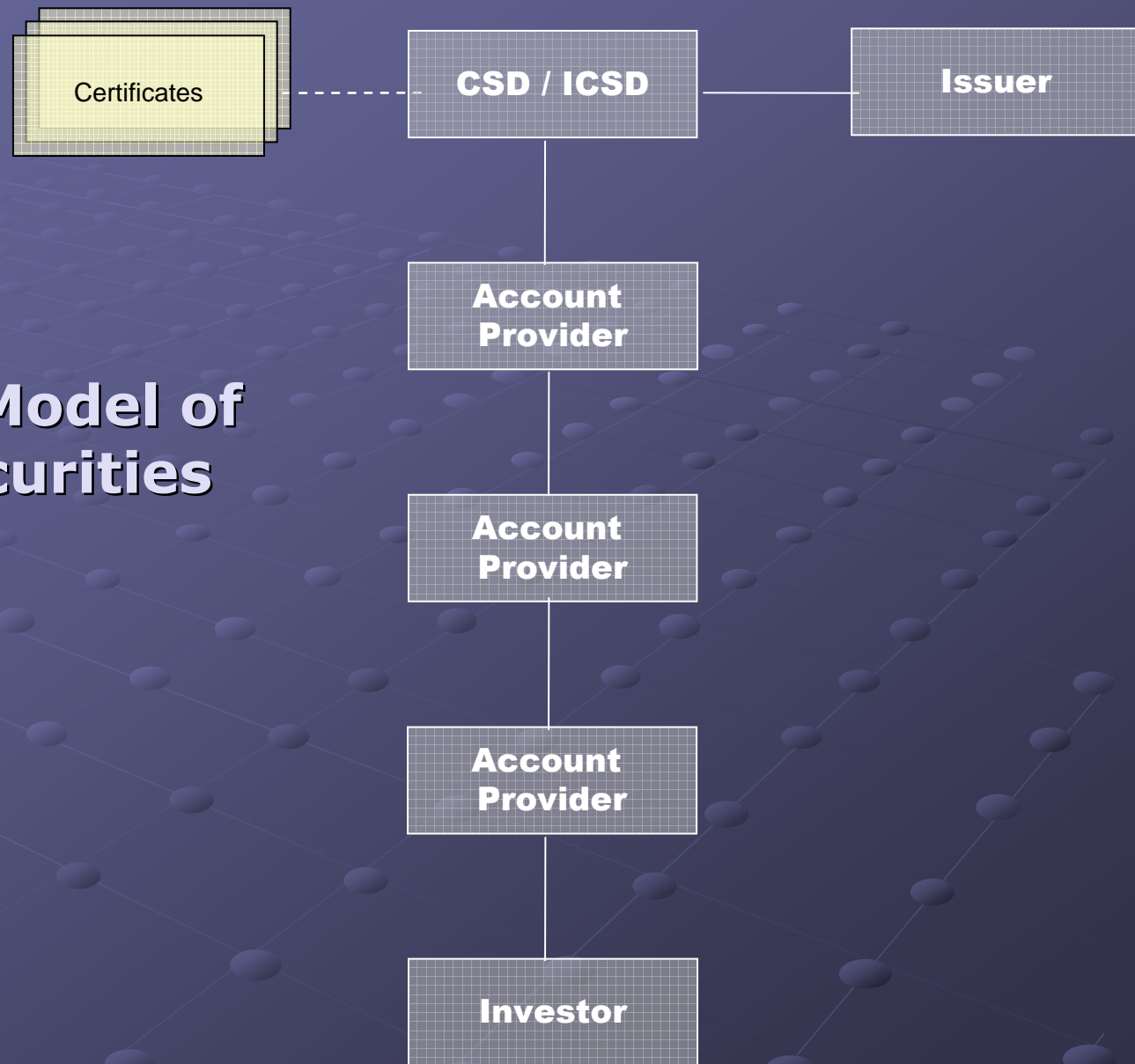
*Legal Certainty Group Conference
Brussels, 23 October 2008*

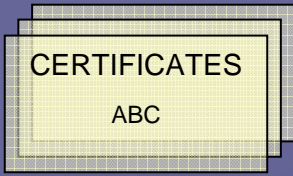
Philipp Paech
European Commission
Secretary of the LCG

2 traditional models of securities holding



Simplified Model of modern Securities Holding I





Useful?

