City of London Law Society

4 College Hill
London EC4R 2RB

Tel: 020 7329 2173
Fax: 020 7329 2190
www.citysolicitors.org.uk

European Commission Consultation: Legislation on Legal Certainty of Securities Holdings and Dispositions
CLLS Response

The City of London Law Society ("CLLS") represents approximately 14,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response in respect of the European Commission's Consultation on legislation on legal certainty of securities holdings and dispositions has been prepared by the CLLS Company Law Committee (the "CLC") with input from the CLLS Regulatory Law Committee.

A. INTRODUCTION AND SUMMARY

We welcome the opportunity to provide feedback on the Commission's consultation regarding the improvement of the legal framework for holding and disposing of securities, and the exercise of rights attached to securities.

The Company Law Committee's purpose is to represent the interests of those members of the CLLS involved in company law and related regulation. Accordingly, this response responds only to those questions which primarily give rise to company law issues. The CLC has however seen in advance the response from the CLLS Financial Law Committee, and wishes to support the views expressed in that response.

We support a functional approach to the harmonisation of member states' laws in this area in a way which does not interfere with the property laws of Member States or who an issuer has to recognise as the legal holder of its securities. In our view, in the interests of legal certainty the principle that in Member States where an issuer is only required to regard the registered holder as the legal holder of its securities, that approach must be maintained and should be made clear.

B. RESPONSES TO THE COMMISSION'S PROPOSALS AND QUESTIONS

Our responses to the questions contained in the Second Consultation Document are set out below. We have adopted your headings and numbering.

1. Objectives

Q1: Do you agree that the envisaged legislation should cover the objectives described above? If not, please explain why. Are any aspects missing (please consider also the following pages for a detailed description of the content of the proposal)?

We agree with the principles expressed. In particular, we agree that measures at EU level should not seek to harmonise the legal framework of whom an issuer has to recognise as the legal holder of its securities (for the reasons given in the consultation). We consider it critical from a UK perspective that in the UK (and other Member States where a similar approach is adopted) the issuer only has to

regard the registered holder as the legal holder of its securities (a point which applies to the bond market as well as the equity market).

3. Account-held securities

Q5: Would a principle along the lines described above provide Member States with a framework allowing them to adequately define the legal position of account holders?

We support the functional approach to the creation of a common legal framework in this area. We agree that account holders need to be sure what they receive (again, for the reasons stated in the consultation). In principle, we think it is correct that the ultimate account holder should be able to exercise the rights flowing from the securities (such as dividends and voting rights) and that "non-ultimate" account holders should only be able to exercise rights if determined by national law (for example, because they are the registered shareholder in the case of a UK company). We do, however, think the rules will need to provide clarity as to what "rights" the account provider of the ultimate account holder must facilitate; the consultation paper refers to "at least" dividends and voting. In addition, practical/timing problems will need to be recognised. It will not be possible for an ultimate account holder to be put in exactly the same position as a registered shareholder. For example, the process of passing information down a chain and the necessity for account providers to receive instructions in good time to enable them to notify the issuer will always mean that the ultimate account holder has less time than a registered shareholder to make a decision. Likewise, in relation to dividends, there may be transfers or dealings by the ultimate account holder between the record and payment dates, and it is not clear which intermediary in a chain should be responsible if payments made do not correctly reflect changing ownership rights. In relation to meetings, the issuer should need to have regard only to the registered holder, for example if both the registered holder and the ultimate account holder (or some intermediary) turn up to vote (a point which applies equally to meeting provisions in bond documentation). In this respect it is difficult to see how rights can always be "guaranteed".

14. Determination of applicable law

Q27: Would a Principle along the lines described above allow for a consistent conflict of laws regime? If not: Which part of the proposal causes practical difficulties that could be addressed better

We think it is important that both account provider and account holder have certainty as to governing law. Whilst a solution along the lines adopted by the Hague Securities Convention would perhaps have been preferable, it is recognised that this is not acceptable to a number of Member States. On this basis we consider that in principle the governing law should be the national law of the country where the relevant securities account is maintained by the account provider. However, the guidance in relation to where an account is "maintained" will require a number of matters to be taken into account. It will not always be easy to determine where a particular account is "maintained" from the specified list of matters. The consultation indicates that if the position is not clear the "default position" will be the branch which handles the relationship with the account holder in relation to the securities account. However, this will also require an analysis of various matters, many of which will be known to the account provider but not to the account holder. It will not be desirable to have any uncertainty or scope for tactical challenge in this respect, and in our view the account provider's determination in this respect should be conclusive. If there is any uncertainty in this respect we anticipate that legal opinions in relation to the choice of governing law in relevant contracts will need to be qualified, which will give rise to additional and undesirable uncertainty to the market.

15. Cross-border recognition of rights attached to securities

Q30: Would a general non-discrimination rule along the lines set out above be useful? Have you encountered problems regarding the cross-border exercise of rights attached to securities?

We agree. See also the answer to Q5 above.

16. Passing on information

Q32: Is the duty to pass on information adequately kept to the necessary minimum? Is it sufficient? If applicable, would there be any (positive or negative) repercussion of such a Principle on your business model? Please specify.

We agree that information to be passed on should be confined to what is "necessary" for the exercise of rights. However, account providers will need to be clear as to their obligations, and the meaning of the term "necessary" in this context warrants careful consideration, as does the legislative approach in setting it out - are broad guidelines appropriate, or should an exhaustive list-based approach be preferred?

