EU Clearing and Settlement - Legal Certainty Group

Annex to the advice of the Group, July 2006

Practical examples of legal barriers

In its advice July 2006 the Legal Certainty Group explained that it had resolved to use practical examples drawn from its wide professional expertise and legal judgement as the best way to illustrate its view that there is legal uncertainty in the way the laws of the Member States interact with each other and that the type and degree of uncertainty is in many cases a barrier to cross-border efficiency.

A compilation of those practical examples is set out here, arranged by the legal perspective from which they have been contributed. The contributions to this annex are personal views from individual members of the Group.

1. BELGIAN LAW

2. CZECH LAW

3. DANISH LAW

We do not have any anecdotal evidence relating to Denmark specifically, but simply note that in my eyes one of the most important legal barriers in the cross-border context seems to be that the nature of complex rules vary a lot from state to state, so even though in most cases the same result is reached in the end under the various laws it is almost impossible to verify this ex ante. Consequently, probably many defer from cross-border activities.

4. GERMAN LAW

Germany as such does not have legal barriers to efficient and less costly securities settlement. However, legal frictions arise in cross border relations where the diversity of laws may be the source of the need to treat foreign holdings differently from domestic holdings which, in turn, may create uncertainty to market participants in other countries.

Germany has a specific and clear legal basis for holding securities in book entry form and for transferring such securities by transferring co-ownership of such securities by means of debiting and crediting the securities accounts irrespective of whether such co-ownership is based on single or global certificates both held with the German CSD or entries of the CSD in the Federal or a State Debt Register which entries are legally treated as if there were a holding of certificates.

With respect to certain securities held abroad through one or more foreign intermediaries Germany has established as early as 1960 a special regime called “Wertpapierrechnung” (WR) which, in essence, means that the intermediary in Germany acts as fiduciary trustee for the investor/accountholder and holds the rights of whatever nature resulting from the credit on its account with the foreign intermediary for the benefit of the domestic investor. As far as this WR regime is applicable, the accountholder is clearly informed on each account statement that the credit on his securities account is “WR”.

The reason for this special regime was that, according to the conflict of law rules (*lex rei sitae*), it is not the German law but the law of the state where the securities

are actually located which is applicable to the transfer of ownership of the securities.

If such foreign law is identical or corresponds at least in its essential parts to German law regarding the transfer of rights in securities, the German intermediary may treat the respective foreign holding in the same way as a domestic holding. The securities account of the investor is credited with the same legal and economic effect as if the securities were located in Germany. WR is not applied. This is the case e.g. with respect to securities held in Austria, France, Switzerland etc.

If such foreign law, however, follows a different system – e.g. the UK – a "normal" credit would not transfer ownership or co-ownership of the securities. In order to have a clear basis to determine what the accountholder in Germany gets, the WR regime has been created under which the investor has the same protection against insolvency of intermediaries as in a pure domestic situation.

Thus, it is not the national German law requiring a system like WR but the fact that some foreign laws have an ownership concept which is not or not fully compatible with the German concept. If compatibility of credits to securities accounts could be achieved, the need to differentiate as outlined above would disappear.

5. ESTONIAN LAW

Shortcomings regarding Estonian law have been set out in our responses to the LGC Questionnaire of March 2005. Majority of those are rather theoretical by nature (though important in terms of quality of the legal framework) and have not, to the best of our knowledge, materialized as practical anecdotal problems.

However, our clients and we have faced practical difficulties reaching anecdotal level in the context of regional (Baltic) cooperation of CSDs, where particular reference has to be made to the link arrangement between Estonian CSD and Lithuanian CSD.

The problem relates to exercise of shareholders´ rights with respect to Lithuanian shares that are held by Estonian investors via aforementioned link arrangement on their securities accounts opened in Estonian Central Register of Securities. Set-up of the arrangement is classic – Estonian CSD has omnibus account(s) with Lithuanian CSD - balance of this account represents total holdings of those investors who hold their Lithuanian securities via Estonian CSD.

Considering this setup it would be reasonable to assume that, as an investor CSD, the Estonian CSD should be able to represent Estonian investors in the event of corporate actions and give instructions to that effect in line with general international practice. It would be essential that instructions of the investor CSD regarding exercise of corporate rights attached to securities credited to its account with issuer CSD are recognized (including vis-à-vis the issuer).

Practice has proved that this assumption is incorrect. Estonian investors holding their Lithuanian securities via a link have not been able, for instance, to benefit

from the right to subscribe shares issue of which was directed at existing shareholders.

This was due to a combination of the following reasons:

(1) Lithuanian law does not recognize Estonian CSD´s right to represent beneficial owners recorded in the Estonia CSD when it comes to submission of subscription applications.

(2) In many instances terms and conditions of the issue (applied by Lithuanian issuers) have provided that submission of subscription application requires physical presence in Lithuania either by the beneficial owner or of its representative - we consider that this is very questionable practice that does not consider the cross-border context and operates clearly as a "cost barrier" to cross-border holdings.

(3) In order for the representative to subscribe on behalf of the beneficial owner a notarized power of attorney issued by beneficial owner is required. Further, such power of attorney (PoA) has to be duly (official translation) translated into Lithuanian language. Alternative is notarized copy of custody agreement also officially translated into Lithuanian language. We are of the opinion that notarized PoA is disproportional requirement adding costs and decreasing likelihood that foreign investor will use corporate rights.

All the above requirements are simply too onerous to be complied with and that basically means that certain corporate rights (e.g. additional issue of shares directed to existing shareholders) arising from Lithuanian securities held via the link are just not exercised.

We think that the problematic framework example described above illustrates a number of important points:

(4) It is crucial that that the future EU legal framework supports cross-border corporate actions management via links between CSD-s (in particular rights of investor CSDs vis-à-vis issuer should be recognized in the event of link arrangements).

(5) Domestic actors (issuers) should not create unreasonable obstacles (e.g. physical presence to benefit from pre-emptive right to subscribe shares) with terms & conditions they apply to different corporate events.

(6) There is a great practical need to address language regime - we suggest considering language regime similar to that used in Prospectus Directive / Transparency Directive when it comes to PoA's or similar documentation - i.e. that issuers of publicly traded shares have to recognize documents produced in the language common in international finance.

