Consultation document of the Services of the Directorate-
General Internal Market and Services

INFORMATION ON THE RESPONDENT

A) Name and address of the respondent

Comisión Nacional del Mercado de Valores (CNMV)
Serrano, 47
28001 Madrid
Spain

B) Field of activity of the respondent

The Comisión Nacional del Mercado de Valores (CNMV) is the competent authority in charge of the surveillance of the Spanish Securities Markets and the activities of all the participants in those markets.

Question 1: The far greatest part of securities are held and administered through securities accounts maintained by an account provider (e.g., a bank, a broker, a custodian or similar). What is your estimate regarding the percentage of securities which are not held through a securities account?

In accordance with Spanish legislation securities traded on a Spanish regulated market must be represented by book entry. Furthermore, the securities of foreign issuers which are traded on Spanish regulated markets must be included in the Spanish registration system. To this end, in accordance with Spanish legislation, it is not necessary that the foreign issuer modifies the system of representation of securities, and therefore it is indifferent whether they remain incorporated in certificates or dematerialised in accordance with the respective legislation of origin. However, the sum of balances of accounts of the said foreign securities in the central Spanish depository (IBERCLEAR) must coincide at all times with those which, subject to the Spanish market, a foreign entity authorised for these purposes holds on deposit or registered.

Question 2: Do you assume that the application of the legal framework for acquisition or disposition of book-entry securities, including the

creation of collateral interest, is more complex as soon as there are cross-jurisdictional elements to be taken into account? [Yes, considerably more complex/Yes, slightly more complex/No/I don't know. Please specify and make a distinction between operations occurring inside and outside a securities settlement system, if possible.]

Yes, considerably more complex. If "*securities settlement system*" means the Spanish registration system of book entry securities, it is necessary to distinguish two different situations:
a) Firstly, book entry securities in the Spanish registration system. Spanish law on book entry securities is based on recognition of a securities register, where they legally enter 2into trade and are transferred by means of credits and debits in the accounts of the financial entities specially authorised to participate in this registration function.
The Spanish book entry securities registration system can be described as a system of direct holding, since according to Section 11 of the Securities Market Act (*Ley delMercado de Valores*), *the person who appears entitled in the book entries will be presumed to be the lawful holder and consequently may require the issuer to provide the benefits in favour thereof to which the security represented by book entry grants entitlement.*
In accordance with Spanish legislation, title to book entry securities is of the nature of a right *in rem* and the principles on which the register is based are as follows:
- The transfer of book entry securities takes place by accounting transfer. Registration
of the transfer in favour of the acquirer will produce the same effects as transfer of possession (*traditio*) of certificates. Furthermore, the transfer can be enforced as against third parties from the time when the entry has been made.
- The creation of limited rights *in rem* or other type of encumbrances over securities represented by book entry must be registered in the corresponding account. Registration of a pledge is equivalent to transfer of possession of certificate. Furthermore, creation of the encumbrance can be enforced against third parties from the time when the corresponding entry has been made.
- Registry legitimization. In accordance with this principle, the person who is shown as legitimated in the book entry will be presumed to be the lawful owner and consequently may require the issuer to provide the benefits in his favour to which the security represented by book entry grants entitlement. Furthermore, the issuer who provides the benefit in favour of the person shown as legitimated, acting in good faith and without serious fault, will be exonerated even if the latter is not the owner of the security.

