

Legal Certainty Group's Second Advice: Corporate Actions (Giovannini Barrier 3)

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Overview

- Legal Certainty Group's contribution to removal of barriers to corporate actions processing in Europe
 - Recognition of cross-border chains of account providers
 - Duties of account providers in CA processing
- Relation to Shareholders Rights Directive
- Remaining legal issues



The LCG's mandate

- LCG's mandate: Legal obstacles to cross-border clearing and settlement in Europe related to intermediated securities holding structures
- Three strands in the work of LCG
 - 1) The absence of an EU-wide framework for the treatment of interests in securities held with an intermediary (Barrier 13)
 - **2) The differences in national legal provisions affecting corporate action processing (Barrier 3)**
 - 3) The restrictions relating to the issuer's ability to choose the location of its securities (Barrier 9)
- Covering all types of intermediated securities and all corporate actions
 - Book-entry securities are widespread:
 - All securities of companies traded in regulated markets in Europe are held through intermediaries
 - Most treasuries are held through intermediaries
 - Many private issues held through intermediaries



The LCG's role in removing Giovannini Barrier 3

- Giovannini Barrier 3
 - National rules relating to corporate actions processing should be harmonised
 - Actors:
 - Private sector
 - Public sector – subsidiary role
- EU Commission expert groups:
 - CESAME: market standards, communication standards
 - FISCO: taxation (for CAs involving transfer of value)
 - **LCG: legal issues**




The LCG's mandate regarding corporate actions

- Focus on the differences between national laws affecting corporate actions processing
- Corporate actions – any action triggered by the issuer or by terms of a security and affecting the security
- Processing of CAs – functions necessary in the chain of account providers to ensure investor's participation in a corporate action



Key Issues

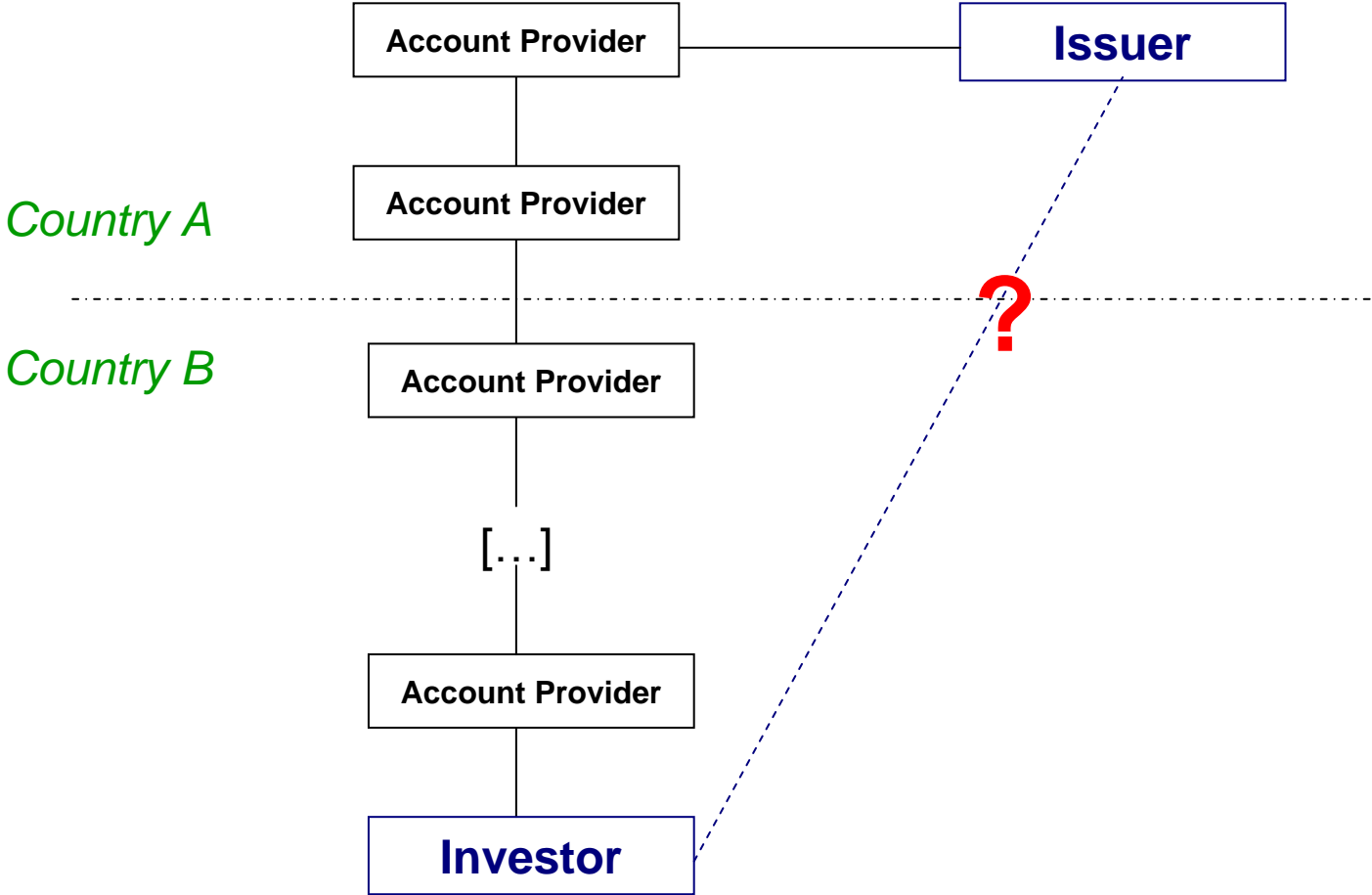
- The interposition of intermediaries/account providers between the investor and the issuer
- The fragmentation and complexity of cross-border intermediary chains within the EU