6. GREEK LAW

Greek legislation on securities held with intermediaries deals mostly with securities of Greek issuers listed in a regulated market operated in Greece and held with a Central Securities Depository (CSD) established in Greece. Greek Law cannot tackle the interaction between domestic law and foreign legislation – i.e. if issuers of securities held with a CSD or an account operator governed by Greek Law are governed by a different EU-member state jurisdiction than the one governing the mentioned CSD or account operator and vice versa – which can only be dealt with on a European level. This lack of interaction unavoidably leads to incompatibility problems constituting impediments in the cross border circulation of securities within the EU. In fact, the legal regime of a) securities issued by foreign issuers listed in a Greek regulated market and b) securities issued by Greek issuers listed in a foreign (EU or other) regulated market, especially regarding the investors' rights towards the issuer, but also regarding trade and settlement legal characteristics, could significantly differ from the regime of securities of Greek issuers listed in a Greek regulated market and held with a CSD governed by Greek Law and, in any case, raise legal uncertainty (see below under 1-3). Furthermore, certain rules governing the Hellenic CSD could again lead to legal uncertainty regarding the protection of investors' rights where the securities are held with foreign custodians/account operators (see below under 4).

(1) Greek legislation does not regulate the prerequisites for book entries keeping through the CSD and ancillary custodian services provided by the latter (that means providing book entries facilities and accounts custody services, i.e. keeping and administering securities accounts in which rights in and on intermediated securities are registered) except for securities issued by Greek issuers and listed in the Athens Exchange (ATHEX), which are held with the Hellenic CSD or with the BOGS (Registry System operated by the Bank of Greece). Regarding securities traded in ATHEX, only securities issued by Greek issuers could be issued in dematerialised form and must be held by the Hellenic CSD for which *lex societatis* property rights especially with respect to the securities issuers are established. The fact that the provisions of Greek law governing the securities issuer are related only to the registration with a CSD or an account operator governed by Greek Law is due to the lack of harmonization of the CSDs / account operators regime within the EU (see in detail under 2).

Securities issued by Greek issuers and not traded in ATHEX should be in paper form. If these securities are traded in other regulated markets than the ATHEX, several problems regarding investors' rights as well as the clearing and settlement of the "rights" traded in these regulated markets could arise. For example, even immobilisation of these securities is not possible from a company law perspective, because the issuer of the securities, in relation to the rights emanating by the latter, would recognize only the holder of the "securities in paper form" issued directly by himself and not the holder of the "depository receipts" issued by the Securities Depository or the Custodian, which will hold the original securities. Therefore, the cooperation of the Securities Depository or the Custodian would be necessary in order for them to enable the "beneficial owner" of the securities to exercise the rights emanating from them. And even in such a case, legal uncertainty

could arise, if the issuer would finally put into question the authorization of the beneficial owner from a company law perspective. The above statement is also due to lack of interaction between company law and law governing the CSDs / account operators regime within the EU (see more specifically under 2).

(2) As a result, it could be argued that the exercise of investors' rights on securities issued by a Greek issuer and traded in European regulated markets could vary depending on whether the securities are listed in ATHEX or in another (non Greek) European regulated market. And vice versa: Securities issued by non Greek issuers and listed in ATHEX could not be held in dematerialized form and the exercise of the investor rights depends on the jurisdiction governing the issuer.

Reason for the above is the lack of links between issuers and CSDs governed by two or more different EU-member state legislations, due to the fact that the member states company legislation governing the issuer, in the absence of harmonization, cannot establish rights and obligations regarding book entries kept by foreign account operators. This could lead to discriminatory treatment and consist a barrier in the free circulation of securities, since securities, to be admitted in the regulated market of an EU member state different than the member state of the registered office of its issuer ("foreign securities"), could be treated differently after their registration with the CSD linked with the said regulated market than domestic securities, e.g. securities issued by issuers governed by the same jurisdiction as the one of the CSD. This could affect investors' rights as well as issuers' and account operators' interests, thus creating an unacceptable barrier in the European financial markets.

(3) As a matter of legal risk, the European Member State jurisdiction which governs CSDs (and, in general, account operators) is in reality a factor influencing the decision of an issuer regarding the regulated market, in which his securities will be traded, as well as of an investor regarding the securities he will acquire. That means that the rights deriving from a book entry in the operator's accounts and their exercise constitute a discriminatory factor for investor rights against the issuer, based on the jurisdictions governing the account operator and the issuer. In other words, the jurisdiction governing the book entry and holding of securities materially affects the legal certainty intrinsically linked with proprietary rights emanating from these securities in book entry form.

Therefore, the rights of an investor, who holds securities in book entry form through an account operator or through a chain of account operators, against the issuer could suffer from the interaction of the different member state legal systems governing the issuer and the intermediaries.

(4) Furthermore, the lack of rules in the Regulation of the Hellenic CSD safeguarding the existence of separate omnibus accounts held with banks and investment firms participating as account operators, at their request, could lead to legal uncertainty.

Greek Legislation safeguards investor rights on securities held in dematerialised form in the name of the ultimate investor with the CSD, because it provides for the option to hold securities through the Hellenic CSD in the name of the end-investor. Furthermore, Greek Law provides for the protection of investors' rights over securities even in book entry form held by Greek banks and investment firms acting as account operators, inter alia, in cases where a) insolvency proceedings have been instituted against investment firms or banks or the latter have been placed under specific liquidation procedures, b) against upper tier attachment and seizure by creditors of the banks and investment firms, independently of the physical segregation of the securities on the upper tier level.

The mentioned lack of provisions in the Regulation of the Hellenic CSD allowing the keeping by banks and investment firms, acting as custodian and account operators, through the CSD, of omnibus accounts, could – under circumstances and depending on the jurisdiction governing foreign account operators – lead to a protection failure of the latters' customers. This could happen if a foreign legislation would require, for the protection of investors' rights, that clients' securities should be held physically segregated by a custodian (account operator) from the securities held by the latter for own account.

It must be pointed out that this issue – contrary to the one described above under 1-3 – could be remedied on a domestic level, through an appropriate provision in the CSD's Regulation. Nevertheless, Community Law stating organisational rules for account operators – imposing for example the obligation for account operators to open omnibus accounts at the request of account holders being credit institutions or investment firms – would provide a minimum level of harmonisation in the operation of CSDs and account operators across the EU and thus would exclude legal uncertainty.