Simplified Model of modern Securities Holding II

ABC Issuer

1000000

Direct or indirect possession

CSD / ICSD

70000

930000

Account Provider X

Other Acc. Prov.

20000

25500

11000

13500

other investors

Account Provider M

Account Provider N

other Acc. Prov.

380

120

25000

700

300

10000

Investor aa

Investor ab

other Investors

Investor ba

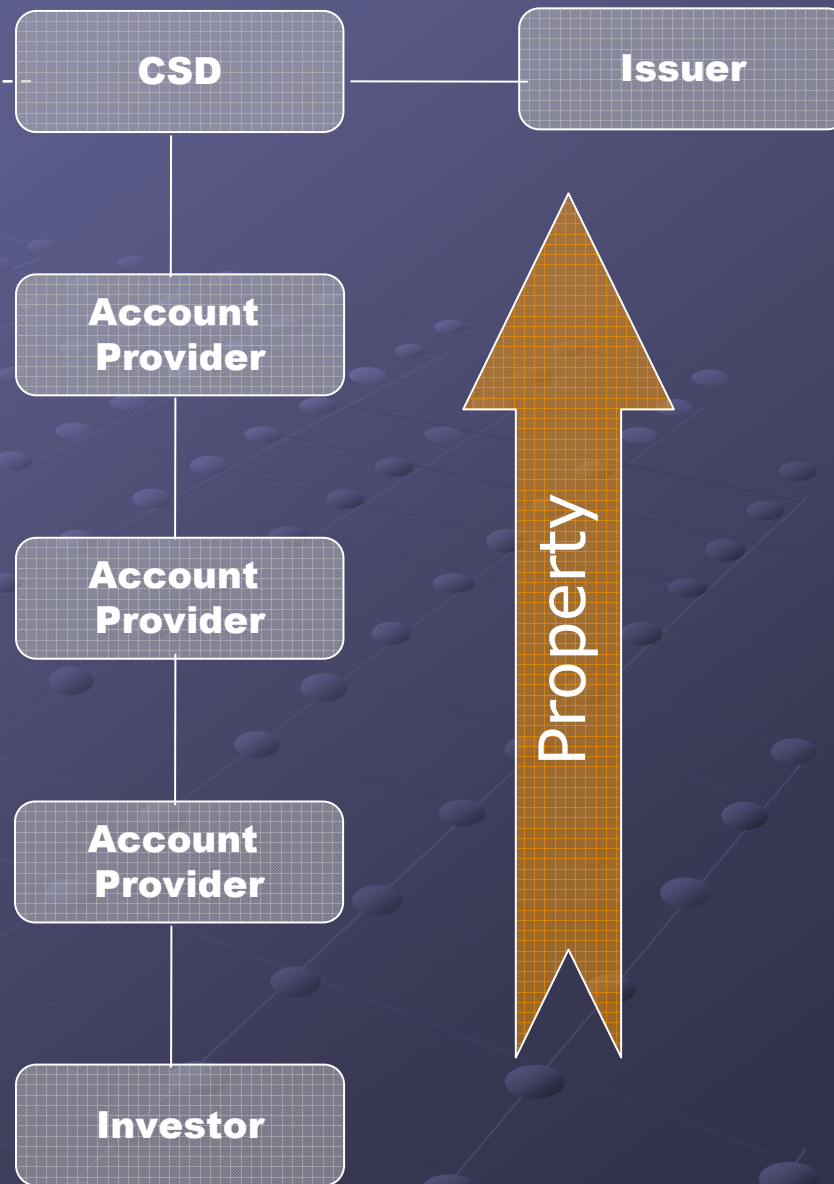
Investor bb

other Investors

Key notions

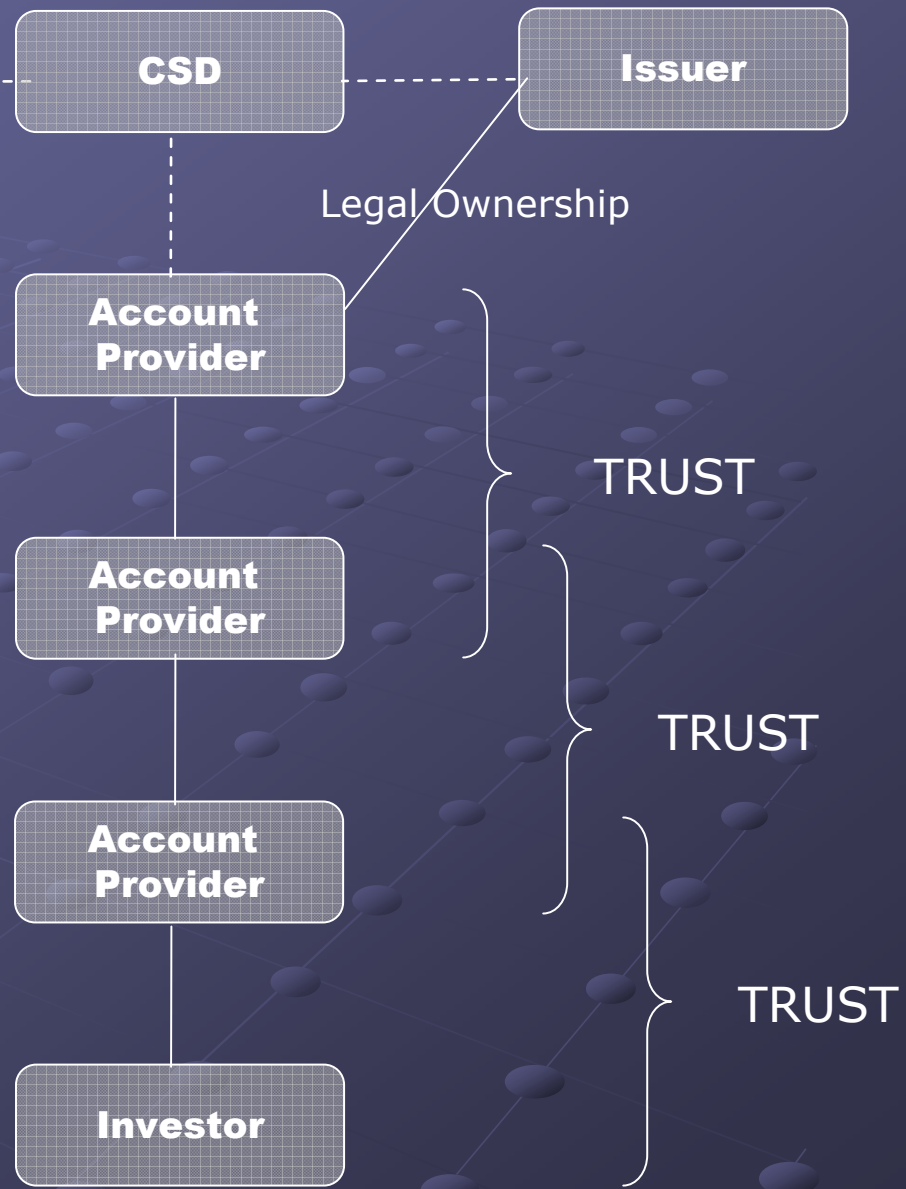
- Immobilisation – dematerialisation
- Fungibility – pooling – commingling
- Account provider – Intermediary
- Account holder – investor
- Securities – book-entry securities – intermediated securities