- Principle of priority and chain of title. In accordance with the principle of priority, after any registration is made no other may be made in respect of the same securities which result from an event occurring previously insofar as it is inconsistent or incompatible with the former. Furthermore, the act which first accesses the register will have priority over those which access subsequently, and the entity responsible for maintaining the register must implement the corresponding transactions in accordance with the order of presentation.
In accordance with the principle of chain of title, in order to register the transfer of securities the prior registration thereof in the register in favour of the transferor will be necessary. Furthermore, registration of the creation, modification or extinction of rights *in rem* over registered securities will require their prior registration in favour of the disposing person.
- Rectification of entries. The financial institution responsible for the register may only rectify inaccurate entries pursuant to a judicial decision, except in the case of purely material or arithmetic errors which result from the register itself or from a simple comparison against the document pursuant to which the entry has been made.
- Exercise of financial rights. The right to receive interest, dividends and any others of a financial content must be exercised through the entities in whose records the securities are registered or with their assistance.
- Liabilities. Failure to make the corresponding entries, inaccuracies and delays therein and infringement in general of the rules laid down for maintaining registers will give rise to liability of the entity in breach or, as the case may be, of the central securities depository (IBERCLEAR), in relation to those who are prejudiced, in the absence of exclusive fault of the latter. As previously indicated, foreign securities which are traded on Spanish regulated markets are incorporated in the Spanish registration system independently of the manner in which they are represented in accordance with their law of origin. Consequently, transactions in these securities carried out on Spanish regulated markets and registered in Spain enjoy the legal regime referred to.
b) Book entry securities not subject to the Spanish registration system:
There are other securities which, without being subject to the registration system described, are entered in the securities accounts of the financial entities which act as depositories, and which are not considered to be included in the Spanish registration system. In these cases Spanish law does not recognise these securities as part of the registration system which was explained previously, and therefore their registration will basically be governed by the contractual relationship which exists between the holder of the securities and the financial intermediary, independently of the original system of representation of the securities.
In short, the legal regime of securities recorded in a securities account subject to Spanish law differs substantially depending on whether the said

securities are incorporated or not in the Spanish registration system, since greater guarantees are given to securities which are incorporated in the register.

Question 3: Do you think that harmonisation of the law of holding and disposition of book-entry securities should be done by way of minimum harmonisation, i.e. that in general, Member States' law shall continue to define the general legal characterisation of book-entry securities, whereas certain characteristics of book-entry securities are harmonised? [Yes/No/I don't know; please specify]

The harmonisation of regulation of holding and disposition of book entry securities between different Member States is a complex question, since it affects fundamental aspects of the system of each State such as property law, company law, supervision of financial activities, etc. A harmonisation via the route of legal effects must take place in any event without altering the basic institutions of each legal system and provide equivalent solutions to the problems raised in each jurisdiction.

Question 4: Do you think that book-entry securities should confer upon the account holder the following minimum rights [Yes/No/I don't know, please specify and indicate whether additional elements should be harmonised]:
(a) the right to exercise and receive the rights attached to the securities, as far as the account holder itself is identified by the issuer law as the person entitled to these rights;
(b) the right to instruct the account provider to dispose of the securities;
(c) the right to instruct the account provider to arrange for holding the securities with another account provider or otherwise than with an account provider, as far as the applicable law allows holding otherwise than with an account provider.

Yes, although the problem does not consist so much of establishing a minimum content of rights of the book entry account holder, but how these rights are enforced against the issuer of the securities, given the chain of financial intermediaries involved in indirect securities holding structures in the cross-border field.

Question 5: Do you think that a fix set of methods for acquisition and disposition of book-entry securities (crediting an account; debiting an account; earmarking book-entry securities in an account, or earmarking a securities account; removing of such earmarking; concluding a control agreement; concluding an agreement with and in favour of an account provider) should be available to market

participants throughout all EU jurisdictions? [Yes/No/I don't know; please specify]

No. As indicated in the answer to question 2, in accordance with Spanish law only book entry methods are accepted, i.e. only by entry in the corresponding account are securities or rights *in rem* over them acquired. Non-book entry methods raise the legal problem of enforcing legal transactions concluded in book entry securities against third parties, and therefore they present greater complexity and uncertainty in terms of establishing a harmonised legal framework with respect to the legal effects of transactions in the said book entry securities.

Question 6: In the event of not all six methods listed in Question 5 becoming available to market participants in all Member States: do you think that the law of any Member State should recognise, in particular in an insolvency proceeding, acquisitions and dispositions effected by one of these methods under the law of another Member State, even if the law of the first Member State does not provide for that method? [Yes/No/I don't know; please specify]

No. Book entry methods present greater legal certainty to the extent that the book entry or registration cannot be altered by the account provider except in exceptional and defined cases. The efficacy of the different "methods" for acquisition or disposition of rights over book entry securities should be the same in all Member States. Efficacy against third parties of the different "methods" is based on accreditation of rights to the securities by the account provider itself, and therefore harmonised regulation should provide for an independent regime for action by these entities and book entries.