7. SPANISH LAW

8. FRENCH LAW

To answer the question about barriers. From a theoretical point of view, only:

France: French law perspectives

(1) We agree on the first barriers you stress in the paper 'Major examples of legal barriers' (see section 26 below):

If under French law, investors' rights against the intermediary given by a book entry are exactly the same whether the securities are domestic or foreign securities - to dispose of the rights, to pledge, to change the account on which the rights of the securities are held... and investors are protected in the same manner against the intermediary's bankruptcy-, problems can arise for French investors:

- when a foreign intermediary is selected (i.e.: an account-keeper operating from an office outside of France) for domestic and/or foreign securities:

rights against the foreign account provider depend on the law applicable law of the Member State where the securities account is maintained (L. 613-31-5 of the M&FC) and the investor could be less protected than under the protective regime contemplated under French law without being really aware of this situation (i.e.: in France, the securities custody is a regulated industry which is protective of the investor's rights).

- when there is a foreign intermediary in the chain of intermediaries:

rights against the French account provider could be, in practice, affected: for example, *quid* if the French intermediary is dealing with a foreign intermediary whose law does not provide for the segregation of securities in the securities accounts? A creditor of the French intermediary could seek an attachment at the foreign intermediary level where there is no segregation between assets held by the French intermediary for its own account or for others. In fact the French investor's right to reclaim securities (*droit de revendication*) may be paralysed by the insufficiency of securities.

Therefore, a set of harmonised rules governing account holders rights in respect of holding securities, against the account provider, whether the account holder is acting for its own account or for others, may contribute to a better efficiency of the Market. This also raises the issue of regulation of the function of a securities custodian. Our experience is that, in a fully dematerialised mode, a minimum of regulations and rules of conduct are essential. We do not believe that the proposed scheme would be credible or workable without a minimum set of rules and could not achieve its purpose.

We agree on section 2.1 providing for the rights resulting from the book entry (rights to dispose of the rights, to pledge, to change the account on which the rights of the securities are held) with a nuance concerning the right to 'withdraw' the securities by delivery of a certificate, which could be impracticable in a full dematerialized system. In this respect, there is a misstatement of French law in the paper. Certificates can only be issued by Euroclear France (not by a French issuer) for circulation abroad. Such certificates are not constitutive of title and are not issued under the terms of the securities. In respect of debt securities, certificates may only be issued in respect of issues outside of France if the terms of issues so permit. We agree on the aim of the section 2.1.3, even if the terms have to be discussed.

But, these rules are not enough to avoid, for instance, the uncertainty stressed above. A set of harmonized rules governing the intermediaries authorized to provide the service of maintenance of securities accounts (authorization, control, duties, segregation) would be an appropriate remedy. Section 2.6 provides some of these important rules.

(2) We agree on the barriers arising from the lack of uniformity regarding the corporate rights which can be exercised by Intermediaries on behalf of account holders.

Under French law, as matter of principle, investors exercise their corporate rights directly against the issuers. But intermediaries (account providers) have to facilitate

the exercise of the rights. For instance, the vote of French shareholders in GM of French issuers is exercised by the shareholder himself or through a proxy designated by the shareholder. The French Intermediary does not vote on behalf of the account holder, but he has to conduct its activity with care in order to facilitate the exercise of the rights. In this respect, the Intermediary is under the duty to convey to the issuer the request of its client to be provided with the documents related to such meeting before the relevant shareholders' meeting or otherwise to make those documents available to its clients subject to such documents being made available by the issuer pursuant to the contractual obligations of such issuer (Article 332-38 of the AMF General Rules). As one exception, the vote of foreign shareholders (*non-résidents*) in GM of French issuers can be exercised by the French registered intermediary, authorized to be recorded on behalf of the foreign shareholders.

But *quid* for a French investor holding foreign shares in an account maintained in France by a French Intermediary dealing with a foreign Intermediary? Is the shareholder entitled to vote directly at the GM of the foreign issuer? Is the French Intermediary under the duty to convey to the Foreign Intermediary the request of its client to be provided with the documents related to the meeting?

In fact, we can make a distinction between:

* barriers arising from the diversity of company laws governing the rights against the issuer: who is entitled to receive what rights?

* barriers arising from the difficulties, for the person entitled to receive the right to exercise the right (i.e. transfer vote) and for account providers to obtain whatever information or tools from upper tier intermediaries or issuers to effectively facilitate exercise of shareholders rights under the company law, so that shareholders can effectively exercise those rights.

- The first issue is clearly a matter of *lex societatis*. Do we have to interfere in this issue? We are afraid we are not sure. But if we deal with this question, we believe that the first part of section 2.12: to vote the security and to receive dividends, interest and all other income to which holders of the security are entitled may need redrafting: a distinction between holders acting for own account and for others as intermediary needs to be made in order to remain consistent with national corporate law regime. For instance, in the French system the shareholders defined as owners of the security exercise voting rights directly as holders for own account.

- The second issue relates to the exercise of the rights: how to facilitate the exercise of their rights by the investors? This is a matter addressed by the Proposal for a directive on the exercise of voting rights by shareholders of companies. We have to keep this Proposal in mind as the document assumes. For the information (second part of section 2.2), we think that the rules providing the duties of the account providers, as written in Section 2.6., deal with this matter effectively.

9. IRISH LAW

10. ITALIAN LAW

Re: Practical Examples Supporting the Doctrinal Approach

The discussions held so far have evidenced that the majority of the LCG members think that Europe should adopt a Unidroit-like functional approach, but have not been able to offer practical and legal arguments supporting such position or at least, despite my repeated invitations, arguments proving that the doctrinal approach supported by me and a few others is incorrect.

In order to create a really integrated single market in post-trading we need to test from a practical perspective whether the discrepancies among legal systems create legal uncertainty in a manner that it actually causes cross-border trading, clearing or settlement to become more expensive.

(1) IDENTITY OF THE OBJECT OF THE CLEARING & SETTLEMENT ACTIVITY.