Example legal analysis I
Germany: multi-tier possession



Example legal analysis II

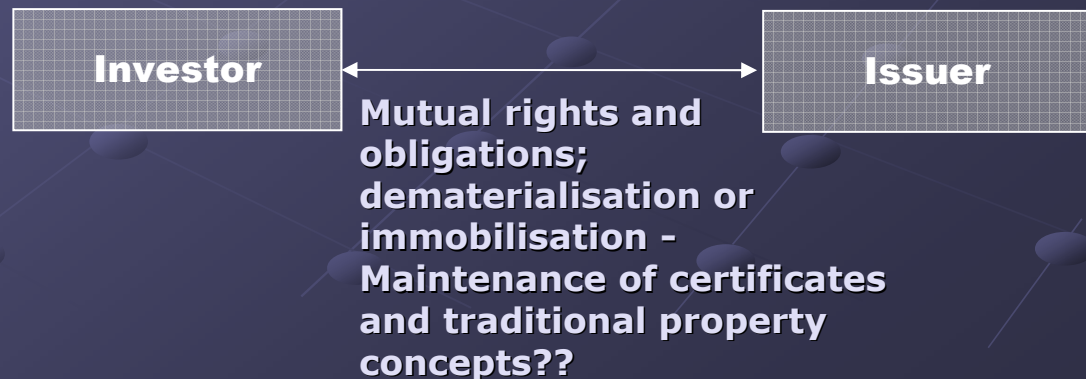
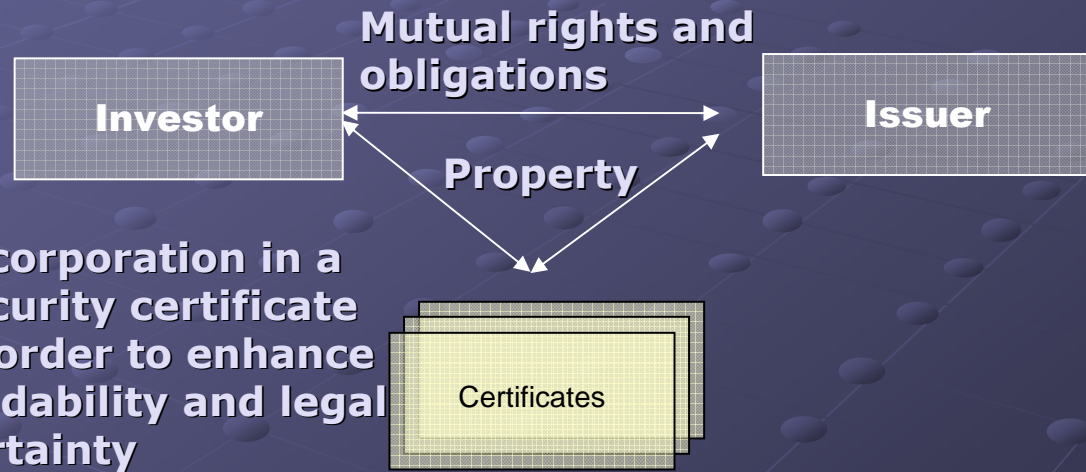
England: Trust