Key Issue 1: The interposition of intermediaries/account providers

- Intermediated holding systems: the intermediary/account provider system substitutes the “evidentiary system” of certificated securities.
- The effect: the investor enters into a legal agreement with its intermediary/account provider to purchase and manage securities.
- The issuer – investor relationship is substituted by a **set of legal relationships**, with various rights and obligations related to the administration of this evidentiary system by the account provider which:
 - Facilitate and streamline the process of mass turnover of securities / can channel certain communication between the issuer and the investor,
 - Are more complex from the legal point of view: the relationships between the issuer and account providers, and between the account providers and the investors /account holders

Key Issue 2: Fragmentation and complexity of account provider chains





Fragmentation – ctd.

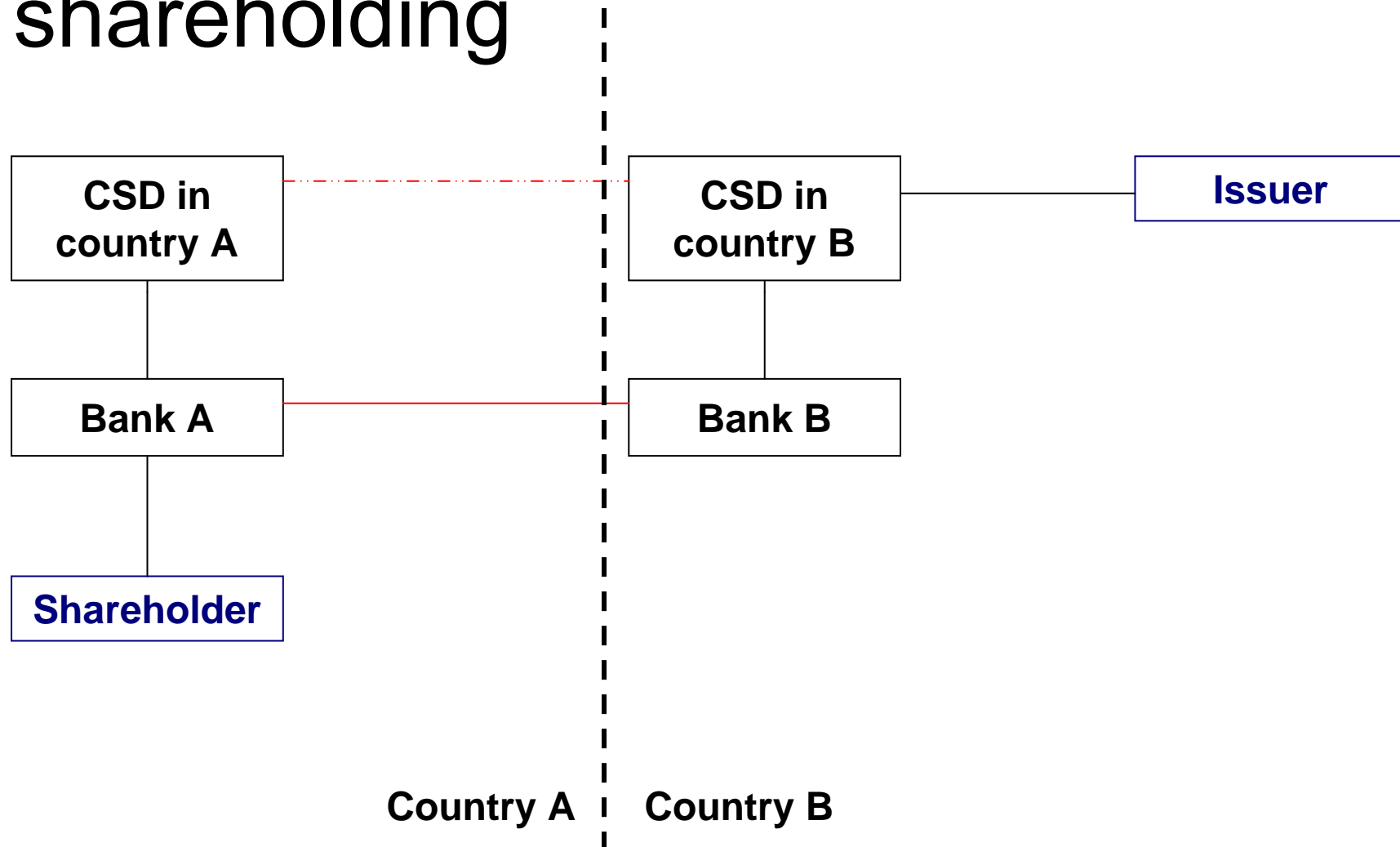
- Non-recognition of longer, cross-border chains of account providers
 - Property law-driven
 - Regulations-driven
- The last intermediary in the local chain considered the shareholder