The first issue to be analysed is whether it is absolutely necessary that in Europe we trade, clear and settle the same asset. In case of an affirmative response, the second issue to be analysed is whether it is necessary that such traded asset should all be securities (i.e., negotiable instruments) rather than an assortment of securities, securities entitlements, claims, and other intangible assets.

a. Trading. If we want to allow competition or consolidation among exchanges, legal uniformity of the traded asset is not always necessary. Exchanges compete with price, liquidity and product innovation. Such three factors are not affected by the legal characterisation of the asset being traded. However, if we want to obtain a true dual listing, the same asset needs to be traded in both exchanges and thus legal uniformity is necessary. We are too well aware of the inefficiencies created by a dual listing of shares in European exchanges and ADRs of such shares in the US exchanges;

b. Clearing. If we want to allow competition or consolidation among clearing houses governed by different jurisdictions or by a jurisdiction which is different from the jurisdiction governing the relevant exchange legal uniformity of the cleared asset is necessary. Clearing houses act as a central counterparty, i.e., they become the purchaser and seller in each trade carried out in the exchange. In order to allow competition between two different clearing houses it is necessary that the legal system governing each clearing house recognises the asset being traded in the relevant exchange. For example, if under Belgian law the object of a trade is a security entitlement, a clearing house regulated by French or Italian law would never be able to clear trades carried out in a Belgian exchange because French and Italian law (as any other civil law legal system) do not allow the sale and purchase of intangible assets they do not recognise;

c. Settlement. If we want to allow competition or consolidation among settlement systems, legal uniformity of the settled asset is necessary. A settlement system makes sure that tradable assets are delivered versus or free of payment among its participants and that transfer of title occurs upon delivery. In order to allow a settlement system to settle trades governed by a different jurisdiction it is necessary that the jurisdiction governing the settlement system recognises the asset being traded in the exchange regulated by a different jurisdiction;

d. Registrar. The comparative survey has evidenced that in the European Union the registrar function is carried out by the local CSD, which normally manages the local settlement system. In practice, an issuer is de facto forced to use the CSD of its home jurisdiction as its first-tier custodian. If we want to allow a CSD of another Member State to act as a first-tier custodian legal uniformity of the deposited asset is necessary. It would be difficult, for example, for a local CSD, which has to apply its own domestic rules, to undertake to act as a first-tier custodian/registrar of an asset that its own legal system does not recognise.

(2) IDENTITY OF THE PLEDGED ASSET. The short and easy answer to this problem is that legal uniformity is not necessary, since we have concluded that whatever happens at the last-tier intermediary level disappears to reappear in a slightly different form at another intermediary, which may be located in a different jurisdiction. The Collateral Directive has imposed the recognition of collateral arrangements in other EU jurisdictions and whatever absolutely needed to be done has already been done.

However:

a. The fact that each collateral taker has to become familiar with 25 different, although similar, collateral legal regimes to understand the risk it is exposed to causes the exercise of taking collateral in the EU extremely more complicated and expensive and thus creates a de facto barrier originated by a legal problem;

b. The problem increases with the exercise of the right of use of the collateral;

c. The problem further increases in connection with the creation of cross-border collateral pools where a collateral top-up in one account in one jurisdiction sets-off a collateral reduction in another account in a different jurisdiction. If the object of the collateral arrangement in different jurisdictions is a similar legal asset, it would become a lot easier to cross-collateralise and document such cross-collateralisation.

(3) CONCLUSION.

We are the European Union and we can and should be more ambitious than Unidroit, which has a very important, but different role and objectives. We did not join the LCG to simply intellectually ratify Unidroit, but to contribute

creating a truly integrated single market in post-trading services to enable future generations to invest more cheaply across the European Union.

We are convinced that if we do not advocate more legal uniformity now, somebody will be here within a few years to do it on our behalf. We are a technical body and we should recommend the most technically sensible solution, even if it appears complicated or politically unrealistic. Just the fact that the best possible legal solution has been pointed out has an intrinsic value that might inspire future generations of lawyers and politicians.

If that means that the LCG has not reached consensus on certain issues, well, our final report should state so.

11. CYPRIOT LAW

12. LATVIAN LAW

We have reviewed materials sent by the LCG Secretariat (on the legal barriers that exist in other Member States) and based on this material we think that in Latvia there are no legal barriers for securities settlement. We could agree with the conclusion that on some issues the regulation in Latvia is may be not so clear.

We don't know if the following issue also could be one of the questions of legal barriers, but we want to mention one example that could impact the cross-border settlement - the tax withdrawal procedure for dividends and interests. This procedure varies from time to time and is not clearly stated for securities.

If we speak about "less costly settlement", in my opinion, in the settlement process where the cross-border transactions are provided (that means special links and IT), the costs could be reduced only after some time.

We were very short. But in our practice we didn't face any legal barriers that restrict activities with foreign securities or restrict domestic securities to be registered in other CSD.

13. LITHUANIAN LAW

14. LUXEMBOURG LAW

15. HUNGARIAN LAW

16. MALTESE LAW

17. NETHERLANDS LAW

In the situation that foreign securities are credited to an account with a Dutch intermediary a Dutch court will probably apply the PRIMA rule and consider Dutch law to be applicable, which could result in the investors not being protected in the event of the securities not being subject to the Securities Giro Transfer and Administration Act or held in custody by a risk remote Securities Depository as prescribed by law, although protection is offered to these investors by the laws of the country of issue.

18. AUSTRIAN LAW

From time to time we have to advise foreign clients how the pledging of Austrian securities accounts is made. Since applicable Austrian civil law requires signs or marks which inform anybody clearly about the existing pledge, and there are several ways to do it, such advice requires some exchange of questions and answers to find the tailor-made solution for the inquiring client (mostly a foreign credit institution or perhaps an investment fund). The Collateral Directive helps in this respect only in case the Austrian pledgor is a credit institution. The Austrian adoption of the Collateral Directive provided that the Financial Collateral Act is applicable in case of "professional players in the financial markets" like banks, central banks, public financing agencies and the like, but not for "ordinary" companies and private persons (section 2 of the Financial Collateral Act based on the option provided in article 3 of the Collateral Directive).

19. POLISH LAW

Cross-border taxation issue: the Polish system creates the tax duty "at source". The tax collection function in the country system cannot be performed by a foreign entity; at the same time, it is technically impossible for any local entity to perform such function in the tax collection process local entity - such entity would not be able to identify the individual investors who bear the tax duty; current tax law is an obstacle to opening of omnibus accounts for foreign entities - eg. CSDs - in Poland;

The catalogue of securities which eligible for crediting on a securities account is too narrow.