Question 7: Do you think that future legislation should leave to Member States the possibility of making the effectiveness of an acquisition or disposition subject to a condition contractually agreed upon between account holder and account provider, in particular a condition that a corresponding acquisition or disposition occurs? [Yes/No/ I don't know; please specify]

No. The effectiveness or efficacy of acquisitions or dispositions in respect of book entry securities should be uniform, independently of the legal transaction which gives rise to the operation, which will be governed by the law of the corresponding Member State.

Question 8: Do you think that there should be a short, harmonised list of conditions giving rise to a reversal of an acquisition or disposition, notably (a) the consent of the account holder; (b) the credit or debit which was made in error; (c) the debit or earmarking or removal of an

earmarking which was not authorised. [Yes/No/I don't know, please specify, indicating which one to add/delete, if any]

Yes. Cases of reversal or annulment of book entries should be exceptional. Nevertheless, the consent of the account holder as ground for reversal of the book entry should be established solely when there is no prejudice to third parties. In accordance with Spanish law, one of the basic characteristics of the book entry registration of securities is its status as legal registration, and therefore entries are subject to protection of the judicial authorities. Consequently, the rectification of entries is only permitted in the case of purely material or arithmetic errors which result from the register itself or simple comparison against the document pursuant to which the entry has been made.

Question 9: Do you think that account holders in whose favour a credit has been made should be protected against the reversal unless they knew or ought to have known that the credit should not have been made? [Yes/No/I don't know; please specify]

Yes. The legal protection of the acquirer of book entry securities must always apply provided he acts in good faith. Consequently, in accordance with Spanish law a third party who acquires securities represented by book entry for good consideration from a person who, in accordance with the book entries, is shown as legitimized to transfer them, will not be subject to reversal unless he has acted in bad faith or with serious fault at the time of the acquisition.

Question 10: Do you think that interests in book-entry securities, notably security interests, which are "visible" in the account, should have priority over book-entry securities which are not "visible" in the account? [Yes/No/I don't know; please specify]

In accordance with Spanish law, the registration of book entry securities, in relation to third parties with whom the securities account holder contracts, accords the same publicity as possession and production in relation to physical certificates. Consequently, under Spanish law a principle of priority governs, which means that after any entry is made no other may be made in respect of the same securities resulting from an event occurring previously insofar as it is incompatible or inconsistent with the former. Furthermore, the act which first accesses the registry will have priority over those which access subsequently, and the entity responsible for maintaining the book entry register must carry out the corresponding operations in accordance with the order of submission. Those trades or transactions which, having book entry securities as their subject matter, are not reflected

in the register or securities account, would be postponed in ranking in relation to the same securities, since the entry is required for their efficacy. Notwithstanding the foregoing, as already indicated, recognition in the case of "nonbook entry methods" for the acquisition and disposition of rights over registered securities must always be subject to the registration methods, which must have priority.

Question 11: Do you think that there should be a legal obligation for account providers to maintain, for securities of the same description, a number of securities or book-entry securities that corresponds to the aggregate number of book-entry securities of that description credited to the accounts of the account holder's clients plus those securities held for its own account, if any? [Yes/No/I don't know; please specify]

Yes. One of the most important questions which a harmonised regulation should cover is mechanisms for control of the integrity of securities issues. In this respect the obligation of securities custodians to ensure precise correspondence between their records and the positions held on behalf of clients must be absolute, on the lines indicated by Article 16 of Directive 2006/73/EC, but with greater specification, as correctly proposed by the Legal Certainty Group in its second report. Furthermore, the regulation which is implemented should also cover harmonisation of control mechanisms, and the regime of liability of account providers. Under Spanish law, as indicated in the answer to question 2, there is liability on the part of account providers to those prejudiced by failure to make the corresponding entries, inaccuracies and delays therein and infringement in general of the rules laid down for maintaining registers.

