



Financial Markets Law Committee (“FMLC”)

Securities Markets Scoping Forum

Date: Wednesday 3 June 2020

Time: 2.00pm to 3.00pm

Virtual meeting

In Attendance:

James Warbey (Moderator)

Carter Brod

Cat Dankos

Leland Goss

Mindy Hauman

Tim Morris

Christina Tarnanidou

Catherine Wade

Milbank LLP

Morgan Lewis & Bockius UK LLP

Herbert Smith Freehills LLP

International Capital Market Association

White & Case LLP

Ashurst LLP

Athens University of Economics and Business

Linklaters LLP

Venessa Parekh

Chhavi Sinha

Katja Trela-Larsen

FMLC Secretariat

FMLC Secretariat

FMLC Secretariat

Guest Speakers:

Dorothy Livingston

Alkaios Sivitanidis

Herbert Smith Freehills LLP

University of Athens

Registered Charity Number: 1164902.

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Minutes:

1. Introductions

1.1. Mr Warbey opened the meeting. Attendees introduced themselves.

2. Linking in with the FMLC (Venessa Parekh)¹

2.1. Ms. Parekh provided an overview of a few non-pecuniary ways in which Forum members, or their institutions, could contribute to the work of the FMLC. These include contributing to research, hosting meetings and events and seconding lawyers to the Secretariat.

3. Securities held through intermediaries in the global context—uncertainty regarding the applicable law (Alkaios Sivitanidis)

3.1 Dr Sivitanidis provided an overview of the intermediation of securities. He noted that in respect of securities held through intermediaries there is uncertainty around the applicable law and this issue has remained controversial for more than twenty years. Traditionally, securities were held directly by the investor who acquired the paper certificate (bearer securities) and was recorded at the issuer's security registry (registered securities). Here the investor could directly exercise any rights deriving from the securities against the issuer. He noted that more recently, there has been a shift from traditional direct holding to modern indirect holding structures. In the indirect holding structures, the securities are dematerialised at a Central Securities Depositories ("CSD") and are held by the intermediaries. The modern indirect securities holding structures are multi-tiered, comprising of CSDs, first tier intermediaries, second/third tier intermediaries and the ultimate investor. Dr Sivitanidis pointed that, in case of the indirect securities holding structures, the rights of the investor or any other third party are recorded to the books of the immediate upper intermediary only. He further explained that the rights of the investor and how these intermediated securities are validly transferred or pledged vary from jurisdiction to jurisdiction. He noted that in some jurisdictions it is a mere contractual right: i.e., a personal claim against the intermediary, whereas in other jurisdictions it is a traditional direct securities right despite intermediation. Most legal systems provide a new category of indirect securities rights which is based on the principal that the investor acquires something more than a personal claim like beneficial ownership, securities entitlements and co-ownership on the rights of the intermediary that relate to interest in securities.

¹ Please see Appendix I below

- 3.2 Dr Sivitanidis noted that cross-border indirect securities holding structures requires ascertaining the applicable law for the holding, transfer and pledge of the intermediated securities. He further stressed that determining the applicable law in the context of cross-border indirect holding is critical for legal certainty and predictability and therefore, there is a need for a universally accepted conflicts of rule that provides the applicable law in this regard. Furthermore, he referred to the Convention on the law applicable to certain rights in respect of securities held with an intermediary (“**Hague Securities Convention**”)² that permits limited choice of law and stipulates fall-back conflicts rules (law of the place of intermediary). Dr Sivitanidis noted that E.U. declined to ratify the Hague Securities Convention but has not addressed the issue completely in any other legislation. In limited instances, E.U. law applies the law of the place of account in this context.
- 3.3 Dr Sivitanidis stressed that the issue to be discussed with regards the conflicts of law rule is the indirect securities right in the modern securities holding structures. These indirect securities rights are rights *in rem* on another person’s (the intermediary’s) rights—the ‘center of gravity’ of these rights is close to the intermediary; and therefore, the applicable law should be provided by an intermediary-oriented conflicts rule. Dr Sivitanidis emphasized that the direct securities rights should fall outside the scope of the conflicts rule in question with an exception to semi-indirect holding systems that allocate direct (rather than indirect) securities rights to the investors, despite the intermediation. In light of this argument, he suggested that the criterion should be the direct or indirect nature of the securities rights in question rather than the direct or indirect holding structure. He further raised a concern that this position is not entirely clear under the Hague Securities Convention; as both semi- and fully-indirect holding systems may be subject to the same conflicts rule. The reason is that as direct securities rights are the rights that can be exercised directly against the issuer, it is critically important to be governed by issuer-oriented conflicts rules. In this regard, a distinction can be adopted, i.e, for direct securities rights, one might adopt issuer-oriented conflicts rules and, for indirect securities rights, intermediary-oriented conflicts rules might be more appropriate. Indirect securities rights become relevant mainly at the unfortunate event of the insolvency of the intermediary.
- 3.4 Dr Sivitanidis suggested several appropriate connecting factors that should be considered while determining the applicable law, these among other things include law of

² 36: Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary, available at: <https://www.hcch.net/en/instruments/conventions/full-text/?cid=72>

incorporation of intermediary, one single law to govern all indirect securities rights of the same intermediary and easily ascertainable by third parties.