20. PORTUGUESE LAW

21. SLOVENIAN LAW

In my opinion no evidence exists of legal barriers in Slovenia, even though the restrictions on the manner in which securities may be held, described on page 4 of the paper "Major examples of legal barriers", appear to exist in Slovenia. We have worked with the KDD (Slovenian CSD) since 1995, so I would have with high probability encountered such evidence if in practise such problem arose.

22. SLOVAK LAW

We agree with all of the barriers (identified in the paper at section 26 below) although some of them are not relevant for legislation of the Slovak Republic.

One of the legal barriers that has not been explicitly mentioned is non-existence of nominee concept for cross-border holdings of Slovak securities by foreign investors, which until recently was the case in Slovakia.

We acknowledged that this was a serious obstacle to efficient post-trading activities in cross-border context and therefore we introduced into the Slovak securities legislation by means of amendment to the Act No.566/2001 Coll. on Securities and Investment Services as amended, effective from 1 May 2006, a nominee account for foreign central securities depository (further referred to as „the CSD“) that becomes a member of the Slovak CSD. (We are already working on software solution in order to allow nominee accounts to be used in practice.) This nominee account is called “holder's account” and owner of holder's account is not deemed to be an owner of securities registered in such account. However, it seems that it was not enough to provide this facility only to the foreign CSDs on condition they become a member. Therefore, we are making an analysis of possible solutions within the working group under the auspices of the Ministry of Finance of the Slovak Republic, where all market participants have their representatives to table proposals. Recommendations of this working group will certainly address the problem of nominee concept; they should also deal with the method of how ownership rights to dematerialised securities are created, what should be the best solution for securities accounts structure in Slovakia and the role of intermediaries in the domestic market. Unfortunately, we cannot provide you with any preliminary recommendations since the work is still in progress and the group has not agreed on any common solutions yet.

Another obstacle for Slovakia, which was identified by LCG, is the non-existence of legal treatment of foreign securities held by Slovak investors.

We should point out that although it is theoretically possible to credit foreign securities to securities accounts administered by participants of the Slovak CSD, this is not the case in practice, because a precondition to holding foreign securities through the CSD under the current securities legislation is that domestic CSD holds

a nominee account with a foreign CSD where foreign securities are issued. Although for the Slovak CSD it is legally possible to open a nominee account with foreign CSD in compliance with §99 par.4e of the Act No.566/2001 Coll. on Securities and Investment Services as amended (effective from 1 January 2001; please see the *note) so far there has not been any request from the Slovak CSD participant to open such account. The fact that the rights to foreign securities either held through the CSD or through custodian are not covered by the Slovak legislation, has not been identified as a problem by domestic market participants, but we see it a potential problem that should be addressed at the working group organised by the Ministry of Finance of the Slovak Republic and the Slovak CSD will raise this question.

*Note: Although the Act No.566/2001 Coll. on Securities and Investment Services as amended entered into effect on 1 January 2002, Slovak CSD has been providing its services in compliance with this act only since 19 March 2004; there was a transitional period during which depository had to adjust its operations to the Act, including licensing procedure.

23. FINNISH LAW

Regarding the second barrier ("Investor rights in foreign issued book-entry securities credited to a domestic account are unclear in many Member States' laws"), Finland can be counted as one of the countries of such type. In fact, you could insert Finland in the same parenthesis as Estonia with the reference "... and the book-entry system regime in Finland".

We might add one item that is largely considered as a legal barrier in Finland by Nordic market participants.

In Finland nominee registration of dematerialised shares of Finnish companies and holdings of such shares through nominees (i.e. indirect holdings) is only allowed for foreign investors. Finnish investors (be they private individuals or legal corporations) may not hold their dematerialised Finnish shares in an omnibus account or to have the shares registered in the name of the nominee (there are certain very limited exemptions to this rule). The effect of this limitation from a cross-border perspective is that where nominee registration is not allowed, the affected domestic Finnish investors can not be offered the same service selection as to foreign investors. The restriction requires custodian banks to have separate processes in respect of Finnish investors. Furthermore, the restriction reduces the flexibility in choosing the applicable legal system for securities holdings. In the Finnish debate, it has been recognised that one of the fundamental preconditions for allowing nominee registration for also Finnish investors is the establishment of a sufficient legal framework for indirectly held securities.

Thus the implementation of the framework proposed by the Legal Certainty Group would be paramount in removing this obstacle.

24. **SWEDISH LAW**

We have hands-on experience from more than ten years of working with and establishing cross-border links - both direct CSD-links and indirect links via custodians. My experience is that the main cross-border barriers are of a legal nature: both uncertainties regarding the effect of having a securities account in a foreign country/jurisdiction and complications regarding the foreign tax situation for the issuer as well as for the investors (or both). These barriers are often costly for several reasons: (i) they often necessitate a number of legal advisers from all jurisdictions involved and sometimes numerous legal opinions, warranties and the like; (ii) they are often time consuming since obtaining the proper advice/information (not least from officials, e.g. tax authorities) is so difficult (other language, other currency, other legal/tax regime).

Regarding the exclusion of CSDs from a future regulation, we believe that we (and the Commission) would make a great mistake if CSD accounts were not to be included in the future regime. In fact we even think that much could be achieved if ONLY CSD accounts were to be included. Then there would finally be some material conformity among CSDs, there would be an important extent of a level playing field and a great example of legal harmonisation. We agree that if there is uncertainty (as there is today) at the top level it will spread like a "disease" (as it is today). And we would like to add that if there is CERTAINTY at the top level, it too would spread like a "beam of light" along the chain of intermediaries and a very effective barrier for competition between CSDs and other intermediaries would disappear.

We would caution strongly against the expression "the new Interest in Securities". First because there is nothing new with the interests we are talking about – they already exist and will not be created though some EU legislation; secondly because it is spelt with capital letters, indicating that we create here something "special". We must be aware that the English language, however useful it is in our discussions, is and will NOT be used in domestic legal language in more than 20 (at least) of the 25 EU countries. So the expression "Interest in Securities" would have to be translated anyway and therefore there would be a number of "names/wrappers" in different languages to denote "the legal effects of book-entries/book-entry securities". We think that what we should propose generally speaking is not totally new and not so special other than a uniform enumeration of the minimum legal effects of a book-entry on a securities account and minimum responsibilities of an account provider/intermediary.

25. **ENGLISH LAW**

There are barriers of two kinds to mention.

