



EUROPEAN COMMISSION

Internal Market and Services DG

FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS
Financial markets infrastructure

MARKT/G2/D(2005)

**Subject: EU Clearing and Settlement
Legal Certainty Group
Questionnaire**

Please provide clear and concise answers specifying the existing legal situation, whether there are points of uncertainty, and upon what specific elements the answer given depends (for example, the terms of any relevant contract).

It is fundamentally important in all applicable instances that the answers given should specify in what ways the answer would differ according to type of issuer, of intermediary or of security.

It is to be noted that the bulk of the questionnaire draws no distinction between (I)CSDs and other intermediaries (in the sense proposed below). Answers should make the distinction wherever relevant.

Where helpful, please identify the source of law (for example, legislation, regulation, jurisprudence or doctrine). In the case of legislation specific to the subject-matter of the questionnaire, please provide copies (or weblinks).

In this questionnaire, 'securities' is to be taken to mean all financial instruments (excluding cash balances unless explicitly asked for below) that embody entitlements and that can be subject to book-entry holding and transfer, irrespective of whether the holding can be characterised as direct or indirect.

In this questionnaire, 'rights in securities' is to be taken to mean both rights arising out of the instrument against the issuer or third parties and rights or entitlements of the holder in respect of the instrument as such, and 'rights in securities' is to be taken to be synonymous with 'interests in securities'.

In this questionnaire, 'intermediary' is to be taken to mean any person or entity that maintains positions regarding securities by way of book-entry. In this meaning, note that intermediary does not exclude an entity that maintains positions by way of book-entry for investors where according to the applicable law there is a direct relationship between the investor and the issuer. And in this questionnaire, 'securities accounts' is accordingly to be taken to mean all accounts maintained by intermediaries where positions for clients regarding securities are entered by way of book-entry.

Please note also that some issues are intentionally addressed more than once from different angles.

QUESTIONS

- (0) In respect of what legal system are the following answers given?

I. CONTENT AND STRUCTURE OF A LEGAL SYSTEM

General aspects

- (1) What are securities? Does a concept of securities such as is used in the Directive for Markets in Financial Instruments 2004/39/EC exist? If not, please describe the concepts used. What distinctions (e.g. bearer, registered, physical, dematerialised, book-entry) are made and with what consequences?
- (2) In what manner are securities created and issued? What steps are necessary to have (existing or newly issued) securities validly held and transferred with the involvement of intermediaries?

Securities accounts

- (3) What is a securities account? What is its role and function? What are the relevant custody, commercial, accounting and tax laws?
- (4) What securities may be credited to securities accounts? May cash be credited to securities accounts and, if so, does the account-holder have a right enforceable against third parties or against the intermediary only? What is the nature of such right?
- (5) Must the investor be recorded by name on the books of an upper-tier intermediary or of the issuer?

Nominee and omnibus accounts

- (6) May securities be credited to a securities account in the name of a person or entity who is acting on behalf of another (i) where the existence of the other is not indicated and (ii) where the existence but not the identity of the other is indicated? May the securities account be opened in the name of the person or entity who is maintaining the account? May securities be credited to a securities account in the name of a person or entity who is acting on behalf of more than one other, i.e. such that those others hold a collective securities position, rather than segregated individual positions per person? Is the person or entity in whose name the securities account is credited (if different from the person or entity maintaining the account) considered to be an intermediary? Does that person or entity have to disclose whether it is acting on behalf of investors and, if so, their identities?

Nature of rights

- (7) What rights arise when securities are credited to securities accounts? Is there a specific regime for establishing these rights? Are these rights characterised as a claim, an intangible, a chattel, or a new and separate legal asset, distinct from the underlying securities, which can be the object of proprietary rights (e.g.

ownership, security interest, usufruct) and proprietary dispositions (e.g. sale, pledge, loan)? What obligations of the investor may also arise?