- 3.5 Members discussed different approaches followed by countries with regards to the applicability of modern securities law. A member pointed out that the modern securities legislation in Greece has introduced a property rights approach to securities law, following on from the German law approach. She further noted that for the direct holding system, the applicable law is based on the *lex situs* doctrine. Members observed that the Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (“**the Central Securities Depositories Regulation**” or “**CSDR**”) addresses this issue. A member asked if under Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (“**the Shareholders Directive II**”) there can be a holder other than the local national registry/registrar. Members agreed that there can be.

4. **Law Commission Consultation on Intermediated Securities (Dorothy Livingston)**

- 4.1. Ms Livingston gave a brief overview of the structure of intermediation for equity and debt securities. She explained that English law understands the intermediary chain as a series of trusts and each level in chain down to ultimate investor has a beneficial interest in the securities. She further explained that for equities only those with direct relationship with CREST/Corporate Registrar level have a legal interest. For bonds the legal interest lies at level of custodian of the global bond (an investor cannot be a legal owner).
- 4.2. Ms Livingston highlighted that the “no look-through” principle, applied in English law (and in most other legal systems), prevents ultimate investors or intermediated level holders asserting property or other claims at higher levels in chain or against the issuer in most circumstances. As a result, a dispute at any level of the chain can be resolved without involving parties at other levels.
- 4.3. Ms Livingston stated that Law Commission had published a Consultation on intermediated securities in August 2019.³ She explained that the Consultation questioned

³ U.K. Law Commission, *Intermediated securities Call for evidence* (August 2019) available at: https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2019/08/6.5925_LC_Intermediated-securities-call-for-evidence-web.pdf

the value of the “no look-through” principle and appeared to reflect concerns of small “active” shareholders about exercise of voting and other rights against the issuer. She noted the Consultation predates the judgment in *SL Claimants v Tesco Plc* in which the court held that ultimate investors could be entitled to compensation from the issuer under Section 90A and Schedule 10 of the Financial Services and Markets Act 2000 (“**FSMA**”), as holders of interests in securities.⁴ Agreeing with the judgment, Ms Livingston noted that a claimant cannot be awarded damages unless they have actually suffered them and intermediaries do not suffer loss as they have bare beneficial interest.

- 4.4. Ms Livingston outlined the response submitted by the City of London Law Society (“**CLLS**”) to the Law Commission Consultation. She explained that CLLS highlighted in its response the importance of the “no look through” principle as essential to the international securities markets as the principle is aligned with privity of contract and international best practice. According to CLLS, the “no look through” principle is not an obstacle to ultimate investors exercising voting rights where there is good practice and effective regulation and it does not prevent investors from having appropriate direct rights where they suffer economic loss.
- 4.5. Ms Livingston explained that there are measures to assist ultimate investors such as: education, including how to shorten chain for voting instructions for active investors; development and enforcement of rules on passing on notices of meetings and voting instructions, as well as on feedback on execution, including review of regulatory sanctions; review of where statutory rights against issuer may be appropriate—where they suffer economic loss from issuer action and intermediated chain does not; and extension of innocent purchaser/transferee protection to transfers of intermediated securities.
- 4.6. Ms Livingston stated that questions around the insolvency of intermediaries remain unresolved and the enforcement of separate rules in this context would improve the prospects of full recovery by investors, consistent with existing property rights.
- 4.7. Members discussed whether there are any issues of legal uncertainty. Ms Livingston explained that this is more of a policy issue. She noted that the Law Commission can clarify this position in three ways: 1) by stating what the law is in their view, which is arguably what it has done with regards the validity of electronic signatures; 2) by writing a report for the government without necessarily proposing legislation; or 3) by proposing legislation for the government to adopt. Ms Livingston noted that it’s not entirely clear what the Law Commission would do here but as this issue will impact several aspects of

⁴ [2019] EWHC 2858 (Ch)

English law, it is more likely to be a set of recommendation with a set of statutory provisions.

5. Any other business

5.1. No further business was raised at the meeting.