The first kind is procedural requirements, particularly requirements for or relating to documentation. Examples are share transfer forms or forms required for registration of security. Documentation requirements are often associated with tax collection, e.g. stamp duty in the UK or the Italian data certa stamp requirements.

You will appreciate that although Collateral Directive has helped with this, there are many situations where it does not apply.

The second kind is the legal certainty issue that arises in cross border situations and which is the fundamental issue which the Group is considering. The above advice on the Swedish law has referred to costs associated with legal and tax advice regularly sought in cross border situations. This is absolutely right. We are regularly asked to consider for example

- what is the appropriate way to take security over a portfolio of securities held through a number of different systems, or

- how and when can a lender determine that a condition precedent to a financing has been satisfied. The sort of condition precedent WE have in mind is one which requires that for example shares being acquired have been effectively transferred and acquired. For agents or arrangers of financings this is a very risky question as they will frequently be expected to confirm to the lenders in a syndicate that conditions precedent have been satisfied. So getting this wrong carries real liability. As we know the legal position in cross border situations can be uncertain.

With respect to this second kind (of legal barrier) please bear in mind that Basel 2 capital requirements envisage allocation of capital to cover operational, including legal, risks. One can imagine that, absent a resolution of this uncertainty, banking industry participants may be called upon to quantify this uncertainty or the risk it carries and allocate capital to it.

26. FROM THE EU PERSPECTIVE

(NB the examples given are taken from the LCG's Jumbo Compendium of responses to its Questionnaire of March 2005. They are only illustrations of the types of rules that Member States have in place and that may constitute substantive law barriers to an integrated post trading market.)

CATEGORISATION OF LEGAL REGIMES

Several MS laws determine account holder rights within a book entry system depending on whether or not they come within the terms of their domestic legislation on collective custody, i.e. a special legal regime (e.g. Germany – German Securities Deposit Act (1995) on collective custody (Girosammelverwahrung), Netherlands - the Giro Admin and Transfer Act, Belgium - Royal Decree 62).

These special legal regimes recognise (co-)ownership rights on fungible securities held in a pool with the national CSD transferable by means of book-entry credit (e.g. providing the right to exercise corporate rights directly against the issuer which in practice usually requires the assistance of intermediaries) that are equivalent to ownership of a share certificate only to account holders that come

within the terms of that special regime. If they do not come within the terms of the regime, only the intermediary as trustee has the ownerships rights or a comparable legal position in respect of the securities vis à vis the issuer.

In these special regimes, IF BOOK ENTRY SECURITIES ARE FOREIGN ISSUED, THE INVESTOR MAY BE FORCED INTO A REGIME OTHER THAN THE COLLECTIVE CUSTODY REGIME APPLICABLE TO DOMESTIC OR QUALIFIED FOREIGN ISSUES. In certain of these regimes, this will also be the case if the SECURITIES ARE HELD ABROAD.

An example of this type of regime is the German WR-Credit Law, which is a sub regime for foreign book entry securities held with a foreign sub-custodian through domestic custodians. The securities are treated *as if* owned by the account holder although they cannot come under the terms of the collective custody regime of the German Securities Deposit Act. Under the WR-Credit law however the account holder only has *in personam* rights against the domestic custodian holding the foreign securities in custody abroad for him. If the securities were held under the collective custody regime (Girosammelverwahrung), the account holder would have co-ownership rights in the securities pool held with the national CSD and reflected on his account.

Thus legally foreign issued securities coming under the WG-Credit Law (i.e. that either may not conform to the German law definition of a 'security' or where it is not entirely clear whether property has been acquired) are treated differently from domestic issued securities.

As regards the Netherlands, if the book entry securities are foreign issued, whether they are bearer securities physically held in the Netherlands outside of the Giro Act by a Dutch intermediary on behalf of investors (foreign or domestic) or if they are bearer securities held abroad for a Dutch intermediary by a foreign sub-custodian or non-bearer securities registered in the name of the intermediary, THE INVESTOR MAY BE FORCED INTO A REGIME OTHER THAN THE COLLECTIVE CUSTODY REGIME APPLICABLE TO DOMESTIC ISSUES (i.e. the DUTCH GIRO ACT).

As regards Belgium, the ROYAL DECREE of 1962 is the regime for book entries on intermediated accounts, but this regime does not apply to accounts with account providers that are not affiliates of a recognised Belgium settlement system (e.g. Euroclear, NBB).

With respect to some securities held abroad through one or more foreign account providers Austria has followed the German *Wertpapierrechnung* (WR) regime which, in essence, means that the Austrian account provider acts as fiduciary trustee for its account holder and holds the rights of whatever nature resulting from the credit on its account with the foreign account provider for the benefit of its account holder. The account holder is informed on each statement of account that these securities are held in "WR". The reason for a credit entry in "WR" was that as a consequence of the *lex rei sitae*-principle it was unclear whether the account provider obtained property or any other rights similar to property which existed in the foreign country. In case the foreign law was well known and property was acquired (e.g. in Germany, Switzerland, France) the account holder would be credited the foreign securities without qualification by "WR" and would know that

he acquired property in the meaning of Austrian law. With other less 'well known' laws, however, this may not be the case

Some MS also differentiate the legal treatment of the account holder depending on whether the securities are held in a domestic CSD account or in a non CSD intermediary account, regardless of whether they are foreign or domestic (DK, ESP).

If the securities are held on the account of an INTERMEDIARY which IS NOT AN INSTITUTION WHICH IS A PARTICIPANT OF A PRIVILEGED DOMESTIC SETTLEMENT SYSTEM, the investor may not be recognised by domestic law as full owner of the securities vis à vis the issuer.

This is the case with the Spanish regime, which is based on participation of the intermediary in IBERCLEAR.

In Spain, for example, the investor will have full ownership rights only if he holds his book entry securities through a registered individual account at IBERCLEAR or with a participant in IBERCLEAR. The investor thus has no choice but to keep his account with particular domestic intermediaries, and if he chooses an intermediary which is not participating in IBERCLEAR Spanish law will not accord the same legal effects to his book entry on that account.

This situation argues in favour of a minimum set of legal effects for book entries harmonised at EU level regardless of the status of the intermediary providing the account - in the interests of legal certainty and market efficiency.

