



- Chairman -

Philipp Paech  
Unidroit  
via Panisperna, 28  
I-00148 Rome  
Italy

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Contact person: Mr. Klaus Löber  
Tel.: +49 69 1344 7225  
E-mail: secretariat@efmlg.org

Dear Mr Paech,

**The Position Paper of August 2003 of the Unidroit Study Group on harmonised substantive rules regarding indirectly held securities**

On behalf of the members of the European Financial Markets Lawyers Group (EFMLG), I would like to thank you for your kind letter of 11 August 2003 regarding the publication of the EFMLG report on the harmonisation of the legal framework for rights evidenced by book-entries in the European Union (EU). Indeed, as you rightly stress in this letter, considering the rapid movement of developments in the area of the international securities markets, it is of predominant importance for all institutions that are actively seeking to promote a modernisation and harmonisation of the underlying legal framework for cross-border transactions involving financial instruments to liaise and share experiences. Only in doing so, the efforts can be focused and consistency as regards the ensuing proposals can be safeguarded.

Traditionally, the EFMLG has paid great attention to legal issues related to transactions in securities with a particular focus on developments in the European Union. Since the EFMLG was established in 1999, there have been a number of significant and highly welcome legislative developments affecting the EU securities markets. These include the implementation of the

Settlement Finality Directive and the adoption of the Collateral Directive, which was actively demanded for and supported by the work of the EFMLG. Although these Directives mark a very important step towards a fully integrated single market for financial services in the EU, such market is not yet a reality for the cross-border circulation of financial instruments within the EU. In particular, the absence of a harmonised legal regime governing the holding and transfer of financial instruments in the EU still gives rise to distortions. As a consequence, further work in that area is currently being considered at a Community level (the Securities Account Certainty Project).

For these reasons, since 2002, the EFMLG has observed with great interest the on-going activities of the Study Group as regards harmonised substantive rules regarding indirectly held securities. The EFMLG regards the effectiveness of book-entry transfers, finality of transfers made by book-entry debits and credits as crucial to reduce uncertainty and systemic risk. The publication of the Position Paper of August 2002 is clearly a major step forward in identifying the issues at stake and in shaping the further discussions as regards harmonisation efforts. We welcome the activities undertaken by the Study Group and are happy to provide you below with the EFMLG's ideas on this subject.

We note that the Project Paper makes reference to on-going international initiatives in this field, in particular the G 30 plan of action, the Giovannini Report (and the related EFMLG report) and the IOSCO recommendations for securities settlement systems. These initiatives jointly identify the need for a reliable and smoothly functioning legal framework in the area of the cross-border holding and the transfer of securities. The EFMLG considers that such reform is not only desirable to strengthen the internal market for financial instruments, but is technically feasible as well.

The Position Paper acknowledges the substantial work already done in the context of the EU Collateral and Settlement Finality Directives as regards (cross-border) dispositions of securities as collateral. Given the rich discussions and background materials that led to the adoption of these legal acts, we are certain that the Study Group can draw on the preparatory work and the solutions found in the European context (affecting the soon 25 Member States plus the EEA countries).

With regard to the legal framework for book-entry securities, you are of course aware that the EFMLG strongly recommends to harmonise the legal regime governing the holding and transfer

of financial instruments by way of book-entries, supported by a system of statutory dematerialisation. In the view of the EFMLG, a statutory dematerialised holding regime based on book-entries, allowing for transfers of financial instruments under terms harmonised to a sufficient extent so that their differences do no longer constitute barriers to cross-border trading, would be instrumental to take full advantage of the huge advances in computer technology.

In the EFMLG's opinion, as further set out in the EFMLG report<sup>1</sup>, such legal regime for the holding and transfer of financial instruments by way of book-entries would need to focus on a number of key principles to balance the conflicting interests of investors and intermediaries. It should establish the conditions for transfers and cross-border movements of financial instruments, as well as foster legal certainty and protection for investors when acquiring or transferring their rights in respect of financial instruments.

The effects of book-entries in securities accounts would need to have certain harmonised characteristics. In particular, a high degree of harmonisation is required for the exact nature and extent of an investor's right as evidenced by a book-entry (which, in the view of the EFMLG should be based on ownership principles), the protection of investors' rights to the maximum extent possible, even in the case of insolvency of the intermediary, the full tradability of rights in securities as evidenced by book-entries, including the protection of acquirers in good faith, and the safeguarding of the safety of a system of holdings of securities by book-entries by double-entry bookkeeping and clear rules for movements of securities on accounts.

In the opinion of the EFMLG, any proposed reform should not affect prudential rules for participants' conduct of business in the securities markets. Furthermore, it should not advocate a specific infrastructure for the securities markets. An harmonisation of rules should be pursued to the extent that they are necessary to reduce legal or systemic risk or to promote market efficiency. It should be safeguarded that the project continues working on a functional approach.

At its October 2002 meeting, the EFMLG agreed to continue to follow closely the further progress of the Unidroit project and to offer our support and co-operation, if deemed useful by the Study Group.

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<sup>1</sup> See the EFMLG's website [www.efmlg.org](http://www.efmlg.org)

We look forward to hearing further on these issues and the EFMLG stands ready to follow as appropriate the work of the Unidroit Study Group.

Yours sincerely,

[signed]

Antonio Sáinz de Vicuña