

# **DEMATERIALIZATION IN EUROPE**

**By Frédéric Nizard and Hubert de Vauplane  
BNP Paribas**

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## DEMATERIALISATION QUESTIONNAIRE

	ENGLAND	FRANCE	GERMANY
<p><b>A. Holding system</b> How are debt securities held ?</p>	<ul style="list-style-type: none"> <li>- Where Crest is used, investors (or their nominees) are recorded on the issuer's registers (<i>direct holding system</i>)</li> <li>- Where Crest is not used, investors are recorded on the books of financial intermediaries (<i>indirect holding system</i>)</li> <li>- Investors are not in possession of bearer bonds</li> </ul>	<p>Securities issued in France by French issuers can either be <i>nominatif</i> or <i>au porteur</i> (Article 94-II of Law n° 81-1160 of 30 December 1981 [now Article L. 211-4 du Code Monétaire et Financier] and Article 1 of Decree n° 83-359 of 2 May 1983). This terminology is misleading, as strictly speaking, the so called <i>au porteur</i> securities (which means <i>bearer</i> instruments) are no longer bearer instruments ! Investors are not in possession of bearer bonds. Now the difference between the so called <i>au porteur</i> securities and <i>nominatif</i> securities is that <i>au porteur</i> securities are recorded on the books of financial intermediaries (and not on the books of the issuer, therefore the issuer does not know who holds its securities [<i>indirect holding system</i>]), whereas <i>nominatif</i> securities are recorded on the books of the issuer (<i>direct holding system</i>).</p> <p>The so called <i>au porteur</i> securities (<i>indirect holding system</i>) constitute the great majority of securities issued in France by French issuers.</p>	<ul style="list-style-type: none"> <li>- Only debt securities issued by the Federal Republic, <i>States</i> and the ECB are recorded on the issuers' registers (<i>direct holding system</i>)</li> <li>- In other issues, investors can be in possession of physical bearer certificates (but it is not frequent) or recorded on the books of financial intermediaries (<i>indirect holding system</i>).</li> </ul> <p>The indirect holding system is the most common system. But, investors have direct co-ownership of the securities held in this indirect system.</p>

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<p><b>B. Transfer</b> How does title pass from the transferor to the transferee ?</p>	<p>By entry on the register kept by the issuer or by entry in an account with an intermediary</p>	<p>French law provides a specific regulation for listed securities. There are discrepancies in the law since, for example, Art. 47 bis of law n° 83-1 of 3 January 1983 Article L.431-2 du Code Monétaire et Financier provides in its first § that title passes upon book-entry in the account with the investor's intermediary. Second § provides that if the account of the intermediary with the CDS is not credited, the investor has no right!. Title only passes when there is a book-entry in the books of the intermediary <b>and</b> a book-entry in the books of Euroclear France.</p>	<p>By entry in an account with an intermediary or by delivery of a certificate or by entry on the register kept by the issuer. Entry in an account with an intermediary is most common.</p> <p><i>Account status shown by a print-out produced by the immediate intermediary evidences title, if the intermediary is in turn recorded as a holder, directly or indirectly, with the CDS,</i></p>
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<p>Does the buyer (or pledgee) acquire debt securities free from any defects of title that the seller or any other prior holder may have ?</p>	<p>Yes</p>	<p>As far as <i>nominatif</i> securities are concerned, a bona fide acquirer for value without notice <b>does not</b> acquire his securities free from defects of title (see Cass. Req., 17 December 1873, S., 1874, 1, 409; Cass. com., 24 January 1989, <i>Bull. IV</i>, n° 39, <i>Nortène</i>, Tribunal de commerce de Paris, 12 June 1995, not published). It is unclear whether such a</p>	<p><i>Yes, provided the buyer acts in good faith</i></p>

		dangerous solution would apply to <i>au porteur securities.</i>	
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<p><b>C. Fully dematerialised system or partially dematerialised system</b>  Can investors call for the delivery of certificates kept in the vault of the CDS ?</p>	<p>No (unless it is provided for in the securities issue)</p>	<p>No. The French system is a fully dematerialised system. Securities issued in France by French issuers are evidenced only by book-entries: there are no certificated securities. This has been imposed by law n° 81-1160 of 30 December 1981, which became effective on 3 November 1984. Yet, this is only true for securities issued in France by French issuers (whether <i>au porteur</i> or <i>nominatif</i> securities). Thus, securities issued outside France or issued by foreign issuers can be certificated.</p>	
<p>In your legal system, are there fully dematerialised securities which can only be evidenced by book-entry in an account ?</p>	<p>No. But it is thought that there is no legal impediment to the existence of fully dematerialised debt securities (see FLP's Operation Machete)</p>	<p>The French system is a fully dematerialised system since November 1984</p>	