Consequences of non-recognition of cross-border intermediary chains

- Late or missing CA-relevant information
- Impediment to proper identification of the investor
- Application of mandatory bid thresholds to the holdings of the intermediary
- Split voting and partial voting not permitted
- Non-recognition of proof of shareholdings issued by a foreign intermediary
- Application of tax rate of the intermediary, not the final investor, to proceeds

Fragmentation: Proof of shareholding





Solutions


- 1. EU legislative action necessary
- 2. Recognition of multi-tiered cross-border chains of account providers
- 3. Duties of account providers



1. An EU legislative action is required

Recommendation 12

- EU legislation is needed in order to remove legal obstacles to corporate actions processing arising from cross-border holding of securities through chains of account providers



2. Member States should recognise cross-border chains of account providers

Recommendation 13

- Legal effects of book entry – credit to securities accounts confers title to rights vested in securities (Recommendations 3 and 4)
- Recognition and compatibility with cross-border multi-tiered chains of account providers, e.g.
 - holding through one or more account providers
 - holding through omnibus accounts
 - holding of securities by an account provider acting in its own name for the account of another person or other persons
- No discrimination of investors based on holding patterns
- LCG's Advice is neutral as to whom the issuer should recognise as shareholder
 - but if the company law points to the issue of holding shares on a particular date, the harmonised law of effects of book-entry ensure shareholder identification



3. Harmonisation of account provider duties

Recommendation 14

- Passing information/communication up and down the chain of account providers
 - Information passed through the chain of intermediaries
 - Necessary for enjoyment of investor's rights vis-à-vis the issuer
 - Standardised information for a whole class of securities

- The account provider should at least:
 - Facilitate the exercise of rights by the account holder *vis-à-vis* the issuer or a third party (direct exercise of rights by the account holder) or
 - Facilitate the exercise those rights through another intermediary/account provider on behalf of the investor and according to his instructions (exercise of rights through the chain of intermediaries)

- The minimum scope of mandatory exercise of corporate events by intermediaries:
 - Dividends and interests, subscription and exchange rights, acceptance of takeover bids, mergers, other purchase offers and conversions



Relation to the Shareholder Rights Directive

- Both aim to improve cross-border exercise of investor rights
- SRD focuses on strengthening of voting rights vested in listed securities
- LCG focuses on the intermediated securities holdings environment
 - Aims at removing legal obstacles to smooth processing of the exercise of all shareholder and other security holders rights through in the intermediated securities holdings systems – covers all securities and all corporate actions