INVESTOR RIGHTS IN FOREIGN ISSUED BOOK ENTRY SECURITIES CREDITED TO A DOMESTIC ACCOUNT ARE UNCLEAR IN MANY MS LAWS

This is largely the case in the new member states where the applicable laws tend to assume that the securities are domestically issued (i.e. under domestic law). Where the securities are not domestically issued, although credited to a domestic CSD account, the legal status of those securities in domestic law is not clear.

In some MS where the top tier intermediary is a central securities depository or registrar, the domestic book entry legislation will only apply to foreign securities if they are directly registered at such top tier CSD. There is no regulation applying to custody of foreign securities in cases where the domestic book entry legislation is not applicable (e.g. ECSA regime in Estonia). Similarly, in Denmark the Stock Trading Act only applies, to recognise legal effects of book entries vis à vis third parties, if the securities in question are registered at a CSD.

In several MS, especially where the book entries are evidenced in a central securities registry, the arrangement for record keeping and settlement differs for foreign securities from the arrangements applied to domestic securities, e.g. more administratively cumbersome, time consuming.

DOMESTIC LAW RESTRICTIONS ON WHAT SECURITIES MAY BE CREDITED TO ACCOUNTS SO THAT ACCOUNT HOLDERS ACQUIRE RIGHTS

There is no definitive, uniform list of all the types of assets that can be credited to an account. The existing MS laws vary widely on this question. The concept of "securities" is diverse in meaning across the MS. Even the term 'transferable securities' in MIFID annex C is not free from doubt and it has been diversely implemented across the MS.

Most MS laws (e.g. Austria, Italy, UK, Sweden, Finland) do not have fully dematerialised systems and allow for the issue of securities certificates in some cases.

The assumption that securities are issued in physical form still underpins to some extent the securities laws of many of these MS. Thus the book entry concept has to be applied by analogy to existing legislation which assumes a physical issue of the security.

This has an impact on the way in which these MS laws define which asset or instrument may be credited in a book entry form on an account and thus leads to significant variations in what rights in book entries are recognised from MS to MS.

In many countries it is up to the local CSD and any account provider to decide what kind of instrument may be entered on a securities account. Although decisions, partly laid down in general business conditions, tend to be made for business reasons, the new legislation should say, which instruments should at least be allowed to be credited to securities accounts.

In English law, any form of financial asset may be credited to an account, and it is essentially a matter of contract. English law accepts money market instruments as securities, whereas most other EU legal systems do not, and indeed this is reflected in the categorisation of financial instruments in annex C of the MIFID directive. On the other hand, German and Finnish laws accept derivatives as securities if they are issued in certificate form.

If one and the same financial asset can be credited to an account in one MS but cannot be credited to an account in another MS, this represents a substantive law barrier to a single efficient market.

This argues in favour of a broad definition of 'securities account' and what may be credited to such an account.

RESTRICTIONS STEMMING FROM THE LEGAL VALUE GIVEN BY THE MS LAW TO AN ENTRY ON AN ACCOUNT

Some legal systems by legislation expressly equate the legal effects of a credit entry on an account of book entry form dematerialised securities to the legal effects of delivery of securities in physical form, (e.g. Spain).

However, in other legal systems (e.g. Austria) the relevant securities law assumes in general that the security is physically issued, i.e. that rights represented by the security require the existence of a certificate. In such systems book entry is considered to be a record in the account provider's books and legally it counts as one of the ways of perfection of the transfer of title arrangement (the obligation). In

such systems the correlation of the contract and the perfection of the contractual obligation by means of the book entry is essential in order for ownership in the securities to pass (leaving aside other ways which are of no interest in the context of this paper).

RESTRICTIONS ON THE MANNER IN WHICH SECURITIES MAY BE HELD, I.E. WHICH ACCOUNT PROVIDERS MAY BE USED TO ACQUIRE RIGHTS THAT ARE PROTECTED UNDER THE DOMESTIC LAW

In the Netherlands the legal rights of the account holder vary (and are characterised differently) according to the legal regime under which his securities are held.

This will depend on whether the securities (bearer or registered) are held through a custodian under the Dutch Giro Act - in which case the holder will be recognised as a co-owner in a collective deposit of securities - or whether they are bearer shares held outside of the Giro Act regime for example by a Dutch intermediary on behalf of foreign shareholder - or if they are held abroad.

Consequently the legal results are distorted depending on manner in which the securities are held: if they are held with an account provider that is not a participant in a recognised settlement system (such as Euroclear NL) so that they fall outside the terms of the Giro Act - or if they are registered directly with the issuer (i.e. as registered shareholders) - then the investor will have no rights against his account provider other than those agreed in the account agreement.

Similar restrictions exist in other MS (e.g. Belgium, Slovenia) where the investor's legal rights vis à vis the account provider depend on the account provider participating in a settlement system recognised by the domestic regime for dematerialised securities.

In most of the Nordic and C&EE regimes for book entered securities, disposals of securities must be registered at a central depository or registry, which is a public entity (e.g. Polish KDP, Finnish AKP, Czech Centre for Securities (SCP), Slovenian KDD, etc). If the disposal is not registered in the central registry (or an authorised sub-registry kept by a foreign custodian, for example), the legal effects of that book entry may not be recognized or the domestic law is unclear on that issue (a case in point is Estonia).

In the Nordic systems, which follow the direct ownership model, securities are by and large dematerialised. In such jurisdictions the legal status of securities in omnibus or nominee accounts or of those securities held with intermediaries outside of the book entry system is less certain (e.g. Finland).

The account holder has the right to have his dematerialised securities registered on a CSD owners account i.e. at the top tier (e.g. Sweden). Non CSD accounts are less regulated and are governed largely by custodian agreements.. The intermediated system based on co-ownership in a 'pool' does not normally give the account holder that right.

In some cases, e.g. Slovenia, the domestic law on dematerialised securities goes one step further and requires all end investor accounts to be maintained at the central registry.

There needs to be clarification in this area, so that the investor, who chooses to invest through his usual account provider when the latter is not participating in the settlement system that is privileged in domestic legislation, is not prejudiced in his rights.

CERTAIN MS HAVE DOMESTIC PRUDENTIAL INSPIRED RULES FOR SAFEFUARDING OF CUSTOMER ASSETS THAT RELATE ONLY TO DOMESTICALLY INCORPORATED ACCOUNT PROVIDERS REGARDLESS OF WHERE THEY ARE CARRYING ON SUCH SERVICES BUT NOT TO FOREIGN ACCOUNT PROVIDERS REGARDLESS OF WHERE THEY ARE CARRYING ON SUCH SERVICES.