In the case of information published or made available by the issuer itself it may not be difficult to identify what is "necessary", but that will not always be so straightforward when third party information is involved.

For example, is information in relation to a takeover offer launched by a third party for the issuer necessary for the exercise of any "rights" attaching to the securities if acceptance or approval of the offer does not involve a vote of shareholders of the issuer (as would be required if the takeover offer was being implemented by a scheme of arrangement of the issuer in the UK but not if it was being implemented by a contractual takeover offer made direct by a bidder to the issuer's shareholders).

Further, consideration needs to be given to potential conflict with restrictions on the passing on of information into certain jurisdictions or to classes of account holder, eg. under securities laws. For example, it is common for bidders to specify that information in respect of an offer for a target may not be forwarded into any jurisdictions if to do so would violate securities laws of that jurisdiction. It is however also envisaged that the duty of account holders to pass on information should not be subject to a contractual opt-out. In principle, it does not seem correct that an account holder should be under an obligation to pass on information which the recipient would not have been entitled to receive had it been the registered holder.

We also think it will be necessary to consider the extent and basis of liability of an account holder if it fails to comply with its obligation to pass on information.

We agree market standardisation will be important in this area.

17. Facilitation of the ultimate account holder's position

Q34: If you are an investor, do you think that a Principle along the lines described would make easier any cross-border exercise of rights attached to securities, provided that technical standardisation progresses simultaneously? If not, please explain why.

A system whereby the ultimate account holder is appointed as representative of the legal holder, and as such is able to be recognised by the issuer as the appropriate recipient of information and the appropriate person to exercise rights, is desirable in that it affords both (i) legal certainty to both issuer and ultimate account holder and (ii) more time to the ultimate account holder to exercise its rights (a material issue in time-sensitive contexts such as general meeting notice periods, and rights issue offer periods for example).

As currently envisaged, the proposals might put the ultimate account holder in a difficult position as regards the rest of the chain of account providers. In this regard, each account provider forming a "link" in the chain should have corresponding duties and obligations to facilitate the passing on of information and the flow of rights attaching to the securities. However, where the chain passes into third countries problems will clearly arise in this regard, as account providers in such jurisdictions may not be subject to commensurate obligations.

We are not clear what is contemplated by the "third method" specified on page 30 of the Consultation Document. To the extent this contradicts the basic principle under current UK company law that the issuer only needs to have regard to and deal with the registered holder of its securities (for example a

requirement to issue a certificate confirming or evidencing an ultimate account holder's holding), we do not agree.

22. Glossary

Q43: Do the terms used in this glossary facilitate the understanding of the further envisaged Principles? If no, please explain why.

We are concerned that, as currently envisaged, the terms used in the glossary are extremely wide. For example, the concept of who is an account provider or ultimate account holder is crucial but unclear. We do not consider it is either necessary or appropriate to require all account providers to be authorised for investment business in accordance with MiFID, nor that all account providers are properly considered to be providing an investment service. As drafted, we consider these definitions could have unexpected consequences, as could the definition of "securities" would catch some derivatives and fund units. In the definition of "securities" the words "which are capable of being credited to a securities account" are unclear. For example, on exchange traded derivatives are in most cases "held" on a principal to principal basis through a chain of back to back contracts flowing from central counterparty, through clearing members, their clients and their clients. It is not clear whether these instruments are "capable of being credited to a securities account". Given that such contracts involve liabilities as well as rights and the underlying subject matter of those contracts will cover not only shares and bonds but also commodities, interest rates, currency rates, etc, we do not think that it would be appropriate for such financial instruments to be included within the ambit of the rules. We note that the Unidroit Convention on Substantive Rules for Intermediated Securities (the Geneva Securities Convention) defines securities as being any "shares, bonds or other financial instruments or other financial assets (other than cash) which are capable of being credited to a securities account *and of being acquired and disposed of in accordance with the provisions of this Convention*" [Emphasis added]. This wording makes clear that securities should be fungible (and securities which carry liabilities will not be fully fungible). We also think it sensible to avoid a prescribed list of securities to which the Directive would apply, so as to allow for the evolution of market practice and the creation of new types of securities.

THE CITY OF LONDON LAW SOCIETY

COMPANY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

William Underhill (Slaughter and May) (Chairman)
Robert Boyle (Macfarlanes LLP)
Richard Brown (Hogan Lovells LLP)
Mark Curtis (Simmons & Simmons)
Lucy Fergusson (Linklaters LLP)
Simon Griffiths(Addleshaw Goddard LLP)
Michael Hatchard (Skadden Arps Slate Meagher & Flom (UK) LLP)
Nicholas Holmes (Ashurst LLP)
Simon Jay (Cleary Gottleib Steen & Hamilton LLP)
Eileen Kelliher (Allen & Overy LLP)
Vanessa Knapp (Freshfields Bruckhaus Deringer LLP)
James. Palmer (Herbert Smith LLP)
Christopher Pearson (Norton Rose LLP)
David Pudge (Clifford Chance LLP)
Richard Spedding (Travers Smith LLP)
Patrick Speller (Nabarro LLP)
Keith Stella (Berwin Leighton Paisner LLP)
Martin Webster (Pinsent Masons LLP)
Victoria Younghusband (SJ Berwin LLP)
Tom Carey (Slaughter and May) (Secretary)

Other individuals who assisted with this submission:

Pauline Ashall (CLLS Regulatory Law Committee)