- (8) What is the legal position of the intermediary in respect of the securities credited to an investor's securities account?
- (9) Is there any distinction between (i) the rights arising out of the securities against the issuer and (ii) the rights in respect of holding the security?
- (10) Where securities are held in pooled form (e.g. a collective securities position, rather than segregated individual positions per person), does the investor have rights attaching to particular securities in the pool?
- (11) In what manner does the investor acquire rights in respect of securities credited to his securities account (i.e. is the transferee's right in the securities derived from the right of the transferor or is it originally created in the moment of crediting in his favour)?
- (12) What legal effects arise from a credit entry on a securities account (e.g. book-entry as conferring or evidencing the root of title, book-entry as a replacement for the possession of the document of title, book-entry as an essential element for exercising the rights attaching to securities, other rights or obligations)? Please distinguish the legal effects against (i) the issuer, (ii) the intermediary, (iii) an upper-tier intermediary (or intermediaries) or (iv) third parties?
- (13) Is the investor entitled to set-off or net rights against the intermediary in respect of securities with obligations that investor might have to the intermediary?
- (14) Is the intermediary entitled to set-off or net obligations to the investor in respect of securities with rights the intermediary might have against the investor? Can any such entitlement be altered by contract?
- (15) Is the investor protected against the insolvency of an intermediary and, if so, how? Does the investor have to rely on the intervention of a court or liquidator? In what way is the answer different if the insolvency is of an upper-tier intermediary?
- (16) What liability does the intermediary have (i) for upper-tier intermediaries or (ii) other third parties that it may rely on for the performance of its functions? May any such liability be altered by contract?

Transfer of securities

- (17) What steps are necessary for securities to be transferred? Please elaborate both operational and legal steps. Do these steps differ as regards the effectiveness between the parties to the transfer and vis-à-vis third parties (e.g. perfection requirements)?
- (18) What is the object of the transfer of securities (e.g. a claim against the intermediary, a *sui generis* right, the security itself)?

- (19) At exactly what moment or moments in time does a transferee become entitled, and to what? At what moment or moments in time does the transferor become disentitled?
- (20) Which concepts of finality (e.g. unconditionality, irrevocability, enforceability) apply to transfers of securities? Is any such concept chosen by an intermediary or imposed by law? Do they relate to the transfer orders, the settlement, the passing of title or ownership, the fulfilment of the underlying obligations, or other?
- (21) What would be the effect on concepts of finality of each of (i) a revocation of transfer instructions, (ii) the debiting of provisional or erroneous credits; (iii) insolvency challenges, (iv) fraud? Are there specific rules relating to erroneous entries on accounts?
- (22) Are there specific rules relating to conditional transfers of rights, i.e. rules which specify that transfers of securities are considered to be conditional and which would allow (re-)debiting or reversal and, if so, under what circumstances? What position does the receiving investor have as a result of such credits?

Priorities

- (23) What rules apply when (i) competing claims are asserted against the intermediary; (ii) competing claims are asserted respectively against the intermediary and an upper-tier intermediary?
- (24) What rules protect a transferee acting in good faith (the '*bona fide* purchaser')? What are the limits of the *bona fide* protection?
- (25) Are there rules regarding liens of intermediaries over investor's securities accounts? If so, what are they and are they mandatory?

Upper-tier attachment

- (26) Can the investor enforce rights against an upper-tier intermediary (i) normally, (ii) in the event of breach of duty by the intermediary, (iii) in the event of breach of duty by the upper-tier intermediary, (iv) if the event is insolvency rather than breach of duty?
- (27) In what circumstances can (i) a creditor and (ii) a non-creditor third party (such as a liquidator) of the investor claim securities from an upper-tier intermediary?
- (28) In what circumstances can (i) a creditor and (ii) a non-creditor third party (such as a liquidator) of the intermediary claim securities from an upper-tier intermediary?

Shortfalls

- (29) Is a shortfall (i.e. the intermediary's position with an upper-tier intermediary is less than the aggregate recorded position of the intermediary's account-holders) at the level of the intermediary possible? What rules are applied to resolve the resulting difference of positions? Are there any rules on how to handle such a situation from an accounting point of view (for example through an interim securities debit balance)? How are shortfalls handled in practice?
- (30) What duty is there on the intermediary to avoid shortfalls?

- (31) Does the treatment of shortfalls differ according to whether there is (i) no fault on the part of the intermediary, (ii) if fault, fraud or (iv) if fault, negligence or similar breach of duty? Does the treatment of shortfalls differ according to whether the intermediary is solvent or insolvent?
- (32) Can the responsibility of the intermediary for negligence or wilful behaviour (e.g. of its employees) be contractually excluded or reduced?
- (33) If at any level the underlying securities are physical, what is the position if they are destroyed, e.g. stolen, burned, ruined by water?