CERTAIN MS LAWS HAVE NO RULES ON WHAT ACCOUNT HOLDER RIGHTS ARISE IN CASE FOREIGN ISSUED (BUT DOMESTICALLY LISTED) SECURITIES ARE HELD ON ACCOUNT WITH THE DOMESTICALLY RECOGNISED SSS

For example, Greek law in this area provides for the safeguarding of assets (held in book entry form) by Greek incorporated intermediaries regardless of where they are carrying out these services. However, the Greek law does not provide for safeguarding of assets by non-Greek intermediaries regardless of where they are carrying out these services. The segregation principle is thus applied by law only to book entry assets (whether the investor has in rem or only beneficial rights in them) held by Greek intermediaries.

Also, a non Greek issuer may want to register his securities in DSS or BGOS. There are no national rules on what rights account holders would get and how such rights would arise in such cases. Greek law does not foresee that foreign issued securities which are listed in Greece (on ATHEX) may be held in book entry form on accounts with the national settlement centre, DSS. Greek law on dematerialised securities only foresees DSS (or BGOS) registration of Greek issued securities.

There are thus also no Greek rules on how rights in such domestically registered but foreign issued securities arise.

There are no national rules on the registration of securities issued by Greek issuers but registered with a foreign CSD or custodian (i.e. not with DSS or BGOS).

In the Spanish law, only securities registered with IBERCLEAR or in a IBERCLEAR participant's account are considered valid for generating rights vis à vis the issuer, thus the manner of holding the rights i.e. in which intermediary's account, impacts on what rights you as account holder acquire.

Some MS like Lithuania limit the instruments that can be "transferred" and settled within the national SSS to wholly dematerialised instruments that are registered to the account holder's name.

Further, if they are not so registered, they only allow registration and transfer of ownership within nominee accounts that are managed by a foreign entity custodian. France allows 'nominee accounts' to operate within its dematerialised system only if they are managed by foreign account mangers.

DISTINCTION MADE BY MS LAWS BETWEEN RIGHTS ARISING OUT OF SECURITIES AGAINST THE ISSUER AND THE RIGHTS IN RESPECT OF THE SECURITY

The member states are divided on this, some make a distinction between rights that can be exercised by the owner (account holder) against the issuer and those rights which stem from the account agreement and may affect the rights which can be exercised vis à vis the issuer (e.g. France, Austria), thereby limiting the account holder in enjoying all the rights which ownership of the security confers on him.

Others make no distinction in these rights once lawfully acquired and the ownership arsing from the holding can be exercised also against the issuer (e.g., Poland, Portugal, Slovenia, Slovakia).

NATIONAL RULES RESTRICTING THE ABILITY OF THE ISSUER TO CHOOSE THE PLACE OF LOCATION OF SECURITIES FOR PURPOSES OF THE ISSUE (Q38 of JUMBO)

In some MS legal restrictions exist in this area. By way of a few examples:

Danish legislation prevents the issue abroad of dematerialised securities through a foreign CSD.

Czech Commercial Code provisions on issue of dematerialised securities state that issuers may only issue such securities in certificated form OR in accordance with the Capital Market Trading Act - which implies that the issue of such securities abroad is not permitted.

In Slovenia certain domestic issuers, e.g. banks, are required by law to issue dematerialised securities via the national depository (KDD) and it is thus not possible for them under Slovenian law to decide the place of location elsewhere.

In the UK and Eire share registers must by law be kept in the EUK and Eire respectively.

THERE IS NO UNIFORMITY IN MS LAWS REGARDING THE CORPORATE RIGHTS WHICH CAN BE EXERCISED BY INTERMEDIARIES ON BEHALF OF ACCOUNT HOLDERS. THE EXTENT OF THE OBLIGATIONS OF INTERMEDIARIES TO PASS DOWN CORPORATE INFORMATION VARIES DEPENDING ON WHERE THE ACCOUNT IS REGISTERED

Generally in the Nordic and Baltic direct ownership systems, the obligations of the intermediary vis à vis the issuer and the customer are based on a mandate from the registered owner, which is only a contractual right and can be withdrawn at any time.

In some cases this contractual arrangement is circumscribed by domestic legislation.

For example Finnish law does not allow intermediaries to exercise voting rights on behalf of account holders in their book entry system.

As a rule German custodian banks do not exercise voting rights in respect of foreign securities not listed in Germany.

In the Spanish book entry system only investors with an account with IBERCLEAR or with a participant in IBERCLEAR have a direct relationship with the issuer, with all that that implies for exercise of their corporate rights. Account providers fulfil a dual function, a contractual one and a public interest one as participants in the Spanish public securities holding system, which is a public register.

In some of the new MS (e.g., Hungary, Czech Republic, Slovakia, Poland) the capital market laws impose obligations on intermediaries of accounts registered at the top tier CSD to identify their customers or state if they are operating a nominee account as opposed to an individual account on behalf of customers. These identification obligations tend to be more stringent than in the other Member States.

These differences reflect a more fundamental diversity in the tasks and functions accorded by MS laws to intermediaries and hence the legal status of the intermediaries providing account services.

Rules on good faith purchases and account provider lien over client assets.

In this area there is a sheer diversity of MS laws. They range from MS with no special rules on good faith to those that give account providers a statutory lien over client assets and those that grant account providers no such special treatment and leave it to contract

A minimum level of harmonization is required.

Shortfalls

MS laws do not generally regulate what happens upon such event. In the individual accounts ownership systems, e.g. the case of the Nordic MS, shortfalls are not possible as the rules of such regimes make it possible to trace the ownership of the securities up all the tiers.

A minimum level of harmonization appears desirable, however.

VARIATIONS IN THE HOLDING STRUCTURES ACROSS MS

Are these variations per se an obstacle to an efficient, integrated post trading market? Markets in financial services are still largely national and this is reflected in MS legislation. Differences in MS laws are behind these structural variations. As a result the investor is uncertain about his legal position, especially in a cross border transaction. These legal differences represent additional expense and complication for investors, who are forced to adapt to them if they want to invest in a given domestic market. They thus represent a significant legal barrier to a single market in the settlement of intermediated securities transactions.

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