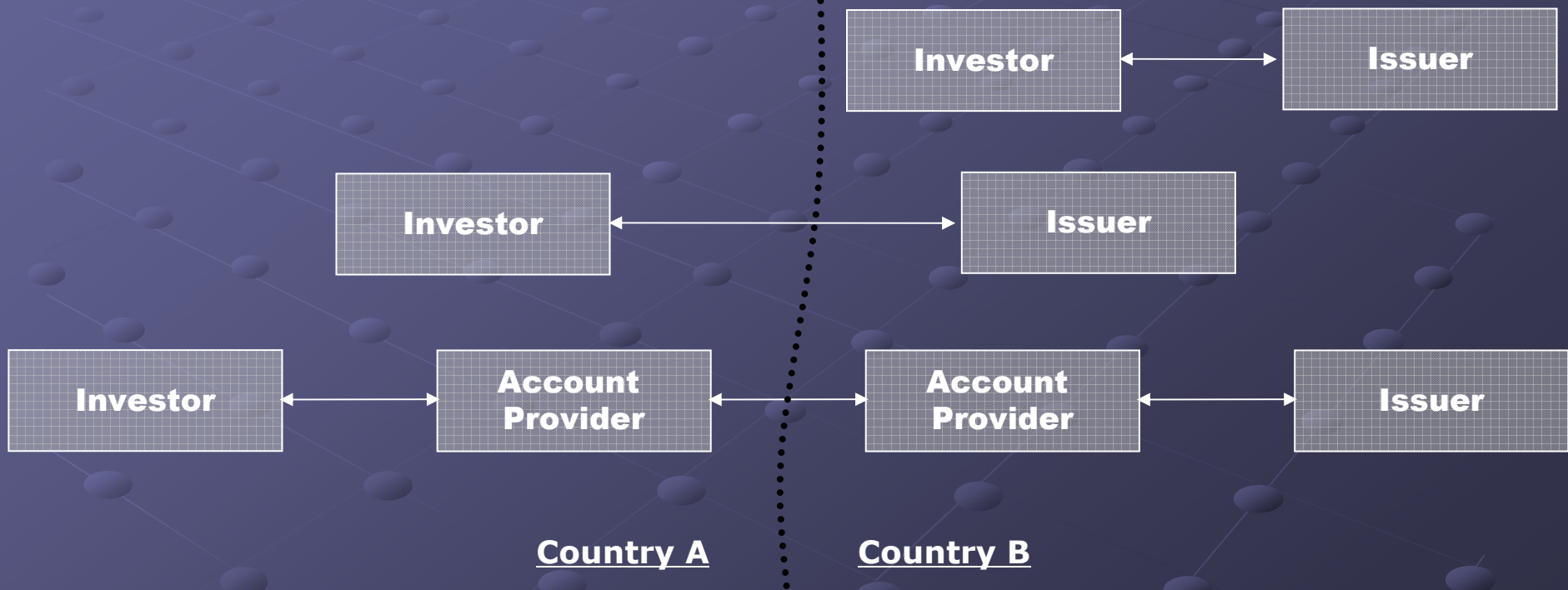
***Analysis 1:
The fate of securities***

The idea of securities and incorporation in certificates
- former
- today
- future?



The „content“ of securities

- Purely national context – law defines content
- Direct cross-border holding – content persists
- Intermediated cross-border holding?



Proposal: Concentration on functional content for cross-border compatibility

- Core value of securities (rights attached to them, i.e. Corporate rights) must be transportable cross-border.
- Economic purpose of securities (disposal, use as collateral) must be ensured in cross border holding.
- Solutions:
 - LCG Recommendation 4a (first indent), together with Recommendations 12-14
 - LCG Recommendation 4a (second indent), together with Recommendations 5-11

