

## EUROPEANISSUERS' COMMENTS ON THE SECURITIES LAW DIRECTIVE

23 June 2010

### INTRODUCTION

EuropeanIssuers represents the interests of companies with securities admitted to public trading in Europe. The legal environment in which securities are held in custody is thus of the utmost importance to us, as it has a direct influence on the relationship between the issuer and its investors.

Intermediaries form part of the investment chain between issuers and investors. Their role should be limited to that of a service provider. However, it appears that often, intermediaries have been entrusted with the prerogatives of investors, which makes the holding chain opaque.

There are two distinctive features that characterize all national legal systems within Europe:

They all guarantee the integrity of the issue by ensuring that there are no more securities in circulation than were actually issued by the issuer.

They all confer *in rem* rights in securities to the investor (ownership rights, co-ownership, trust).

In addition, some systems put in place shareholder identification rules, although the details vary between jurisdictions.

These features should not be lost in adopting this directive.

### OUR MAIN CONCERNS

The main concerns we have with the undertaken Securities Law Directive (SLD) are as follows:

1. *It potentially undermines existing rights under Corporate law*

As a matter of principle, securities law should not remove rights which already exist, whenever the forthcoming Securities Law Directive is contrary to a specific corporate law rule.

For example, rule 3(1) (Effectiveness of acquisitions and dispositions) provides that no further steps than those set out in the rule on acquisitions and dispositions may be required to make an acquisition of disposition effective between the account holder, the account provider and third parties. That rule is only true with respect to a very limited view of acquisitions and dispositions of securities. However, it does not take into account the wider effect of such transactions on the relationship between issuer and investor and might, therefore, even be contrary to provisions of company laws which exist in certain jurisdictions, where the transfer of certain types of securities is subject to the issuer's approval.

Consequently, both rules 3(1) and 3(2) as well as rule 1(1)a should be amended in order to clarify that they apply without prejudice to the relevant corporate law (or law under which securities are issued) that may stipulate further rules governing the relationship between issuer and ultimate account holder / investor.

2. *It elevates the role of intermediaries above that of investors*

The directive should be neutral from a securities holding system standpoint. However, this is not the case of the proposed SLD, which makes a clear political choice in favour of a system where:

- (i) the relationship between investor and issuer is being replaced by a relationship between account provider and account holder. However, most account holders are not investors. E.g. in a holding chain of 4 account holders, there is 1 investor and 3 intermediaries.
- (ii) *in rem* rights are not necessarily conferred upon the investors. In all European jurisdictions, investors purchasing securities acquire *in rem* rights in securities. The exact legal nature of those rights vary, but the fact that the investor acquires *in rem* rights in securities (and *only* the investor) is common to all European legal systems. This should be reflected in the proposed SLD.

3. *It should focus on the core duties for account providers, not only on core rights to be conferred upon the account holders*

Currently, book-entry securities consist of a list of rights conferred upon the account holders in respect of securities credited to the account holder's securities account. Rather the priority should be given to listing the obligations for intermediaries as enumerated in the Geneva Securities Convention.

4. *It should preserve the integrity of the issue, to ensure that only those holding securities have the right to exercise them. Instead:*

a. *It seems to create separate assets at each level of the investment chain, thus leading to potential confusion*

The SLD currently proposes to make a distinction between the issued securities ("securities") and the negotiated securities ("book-entry securities"). The so-called book-entry securities are an enumeration of rights of account holders against their intermediaries. Those rights are the rights flowing from securities: corporate actions and income payment, as well as the right to dispose of securities by instructing the account provider. Those rights should be rights bestowed on investors only, not on each and every account holder in its own right.

Reference to "book-entry securities" under rule 2 (acquisitions and dispositions methods) may give the impression that the object of an acquisition or of a disposition is a financial asset distinct from the issued securities. Likewise, mentioning both "book-entry securities" and "securities" in rule 8 relating to the integrity of the issue, may be interpreted as allowing separate assets being held at each level of the intermediaries chain. How can the balance between the amount of issued securities and the amount of negotiated securities be verified if a distinct asset is created at each level of the intermediation chain?

b. *It fails to ensure that there should be no debit without credit*

The integrity of the issue should be obtained by making sure that each intermediary in the securities holding chain holds with its upper-tier intermediary (or: sub-custodian) exactly the same amount of securities that stands to the credit of securities accounts that it maintains for its account holders. This is referred to as static integrity and is covered by the draft SLD.