Question 12: Do you think that, in case of insolvency of the account provider, securities kept by it for its own account shall be attributed to its account holders, as far as the number of securities kept by the account provider for its account holders is insufficient? [Yes/No/I don't know; please specify]

Attribution of a preferential right of securities holders in relation to those which, of the same class, are held by the account provider for its account is a question of an insolvency nature which should not affect harmonised regulation of holding and disposition of book entry securities. Under Spanish law the fact that the account provider is obliged to maintain strict separation between own and client positions and control over the number of securities which it holds on behalf of the latter, already means a guarantee which does not justify the need to establish preferential treatment of securities holders in relation to other creditors of the account provider.

Question 13: Do you think that a remaining shortage should be shared amongst account holders of that account provider, in the case of its insolvency? [Yes/No/I don't know; please specify].

The rule of distribution of losses between securities holders on the insolvency of the account provider can only be justified, based on a principle of equality of treatment, when in accordance with the applicable legal regime it is not legally possible to identify ownership of the lost securities. In those systems, such as the Spanish system, however, where the securities of clients can be identified, it is unfair to attribute losses of securities as a result of fraud or error by the account provider to all clients.

Question 14: Have you encountered difficulties in the application of the legal framework regarding holding and disposition of book-entry securities that could be fully or partially attributed to an unsatisfactory conflict-of-laws regime? [Yes/No/I don't know; if yes, please specify the difficulties]

As a result of the nature and inherent functions of the CNMV, this body has not been subject to the need to apply conflict rules in relation to book entry securities.

Question 15: Do you think that future legislation on the legal framework of bookentry securities holding and disposition should harmonise issues of substantive law as well as the question of which law is applicable to holding and disposition of book-entry securities, including the creation of security interests? [Yes/No/I don't know; please specify]

The harmonisation of regulation on holding and disposition of book entry securities is a complex question which affects basic institutions in each system, such as property law, company law, etc. Future harmonisation should cover those aspects of substantive or conflict law necessary in order that the basic institutions of each system are not altered.

Question 15bis: If yes: do you think that a uniform conflict-of-laws rule should govern the issues within the scope of the Settlement Finality Directive, the Directive on Winding-Up of Credit Institutions and the Financial Collateral Directive plus the aspects which are to-date not included in the scope of the three directives? [Yes/No/I don't know; please specify]

The conflict rules should be uniform for all cases without making a distinction by reason of the parties or subject matter of regulation.

Question 16: Do you think that holding and disposition of book-entry securities is more costly in cases where the situation involves a cross-jurisdictional element? [Yes/No/I don't know; please specify]

Yes. The presence of cross-border elements in book entry securities holding and disposition systems gives rise to uncertainty from a legal point of view, since different legislation comes together in respect of the same legal transaction. This uncertainty frequently requires its assessment, which involves legal advisory costs and higher operating costs, which are consequently charged by financial intermediaries to their clients.

Question 16bis: If yes, could you give your best estimate of the additional cost and specify what types of cost arise?

As a result of the nature and inherent functions of the CNMV, this body does not have the information to which this question relates.

Question 17: Do you think that investors face difficulties in exercising rights flowing from securities as soon as they hold through a cross-border holding chain? [Yes, considerable difficulties/Yes, slightly more difficulties than in a domestic context/No/I don't know, if yes, please specify the difficulties]

Yes, slightly more difficulties than in a domestic context. The principal problem faced by investors in an indirect securities holding system in relation to exercise of their rights consists of their legitimacy in relation to the securities issuer. In a direct holding system, such as the Spanish, the holder of book entry securities requires the mediation of the depository in order to exercise his rights, but is fully legitimized in relation to the securities issuer.

Question 18: Do you think that the law of Member States should bind account providers to facilitate the exercise of rights flowing from the securities (e.g. by providing the investor, upon demand, with a certificate confirming his holdings; or, by making the investor the account provider's representative with respect to the exercise of the relevant rights {proxy}), where the exercise of rights would be impossible or cumbersome without the assistance of the account provider? [Yes/No/I don't know; please specify]

Yes. As well as harmonised legislation covering regulation of the legal relationship between investor and securities account provider, mechanisms should further be regulated which permit legitimization of the securities account holder with the issuer.

