DEUTSCHES AKTIENINSTITUT

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Response to the 10th Discussion Paper of the Services of the Directorate-General Internal market and Services regarding a “Legislation on Legal Certainty of Securities Holdings and Dispositions”

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Introduction

Deutsches Aktieninstitut and GDV welcome the opportunity to comment on the 10th Discussion Paper of the Services of the Directorate-General Internal market and Services regarding a “Legislation on Legal Certainty of Securities Holding and Dispositions”.

We followed the process regarding the above mentioned legislation very closely and stressed – among other points – the importance of the principle “no credit without debit” which provides a high level of investor protection. This principle excludes any inflation of securities and addresses efficiently the problem described in the discussion paper of “who owns what”. At the same time, in the case of insolvency, securities held in safekeeping by the account provider for third-party account are effectively protected against any seizure by creditors through segregation. The high protection level of the approach based on property law should not be reduced by harmonized legal provisions on securities holding. Therefore, the aspects mentioned in the discussion paper should carefully take into account the principle “no credit without debit”.

Furthermore, it is also important to carefully separate between corporate law and securities law. Corporate law deals with the relationship between the issuer of the security and the end investor (who invests in the security on his own account and who bears the risk of the investment). The criterions for this are the rights and obligations involved in the beneficial ownership of securities. On the contrast, securities law refers exclusively to the relationship between the account holder and the account provider. The legal position resulting from corporate law should not be adversely affected by the immobilisation of securities to the detriment of the end investor. Therefore, it should always be ensured that the national corporate law prevails over the rules of securities law.

Finally, any systemic risk issues should primarily be addressed through supervisory law. Any such considerations in the field of securities law should be limited to exceptional cases.

Answers to the questionnaire

Question 1: Have Member States' experts identified the same developing issues around collateral?

Question 2: Do member States' experts consider that securities should be treated as "property" and not as "claims" akin to money?

For financing needs most of our members are not dependent on the market for repurchase operations and securities lending transactions to satisfy its funding needs. Where transactions of this kind are carried out, they are made in the context of its investment activities. Therefore, the primary focus is on legal certainty; the investor must be sure of the extent of the rights that he has acquired on the securities and he must be able to exercise the rights flowing from the securities. These goals are best achieved by treating securities as property and a strict adoption of the principle "no credit without debit". However, the concept of property law may be replaced by a more flexible approach which delivers the same degree of legal certainty, even in case of losses or insolvencies.

Question 3: Do Member States' experts agree with the analysis and implication set out above of the highlighted failures?

Rehypothecation or re-use of assets create systemic risk because it makes all transactions vulnerable to infection. A greater transparency of ownership and account structures help to raise market participants' awareness to these connections, but it does not offer a protection against that risk. Systemic risk issues should be regulated by supervisory law, not through securities law provisions. Furthermore, re-use of assets should be strictly linked to the permission of the initial owner of the securities.

Question 4: Do Member States' experts consider that the SLL needs to take account of the financial stability and client asset protection problems caused by the complexity and opacity of these funding models?

Securities law matters should be distinguished from client asset protection issues. A clarification of security law aspects in order to increase transparency is certainly helpful. However, the systemic risk resulting from complex funding models cannot be controlled by harmonisation of securities law but requires a specific regulation of such funding transactions.

Question 5: Do Member States' experts agree that the SLL might need to address these Shadow Banking issues?

Risks relating to shadow banking are not primarily a matter of securities law. In this regard, during the consultation of the European Commission on shadow banking we have pointed out that the definition of shadow banking covering all credit activities outside the regular banking sector is far beyond what is necessary.

Moreover, the requirement to post initial margin on a gross basis as well as a prohibition of reusing assets is not so much a matter of securities law but should be addressed in the context of regulating the respective transactions, e. g. derivative transactions.

Question 6: Do Member States' experts consider that there is a need to address "who owns what" in response to the significant challenges that have been identified?

Yes. From an institutional investor's perspective, it is key to have a clear picture about the rights that one has acquired on the securities and the rights which can be exercised. The principle "who owns what" is also a prerequisite for the dialogue between the issuer and its investors (shareholders) and of utmost importance for a successful investor-relations-policy.

Question 7: What are Member States experts' view on these options?

Rehypothecation increases the economic risk for the client because it replaces the client's ownership right by a contractual right to return equivalent securities. Therefore, it is important that the client knows whether rehypothecation is permitted and whether its assets are actually rehypthecated. The strict application of the "no credit without debit"-principle achieves this goal. We would therefore prefer the option described in #64, assuming that a general consent of the client regarding re-hypothecations is required.

Question 8: What are Member States experts' view on these options to increase client protection?

In the interest of transparency, the requirements for the granting of a client consent to re-use or re-hypothecation of securities should be harmonized. If re-hypothecation is intended to protect the account provider against its client's insolvency, then it would be appropriate to connect the volume of permitted hypothecation to the net debt of such client owed to its broker. The introduction of a time limit for rehypothecation transactions is not helpful because it could easily be circumvented.

Question 9: What are Member States experts' views on these five possible solutions?

In order to preserve the integrity of the issue, it is important that any use of investor's assets by account providers for re-hypothecation purposes is made transparent to the investor through a corresponding debiting or earmarking of the client's account. The proposed measures in #82 - #84 of the discussion paper increase transparency for the client and, therefore, are supported.

We also share the concerns brought forward by the EU-Commission regarding omnibus accounts which make it difficult to identify the owner of

the security. Therefore, segregated accounts address far better the above mentioned “who owns what”.

Question 10: Do member States’ experts consider that a conflict-of-law solution may be capable of answering the question “who owns what” uniformly throughout the EU?

Question 11: What are Member States experts’ views on harmonising the concept of ownership for account-held securities across Europe so that there is only one owner?

The conflict-of-law concept is only one condition for answering the question of “who owns what” in the EU. In addition, it is necessary take into account additional requirements, including the “no-debit-without credit” rule and the respect of corporate law requirements prevailing over securities law. A harmonized concept for the determination of ownership in respect of account-held securities requires that

(i) the relevant entry is made in the account that is maintained in the name of the ultimate client;

(ii) an irrevocable entry into that account is only permitted once the bank has obtained a corresponding coverage

(iii) the place of entry mentioned under (i) above determines the applicable law.

Berlin, 14th November 2012