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Internal Market and Services DG

FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS  
**Financial markets infrastructure**

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### NOTE FOR THE FILE

**Subject: Ad-hoc meeting on corporate actions, 5 December 2006 (at EBF's office)**

Patrick Poncelet and Salvatore Lo Giudice introduced the purpose of the ad-hoc meeting which was to exchange views between experts in order to establish a common understanding of the legal and fiscal procedures and related issues which impact or may impact on the full dismantling of Giovannini barrier 3 (corporate actions). Work on dismantling of barrier 3 is carried out by the European Credit Sector Associations (ECSAs), the European Central Securities Depositories Association (ECSDA), the European Association of Listed Companies (EALIC) and the European securities Forum (ESF), in the context of the CESAME group<sup>1</sup>.

While ECSAs and ECSDA have already identified multiple legal and fiscal issues related to corporate actions in an informal paper (and will continue to report on further issues while working on implementation), the Commission services considered that more work needed to be done to achieve the afore-mentioned objective. On the basis of the prior work by ECSAs and ECSDA, the following issues were identified for discussion:

- (1) Moment of transfer of "ownership"<sup>2</sup>, as this is relevant for market claims arising out of failed transactions; a related issue is that of the fiscal characterisation of market claims;
- (2) Impact of lengthy and cumbersome withholding tax procedures on payment date;
- (3) Legal basis for (definition of) dates, in particular record and payment date;
- (4) Legal basis for electronic communication, in particular for issuers;
- (5) Mandatory dissemination by issuers of electronic information;
- (6) Issuers' liability when translating documents into other languages, e.g. English;
- (7) Dematerialisation (to be mentioned for the sake of completeness).

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<sup>1</sup> See pdf-table on the operational conclusions (will be available on the CESAME internet site [http://ec.europa.eu/internal\\_market/financial-markets/clearing/cesame\\_en.htm](http://ec.europa.eu/internal_market/financial-markets/clearing/cesame_en.htm)) for the full set of documents published by the a.m. associations. In particular, see the common deliverables developed by ECSAs and ECSDA, to which reference is made in this note.

<sup>2</sup> *N.B.* there is no common agreement yet on what exactly is transferred in legal terms cross-border in a chain of intermediaries.

## **Moment of transfer of ownership (1)**

The Common Deliverable (i.e. the recommended ECSAs and ECSDA rule) on ex-date (ExD) and record date (RD) is based on the length of the settlement cycle (SC), that is  $RD = ExD + SC - 1$ . This is intended to minimise market claims, which arise every time a distribution, e.g. a dividend, is made to the person not being entitled to it. If the settlement rate is 100%, the a.m. rule ensures that there are no market claims. Nonetheless, when the settlement rate is below 100% – as is usually the case – market claims will arise.

Against this background, it was argued that uncertainty as to the exact moment in which ownership is transferred is problematic especially with respect to OTC transactions. The moment of ownership transfer should be determined in a way that works cross-border. It was further argued that uncertainty as to the exact moment when ownership is transferred may also be problematic with respect to market transactions if market participants have the choice of the settlement provider and this is likely to become increasingly important in the light of the recently adopted Code of Conduct.

► It was agreed that the issue of the moment of transfer of ownership (as a substantive legal property issue) represents the most important among the legal or fiscal procedures issues which have the potential to impact on the full dismantling of barrier 3. Due to the complexities of the issue, it was also agreed that the ECSAs – possibly in cooperation with ECSDA – will draft a note where the relation between ExD and RD and market claims, on one hand, and the issue of the moment of transfer of ownership, on the other, is fully explored. The note should distinguish between OTC transactions – which seemed *prima facie* those for which the problem is more likely to arise – and regulated market transactions – for which a standard settlement cycle exist in each market.

In some cases, the moment in which securities are deemed to be transferred from a fiscal perspective is the same as the moment in which they are deemed to be transferred from a legal perspective. In other cases, the two moments may be different.

► It was agreed that it would be preferable to start working on the legal side.

A related issue is that of the fiscal characterisation of market claims. For instance in case of dividends, are the market claims to be considered as actual dividends or as mere compensations for the loss of dividends? The representatives of the FISCO Group recognised the importance of the issue. However, they made it clear that the fiscal characterisation of market claims is clearly a substantive issue and, as such, is outside of the mandate of the FISCO Group.

► They promised to flag the issue in the second report on solutions along with the other substantive issues.

## **Dates (2) (3)**

The Common Deliverable on payment date (PD) calls for PD to be as close to RD as possible. However, lengthy and cumbersome withholding tax procedures make it very

difficult for this common deliverable to be implemented. This is, at least implicitly, recognised in the FISCO fact-finding report of 2006<sup>3</sup>.

► The work of FISCO goes already in the direction of eliminating or reducing this fiscal procedure obstacle by allowing domestic and foreign intermediaries to assume additional responsibilities in the withholding tax collection and/or relief process..

It was pointed out that, whilst shifting responsibilities to all intermediaries in the payment chain may be a good solution, it may be a long term solution and not always suitable for small markets or small players given the involved potential compliance cost. Moreover, one should also bear in mind the possible additional costs determined by outsourcing or fiscal advisors.

It was therefore recommended to consider "lighter" solutions as well, in view of **their faster time of implementation. For instance, it could be considered to make electronic communications between custodians and sub-custodians equivalent to the actual certified paper circulation. Technically, this solution could be achieved almost immediately.**

► It was agreed that this point would be taken up for discussion in the next meeting of the Fisco group.

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Experts agreed that dates – such as RD and PD – exist for practical reasons in every market. However, they are not legally fixed concepts in each Member State. Is this a problem? There was no consensus that this is the case. On the contrary, most experts argued that the fact that dates are not explicitly recognised is not problematic. What is important is that they exist for practical reasons.

On the contrary, the expert from the FISCO Group argued that explicit legal recognition of RD may be relevant from a fiscal point of view. This is however a substantive issue and, as such, is outside of the mandate of the FISCO Group.

► *N.B.* It would be appropriate if the issue could be flagged in the second report on solutions along with the other substantive issues.

### **Notification process (4) (5) (6)**

The legal issues related to the notification process focus on formal requirements, *i.e.* how national laws deal with:

- a) Formal requirements (mandatory publication? using which means?);
- b) Legal effect of translations of corporate action announcements (legal validity of translation? consequences of deviations between original and translation?);
- c) Legal validity of electronic communication (legal effect if publication in press is mandatory? (additional) electronic feed allowed? consequences of deviations between press text and electronic feed?).

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<sup>3</sup> "There may be insufficient time between the dividend announcement date and the income payment date to allow the beneficial owner to provide the required certificates, through the chain of intermediaries to the issuer prior to the income payment" (p. 25).

Electronic communication should also be recognised by fiscal authorities.

► The Legal Certainty Group (LCG) should look into these issues<sup>4</sup>. It should be verified whether the LCG mandate may accommodate these issues.

► The FISCO Group is already dealing with the issue of electronic communication to fiscal authorities.

A related issue is whether authorities should mandate issuers to disseminate information electronically in the EU, as suggested by ECSDA in their June 2005 report on mandatory distributions.

► Although this item was not discussed, the Commission Services consider that it is a regulatory issue which is not within the context of the legal and fiscal procedural issues which impact or may impact on the full dismantling of barrier 3.

### **Follow-up**

► It was agreed to hold another ad-hoc meeting in March 2007 after CESAME, FISCO and the LCG have met.

Salvatore LO GIUDICE / Doris KOLASSA

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<sup>4</sup> They are not sufficiently addressed in the proposed Shareholders' rights directive