Question 19: Do you know other cases where assistance of the account provider is a prerequisite for the exercise of the right by the investor? [Yes/No/I don't know; if yes, please specify]

Under Spanish law all rights of the securities holder are exercised with the assistance of the account provider.

Question 20: Do you think that Member States' law should make possible the exercise of rights flowing from securities by an account provider on behalf of the investor where the exercise of the rights by the investor himself is impossible? [Yes/No/I don't know; please specify]

Yes. Due to the indirect securities holding systems, the account provider should be obliged on behalf of the investor to take all steps corresponding to the securities holder, since its involvement is essential in order to preserve the financial value and exercise rights in securities for the benefit of the investor.

Question 20bis: In the affirmative case, do you think that this possibility should be subject
(a) to feasibility on the side of the account provider [Yes/No/ I don't know, please specify, in particular, the exact scope of such feasibility exemption], and/or
.(b) to contractually agreed levels of service between the account holder and the account provider? [Yes/No,/ I don't know, please specify].

No. The account provider receives income for the services which it provides, and these services, in the case of indirect securities holding, should not be made to depend on the contractual terms or the economic or technical viability of the resources of the account provider, since the investor has no other option in order to exercise his rights than the necessary intervention of the account provider.

Question 21: Do you think that Member States' law should make possible the exercise of rights flowing from securities by an account provider on behalf of the investor, in a scenario where the investor does not want to exercise the rights himself? [Yes/No/I don't know; please specify]

No. The regulatory framework of the relationship between the account provider and rights holder must make it clear that in exercise of rights which require a declaration of intention by the securities holder his intentions must in all cases be respected.

Question 21bis: In the affirmative case, do you think that this possibility should be subject
.(a) to feasibility on the side of the account provider [Yes/No/ I don't know, please specify, in particular the exact scope of such feasibility exemption], and/or
.(b) to contractually agreed levels of service between the account holder and the account provider? [Yes/No/I don't know; please specify].

N/A

Question 22: Do you think that an account provider should be bound to exercise, on behalf of the investor, the following rights flowing from securities:
.(a) Rights entailing a change of the relevant security itself (e.g. conversions, reorganisation) [Yes/No/I don't know; please specify];
.(b) Collection of dividends or other payments and subscription rights [Yes/No/I don't know; please specify];
.(c) Acceptance or refusal of takeover bids and other purchase offers? [Yes/No/I don't know; please specify];
.(d) Other rights [please specify which and why]

In general, the harmonised legislation should establish a series of obligations on the account provider such that it is ensured that it is obliged to take such steps as may be necessary in order that the securities conserve economic value and the rights attached to them in accordance with the applicable law.

Question 23: Do you think that account providers should be bound to pass on information with respect to book-entry securities which is required in order to exercise a right enshrined in the securities which exists against the issuer? [Yes/No/I don't know; please specify];

Yes. As previously indicated, the account provider must ensure maintenance of rights attached to the securities, which implies an obligation adequately to inform itself of all those circumstances which could affect the said security, insofar as they must be taken into account in order to exercise the corresponding rights. Consequently, and because it must at all times abide by the instructions of the investor in relation to the securities, the account provider should be obliged to adequately inform the investor in order that the latter can decide on exercise of his rights.

Question 24: Do you think that this obligation should be restricted to information

.(a) which is received "through the holding chain", (i.e. directly either from the issuer or an account provider which maintains an account for the account provider in question, or from the investor or another account provider for which the account provider in question maintains an account.) [Yes/No/I don't know; please specify];
.(b) which is directed to all investors in securities of that description [Yes/No/I don't know; please specify]?

No. The obligation to inform the investor should be complete in all matters relating to and which are necessary and relevant for exercise of the rights attached to the securities, independently of the source of information.

Question 25: Would you advise other/additional restrictions to this duty? [Please specify]

This duty should be as broad as possible insofar as it affects basic aspects of exercise of investor rights.

Question 26: Do you think that the processing of rights flowing from securities is more costly in case where the situation involves a cross-jurisdictional element? [Yes/No/I don't know]

Yes. See reply to question 16.