Integrity also means that no crediting of an account can occur without the debiting of the account of the account provider of the disposer (dynamic integrity). The SLD does not provide for this. It must be made clear that:

- (i) An account provider may not debit or credit its account holder's securities account if its own securities account with the upper-tier intermediary is not respectively debited or credited; and
  - (ii) An account provider with 2 account holders who are respectively transferor and transferee of securities may not debit one account without crediting the other account.
5. *It should facilitate the exercise of a wider range of rights flowing from the securities, but without creating confusion as to who has the right to vote on company resolutions.*

EI welcomes the provision that the account provider must provide the ultimate account holder with a certificate confirming its holdings and enabling him to exercise the rights attached to securities. The scope of such facilitation should however be made clearer: it should at least include those corporate actions that call for an action from the investor: for instance a general meeting, a distribution of dividends with options, a voluntary reorganisation, etc., in general any elective corporate event as opposed to a distribution of a cash dividend that will be credited to the investor's account without any action on his behalf.

EI is, however, concerned by the current SLD provision enabling the account provider to exercise the rights attached to the shares on behalf of the investor, where the exercise by the investor is impossible or where the investor does not want to exercise these rights. Allowing the account provider to exercise the rights attached to the shares under the circumstances above would amount to entitling every intermediary in the chain to cast votes on behalf of the shareholder, which runs counter to generally accepted principles under all Member States' corporate law. It follows that an intermediary should not be bound to take action regarding certain corporate actions, unless so instructed by the investor.

Rather, it should be clearly reiterated that, in accordance with the shareholder rights directive, only the shareholder/ owner of the shares or its representative (provided that the owner can still be identified by the issuer in order to prevent the misuse of voting rights), is entitled to exercise the rights attached to the shares, including the right to receive information, the right to attend the GM and to cast votes, the right to cash dividends and the rights entailing a change of the relevant security (conversion, reorganisation). We make some suggestions for ensuring more effective identification below.

6. *It represents a missed opportunity to deal with one of the main challenges for companies in cross-border securities holding systems, namely shareholder identification.*

EI welcomes formal recognition by the SLD draft of the right of the investor, who bears the economic risk, to receive and to exercise the rights attached to securities.

Central to issuers' concern is not only an acknowledgment of the rights of the ultimate investor to receive and to exercise the rights flowing from securities, but also a desire to communicate with and ensure that the ultimate investor has actually been identified and the information passed on to him. Hence, recognition of the ultimate investors' rights should be complemented by an EU wide acknowledgement of the shareholder identification principle, in order to ensure more effective disclosure by the intermediary, wherever the latter is located, of the clients it represents.

In this respect, we welcome the recent publication of the Green Paper on the corporate governance of financial institutions, which specifically asks whether the identification of shareholders should be facilitated in order to encourage dialogue between companies and their shareholders and to reduce the risk of abuse connected to 'empty voting'.

We would like to see the following provisions apply to shareholder representatives:

- Disclosure of the clients’ name as well as the number of shares held on their behalf, if so requested by the issuing company.
- Disclosure of the fact that the designated person is an intermediary, if so requested by the issuing company.
- Authorisation of the intermediary to exercise his voting rights only in accordance with the instructions of the client investor. As a result, in case of objections, he should be able to provide evidence of the investor’s instructions (e.g. client contract).

7. It would make conflict of law rules more confusing

The existing conflict of law rules of the Financial Collateral Directive, the Settlement Finality Directive and the Winding-Up Directive should be maintained since they have never generated substantial uncertainty. The SLD proposes to add a complicated system where the law of the country of the intermediary’s headquarter applies. This should be deleted.

**CONCLUSION**

A few minor changes to the text are required in order to preserve clarity in the holding of securities and address the concerns enumerated in this letter. We have attached some suggested proposals for changes to the text in the annex.

**For further information on any of these issues, please contact:**

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