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<p><b>D. Fungible or non-fungible accounts</b> Are the customers accounts with their intermediaries and the intermediaries accounts with the CDS</p> <p>(a) Fungible accounts ?</p> <p>(b) Non fungible segregated accounts ?</p>	<p>Usually</p> <p>Possibly</p>	<p>Usually</p> <p>Possibly</p>	<p><i>Securities booked in accounts of customers held with the immediate intermediary (bank accounts) are separately indentified; no identification is made in relation between intermediary and CSD</i></p>
<p><b>E. Nature of the investor's interest</b> How is the investor's interest characterised ?</p> <p>(a) as a right <i>in personam</i> against the issuer ?</p>	<p>The question is subject of huge debate</p> <p>The most commonly advocated views seems to be: <b>yes</b></p>	<p>The question is subject of huge debate</p> <p>The most commonly advocated views seems to be: <b>yes</b></p> <p>The most commonly advocated</p>	<p>The investor's interest is characterised as a right <i>in personam</i> against the issuer and as a right <i>in rem</i> over the securities.</p>

<p>(b) as a right <i>in personam</i> against the intermediary</p>	<p>The most commonly advocated views seems to be: <b>no</b>. The investor's claim against intermediaries would be <i>in rem</i></p>	<p>views seems to be: <b>no</b>. The investor's claim against intermediaries would be <i>in rem</i>  Yet, one can argue that since certificates no longer exist and since investors' rights are only evidenced by book-entries in fungible accounts, investors no longer have a property right. It can be argued that investors have a right <i>in personam</i> which is specifically protected should their intermediary become insolvent. French law does not say that investors own such and such securities that can be traced. It only protects investors against claims of the intermediary's creditors. This may not be sufficient to characterise investors' rights as rights <i>in rem</i> over specific securities. It is interesting to see that in New York, Article 8 of the NYUCC does not say that investors have rights <i>in rem</i> over specific securities (in the indirect holding system) but a security entitlement against their intermediaries. And a right against someone is a right <i>in personam</i>.</p>	
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<p><b>F. Control of intermediaries</b></p> <p>(a) who are the «watchdogs» which control intermediaries ?</p>	<p>For the time being, the «watchdogs» are the Securities and Futures Authority (SFA) and the Investment Management Regulatory Organisation limited (IMRO). Under the Financial Services and Markets Act 2000, their regulatory functions will be transferred to the Financial Services Authority</p>	<p>The <i>Conseil des Marchés Financiers</i> (CMF) and the <i>Commission Bancaire</i> monitor and control intermediaries.</p>	<p><i>Bundesaufsichtsamt für das Kreditwesen, annual audit executed by public accountants on behalf of the BAKred</i></p>
<p>(b) how do they control intermediaries ?</p>	<p>Those organisations issue their own rules and regulations with which their members must comply. They monitor compliance through inspections and reviewing reports submitted by their members. They have additional powers of investigation, intervention, discipline and prosecution</p>	<p>The CMF issues its own rules and regulations with which intermediaries must comply ; the <i>Commission Bancaire</i> does not have such a power. Yet, both the CMF and the <i>Commission Bancaire</i> monitor compliance through inspections. The powers of control of the CMF and the <i>Commission Bancaire</i> sometimes overlap. Their control is now more efficient than it used to be, but it could be more comprehensive (especially as far as commingling and segregation are concerned).</p>	<p><i>Regulation concerning the annual audit and interim reports of financial institutions (Prüfberichtsverordnung vom 12. Dezember 1998)</i></p>



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<p><b>G. Insolvency of an intermediary</b> Should an intermediary become insolvent, are there specific rules which protect the interests of the customers who hold an account with the intermediary? In other words, do the intermediary's securities holdings corresponding to customer claims satisfy these claims before they satisfy the claims of general creditors?</p>	Yes, as long as there is proper segregation	Yes, as long as there is proper segregation. The rule is provided by Article L. 431-6 du Code Monétaire et Financier)	Yes, as long as there is proper segregation. The rule is provided by the <i>Securities Custody Act (Depotgesetz)</i>