Question 26bis: If yes, could you give your best estimate of the additional cost and specify what types of cost arise?

The CNMV does not have estimates of these costs.

Question 27: Do you think that an issuer incorporated under the law of an EU Member State should be allowed to arrange for its securities to be initially entered into holding and settlement structures (in particular those maintained by a central securities depository) in, or governed by the law of, another EU Member State? [Yes/No/I don't know; please specify]

No. The form of representation of securities, insofar as it affects the legitimacy of the holder as against the issuer and exercise of the rights inherent in the status of member, as the case may be, affects questions inherent in company law which would have to be previously harmonised in the field of the European Union in order to be able to allow full freedom of choice of central deposit system or entity commissioned by the issuer to maintain its book entry securities. The confluence of a law applicable to book entry securities different from the law applicable to the issuer in itself generates greater uncertainty than subjection of the issuer and CSD to the

same legal regime. In our experience, although at first sight it may be that the possibility of choice of CSD by the issuer involves less costs, the fact is that the possible presence of different applicable laws (the law governing the company and the law governing the book entry securities) generates uncertainty regarding the content of the foreign law and the need to alleviate this uncertainty by incurring additional costs (advice, documentation, etc.).

Question 28: Do you think that holding and settlement structures for securities, in particular those maintained by a Central Securities Depository, which are governed by the law of an EU Member State, should be open for securities constituted under the law of another EU Member State? [Yes/No/I don't know; please specify]

See reply to question 27.

Question 29: Are there, in your view, issues stemming from other branches of law, such as corporate law, fiscal law, etc., or regulatory/supervisory concerns that could advise against the establishment of free choice by an issuer, as set out above. [Yes/No/I don't know; if yes, please specify the issues]

Reference has already been made to the problems which present themselves when the registration of book entry securities, which determines the status of shareholder and constitutes the pre-condition for legitimization and exercise of rights thereof against the company, is governed by a law different from that corresponding to the company itself. Consequently, it is considered that it would be desirable that the harmonised legislation covers these corporate aspects in order to avoid regulatory arbitrage.

Furthermore, the location of the register of shareholders, and subsequently its subjection to a different jurisdiction from that corresponding to the issuer, has important effects on the exercise of competences of regulatory bodies, for example in relation to the communication of major holdings, takeover regimes, corporate governance, etc.

Question 30: Do you at present incur additional cost because either or both of the above possibilities of choice do not exist? [Yes/No/I don't know/Not applicable]

The appearance of cross-border elements in securities holding and disposition systems always involves additional costs deriving from the uncertainty generated by the confluence of different legal regimes. The absence of freedom of choice for issuers effectively leads to the need

always for the involvement of a national central depository and other institutions which recover their costs from this securities holding structure. Nevertheless, the cost saving deriving from future harmonisation in this field should not take place at the cost of the legal certainty provided by the current system.

Question 30bis: If yes, could you give your best estimate of the additional cost and specify what types of cost arise?

The CNMV does not have this data.

Question 31: Do you think that all providers of securities accounts established in the EU should be subject to authorisation and supervision in relation to their services of maintaining securities accounts? [Yes/No/I don't know; please specify]

Yes. Insofar as account providers are the entities responsible for accrediting ownership, and their action is completely necessary for exercise of the rights of shareholders and holders of other securities.

Question 31bis: If no, which account providers should not be subject to authorisation and supervision by competent authorities? [Please designate the type of account provider and specify why.]

N/A

Question 32: Do you think that the service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management (which is a so-called ancillary service under MiFID) should be made an investment service in the sense of MiFID (i.e. inserted in Section A of Annex I of the MiFID and be deleted from Section B)? [Yes/No/I don't know; please specify]

Yes. The service of administration and custodianship of securities should receive the treatment inherent in investment services. In fact, securities holders assume a very substantial risk position in relation to these intermediaries which fully justifies their subjection to a special supervisory regime and establishment of a regime of liability for their actions.

Question 32bis: If yes, do you see any specific difficulties in including certain types of account provider in the full or even a limited scope of MiFID? [Yes/No/I don't know; if yes, please specify the difficulties]

No.