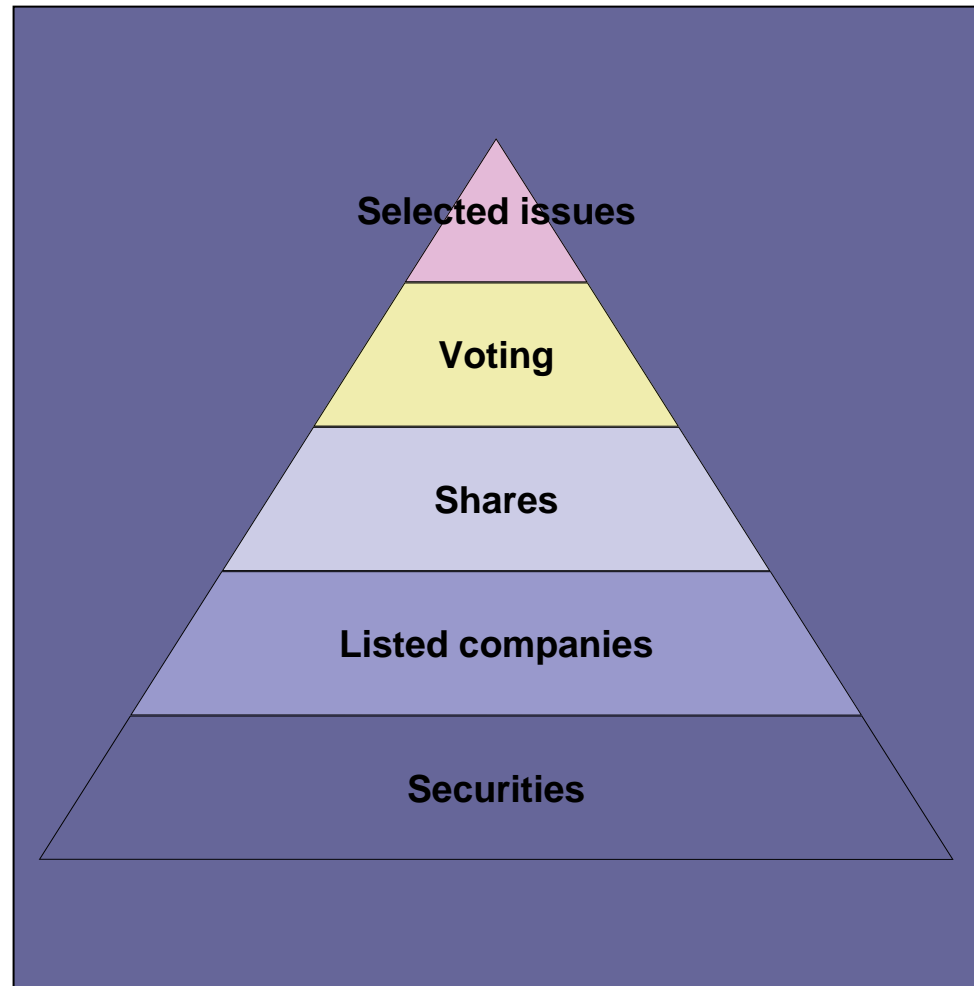


Shareholder Rights Directive – Scope

- Equal treatment (Art. 4)
- Easier access to GM-relevant information (Art. 5, 14)
- Easier access to the GM (Art. 7)
 - Removal of share blocking and introduction of record date
 - Removal of excessive burdens in proving shareholder's entitlement to the issuer
- Striking down the personal presence requirement
 - Exercise of voting rights through proxies and nominees (Artt. 10-11, 13)
 - Split voting permitted
 - Electronic voting (Art. 8)
 - Voting per mail (Art. 12)

SRD's scope and the scope of the LCG Advice

- Selected securities
<> all securities
- Selected corporate actions
<> all corporate actions
- Selected issues relevant for strengthening the exercise of shareholder rights
<> legal issues arising from intermediated securities holdings





Remaining legal issues relevant to Barrier 3 - examples

- Harmonised dates relevant for particular corporate events
- Legal basis for electronic communication between the issuer and investors for all corporate actions
- Issuer-upper-tier intermediaries relations, e.g.
 - Liability for translation and passing down of issuer's documents
 - Liability for distributions after it was passed on the upper-tier intermediary
 - Right of the issuer to demand identification of shareholders by the intermediary



Conclusion – LCG's contribution to dismantling of Giovannini Barrier 3

- LCG's Advice:

- Legal effects of book entry
- Recognition cross-border intermediary chains
- Harmonisation of account providers' duties

- The rest of the Barrier 3 framework:

- Market practices - CESAME
- Taxation recommendations of FISCO
- Further legal issues