II. CORPORATE ACTIONS/VOTING RIGHTS¹

- (34) What are the rights of the investor, and how do they operate in practice, as against (i) the issuer, (ii) the intermediary, (iii) the upper-tier intermediary (a) in relation to voting or receiving of information on shareholders' meetings and (b) in relation to corporate actions, e.g. payments of dividends and coupons, and any other action that affects price or structure?
- (35) How can these rights be exercised? Who is entitled to assert rights against the issuer in respect of securities credited to a securities account? Under what circumstances is the intermediary required to pass benefits on to the investor? How is this achieved if there is an omnibus or a nominee account?
- (36) How is it ensured that no more than those so entitled exercise, or benefit from, the rights attaching to securities?
- (37) Is the investor entitled to exercise a right to set-off or net against the issuer rights in respect of securities with obligations that the investor might have to the issuer?

III. CHOICE OF THE SECURITIES LOCATION/PLACE OF ISSUE

- (38) Are there any rules and, if so, what that have the effect of restricting an issuer's ability to choose the legal and/or operational location of its securities for the purposes of the issue process?

IV. THE CROSS-BORDER DIMENSION

Generally

- (39) Are foreign securities, meaning those that are (i) governed by a foreign law (ii) issued by a foreign entity, (iii) issued within in a foreign jurisdiction or (iv) issued in a foreign currency, treated differently from domestic ones and, if so, how (as regards the issuer, intermediaries and investors)? Does the answer depend on the foreign country to which the securities are related?

¹ These questions are of equal interest to, and may overlap with enquiries made by, those in the Commission dealing with company law and corporate governance issues.

Specifically

- (40) Are there any rules which specifically define a domestic investor's right to foreign securities credited to a domestic account? If so, what is the nature of the right given and does it differ from the right of investor to domestic securities?
- (41) Does the protection of a domestic investor differ in relation to the holding of foreign securities (i) with a domestic intermediary or (ii) with a foreign intermediary, e.g. in case of the insolvency of the intermediary?
- (42) Are foreign intermediaries (where (i) the headquarter, (ii) a branch or (iii) an office is in a foreign jurisdiction) treated differently from domestic ones? Does the answer depend on which country the foreign intermediaries are related to?
- (43) How is finality (in the meaning of questions 20 and 21) achieved for transactions involving (i) foreign intermediaries or (ii) links between more than one intermediary? Does the answer depend on the type of intermediary or securities?
- (44) Do foreign intermediaries which hold domestic securities need a special authorised status in order to convey rights to its investors? How are foreign intermediaries recognised when entering into a link with domestic intermediaries?
- (45) Under what rules may domestic investors acquire foreign securities?
- (46) Under what rules may domestic investors use foreign intermediaries?
- (47) Are there any regulatory or other restrictions affecting foreign investors exercising shareholders' rights in domestic securities, or inhibiting domestic investors from exercising foreign rights?

V. PUBLIC LAW AND REGULATORY CONTEXT

- (48) What rules are applicable to the existence, establishment and operation of intermediaries (and where relevant for co-operation between particular intermediaries)?
- (49) Who is entitled to maintain securities accounts? Does the holding or transfer of securities on behalf of others require any license or any other authorisation from a public authority?
- (50) Is the access of investors to intermediaries in another Member State affected by their access to central bank money and, if so, how?
- (51) Does an account agreement have to comply with any requirements as to form or content?
- (52) Are there any disclosure requirements on the intermediary regarding securities credited to securities accounts (relating -to (i) taxation, (ii) company law, (iii) takeover regulation, (iv) money laundering, (v) control of regulated entities or (vi) any other matter). Is there any requirement to ascertain and/or disclose details of final investors (e.g. beneficial owners) of securities held with the intermediary?
- (53) What data storage requirements are there?

- (54) Are there any transfer restrictions applicable to securities (e.g. are transfers restricted to certain types of investors or intermediaries, is there a need for notifications or certifications, can delivery only occur against payment, is there a prohibition of over-the-counter transactions, etc.)? What is the effect of a breach such restrictions?
- (55) How is it effected that title to the securities passes from the seller to the buyer only at the very moment when the transfer of the purchase price from the buyer to the seller becomes effective (delivery versus payment (DvP))? Are the relevant rules established by an intermediary, by market conventions or imposed by law? Is the effectiveness of the credit to the securities account conditional upon the payment of the purchase price?
- (56) Is the intermediary required to have information about final investors (e.g. beneficial owners) of securities before it takes any action in respect of such securities?
- (57) Is there any specific penal law protection in case of fraud on the side of the intermediary? Are there any other specific rules of penal law applicable to protect the investors' interest against appropriations or other encroachments by the intermediary upon investors' rights?

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