Result 1

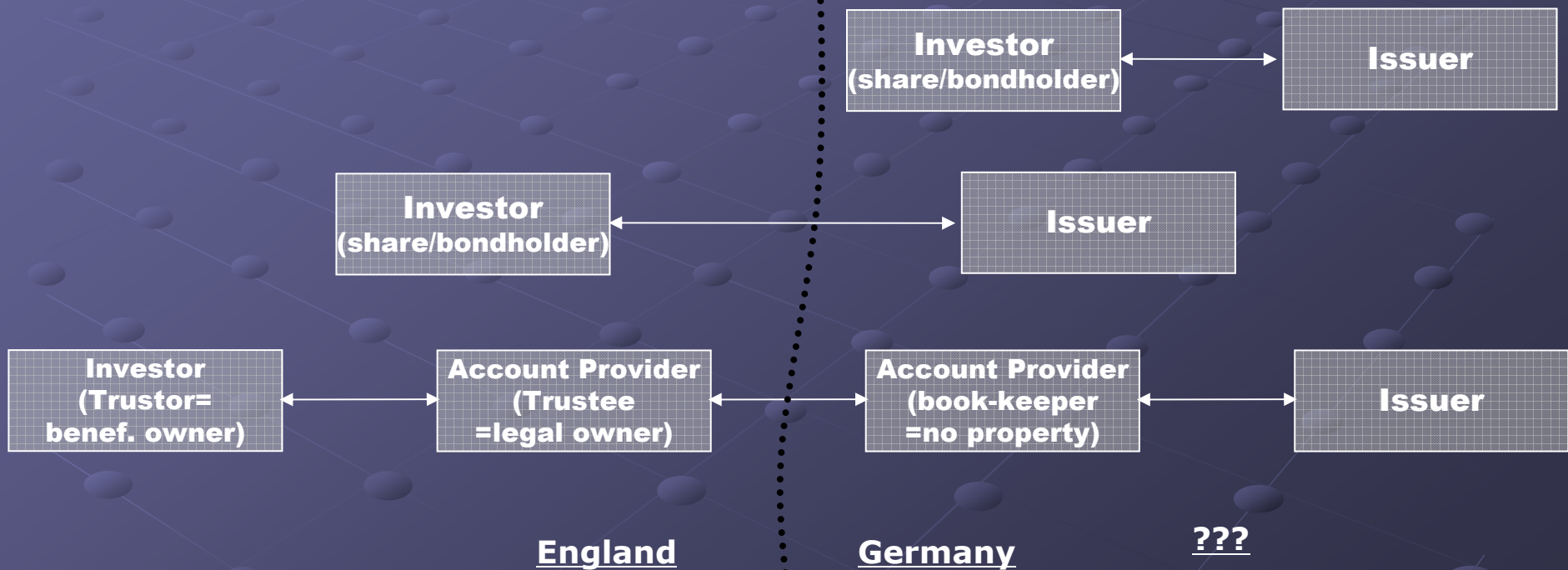
- The security certificate is about to lose its function in both the purely domestic and the cross border context.
- In a cross border context, the core value (voting rights, dividends, etc.) and the economic key function (disposal, use as collateral) need to get through to the investor. The legal nature of the interest (as such) is less relevant.



***Analysis 2:
The search for the entitled person***

Basic difficulty

- Purely national context: shareholder, bondholder
- Direct cross-border holding: shareholder, bondholder
- Intermediated cross-border holding: ???



General Mechanism of intermediated holding

- All systems are built on account holders holding through accounts with account providers
- The practical (!) modern holding consists of a cascade (repetition) of the pattern depicted right-hand side
- This does not prejudice the legal (!) analysis of who has rights in the securities



Entitled person: account holder or investor?

- Account holder as entitled person?
 - Easy to identify
 - No factual differences across the systems
 - Fewer unused voting rights
 - Contradicts the property law concept (where applicable)
- Investor as entitled person?
 - Economically entitled („paid the price“)
 - Best solution in terms of corporate governance
 - Sometimes difficult to identify
 - In some jurisdictions, an account provider is legally entitled to exercise, however on instruction.
- Exception: registered shares: entitled person corresponds always to the registered person

***Proposal: take a functional solution
and sidestep the legal analysis***

The account holder exercises / receives the rights attached to the securities (e.g. voting rights, dividends, interests), as far as he is entitled to exercise / receive under the applicable law.”

[Legal analysis, relating to account holder, Rec. 4a]

The investor shall not be discriminated as regards exercise of the rights because of differing legal analysis of the holding pattern, and shall be in a position to exercise / receive the rights either directly or through the account holder.

[Functional analysis, relating to investor, Rec. 13, 14]

Result 2

- *In principle, the corporate rights should reach the person that bears the economic risk of the securities („who paid the price“?) = investor*
- *In a cross border holding situation*
 - *Identification of the investor might be even more difficult from a technical point of view;*
 - *The exercise by might be blocked by the legal approach of one of the involved jurisdictions.*
- *EU measures and international Conventions need to find a functional solution, promoting the exercise by the investor while at the same time respecting that some jurisdictions make the Account Provider holder of the corporate right (this is without prejudice to the question, whether this Account Provider acts on instruction by the investor)*