"SECURITIES" – BASIC PRINCIPLES OF LEGISLATIVE REGULATION, ISSUES FOR DEVELOPMENT

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Abstract

Securities law exists because of unique informational needs of investors. Securities are not inherently valuable; their worth comes only from the claims they entitle their owner to make upon the assets and earnings of the issuer or the voting power that accompanies such claims. The value of securities depends on the issuer's financial condition, products and markets, management, and the competitive and regulatory climate. Securities laws and regulations aim at ensuring that investors receive accurate and necessary information regarding the type and value of the interest under consideration for purchase.

Keywords: Securities regulation, principles, development of legislative regulation

Introduction

Securities exist in the form of notes, stocks, treasury stocks, bonds, certificates of interest or participation in profit sharing agreements, collateral trust certificates, preorganization certificates or subscriptions, transferable shares, investment contracts, voting trust certificates, certificates of deposit for a security, and a fractional undivided interest in gas, oil, or other mineral rights. Certain types of notes, such as a note secured by a home mortgage or a note secured by accounts receivable or other business assets, are not securities.

The increasing pace of economic integration across borders challenges the traditional concept of national regulation. Nowhere is this discrepancy between the global reach of markets and the national limits of regulation more manifest than in financial markets.

In order to develop effective proposals for standardization and unification of legislation on Securities it is necessary to analyze and review two largest systems of securities turnover, American and European and to reveal common and different characteristics in them.

Comparing u.s. and eu regulations

There are differences in securities rules and approaches on both systems as in US Securities regulations as in EU Securities regulations

Regarding the trading venues, MiFID is not currently applied to dark pools, while in the United States, dark pools are considered as ATS and register as broker dealers. They have to make their quotes available to the public above a certain trading volume threshold.

EU regulators have more discretion in authorizing investment firms and intervening in their management since they can judge whether the managers of investment firms or Regulated Markets are sufficiently experienced and reputable, while the U.S. regulator can only control their reputation and competences. The EU regulations go one-step further in allowing supervisors to control the integrity of ultimate controllers of Regulated Markets regardless of their ownership, while the U.S. rules generally base the notion of control on ownership.

Organizational requirements are broader in scope for exchanges in the United States and focus on disciplinary powers. This is explained by the self-regulatory role of exchanges in the United States versus a more limited role in the EU.

Capital requirements are risk based in the EU and based on the concept of maintaining a highly liquid core of capital in the United States.

The mitigation of conflicts of interest is a broad and general obligation for investment firms in Europe while it is focused on more specific situations in the United States.

Investor protection rules in Europe are two tiered between retail and professional investors (client categorization is binding), while the U.S. regulatory scheme protects all investors, with some carve outs for institutional investors.

Best execution in the United States covers a number of factors, with price being typically the most important; in Europe price is one factor among others to assess whether the client has obtained the best possible result for the execution of its trade. In addition, under MiFID, investment firms are responsible for the best execution of client orders, while in the United States, the responsibility rests with trading centers. This provision implies that market centers in the United States need to link and route orders to one another.

Data consolidation on equity trades exists in the United States and not in the EU: in the United States, quotes and transaction data reported by national exchanges and associations are consolidated into a single system and disseminated to market participants, whereas in Europe, quotes and trades are fragmented between multiple trading venues and no consolidation is required. But the objectives of the two regulations are similar, and some outcomes are comparable: Both regulatory systems aim to maintain fair and orderly markets, protect investors, and provide price transparency.

Equity securities are subject to more scrutiny and transparency requirements than bonds or derivatives. In the two regions, pre and post trade transparency requirements apply to equities while there is currently no or limited transparency requirements for derivatives and bonds. Reg NMS only applies to equities. Internalization is regulated solely are regards equity trades in Europe (concept of Systematic Internalizer).

Investor protection regimes are broad and offer better protection to individual investors, whether the rules to achieve such protection are strictly tiered or not.

There are concerns on both sides regarding the fragmentation of oversight. The U.S. SEC does not oversee futures and government bonds; it also shares supervisory responsibility with the banking supervisors, which supervise commercial banks dealing with securities. In Europe, MiFID is implemented by 27 national supervisors which may lead to different interpretations. For instance, a recent report by CESR emphasizes that pre trade transparency waivers which exclude trading platforms from transparency requirements are interpreted differently across Europe; the report also hints at different interpretations of the concept of SI, given the few firms that have registered as SI (13 so far).[49] A discussion on the outcomes cannot really be achieved without looking at the implementation of the securities regulations. Thus the study suggests some directions for future research:

Assess enforcement on both sides, at the SEC and SRO level in the United States, and at the level of the 27 supervisors in the EU.

Deepen the knowledge of dark pools on both sides and examine how to improve disclosure and price discovery. In Europe in particular, examine ways to achieve **quotes and trades consolidation**.

[49] CESR, "Impact of MiFID on Equity Secondary Markets Functioning," June 10, 2009.

Conclusions for development of regulations

➢ The Securities Law Legislation, should be compatible to the highest degree possible with the Unidroit Convention on Substantive Rules regarding Intermediated Securities (Geneva Securities Convention); however, within Europe we hope for a form of harmonization that focuses less on making divergent European legal systems compatible for its own sake and more on effective measures to ensure investor protection with minimum disruption to individual legal systems.

➢ An SLL should apply to transferable securities:

1. As defined in directive 2004/39/EC, art. 4(18), i.e., securities that are capable of being credited to a securities account (Unidroit art. 1(a));
2. That are dematerialized or immobilized pursuant to the pending CSD Regulation;
3. That are held by account providers that safe-keep and administer securities for account holders.

➢ It should be recognized that legal systems at the national level determine legal requisites of title transfer. Among other divergences, some legal systems involve trust concepts, and some do not. It is not possible or necessary to harmonize these legal systems. Instead, to the extent possible, the focus should be on clarifying and harmonizing the moment at which legal title transfer occurs in order to protect investors, i.e.,

1. At the moment of settlement under the rules of the relevant settlement system (whether operating in the EU or not) and not on trade date or some other time;
2. An Account Provider should undertake to debit or credit an Account Holder's account on the moment of settlement, which should be determined with reference to the rules of the relevant settlement system, which in turn may be a designated settlement system under the Settlement Finality Directive or some other securities settlement system, including a non-EU system, as per the Third Country CSDs regime of the undertaken CSD Regulation; and
3. Account Providers and Account Holders should be able to rely with finality on debits and credits to relevant securities accounts, unless and to the extent necessary to correct an error.

➢ There should be a clear distinction between (1) crediting and debiting of securities accounts, as dispositive incidents of transfer of ownership, whatever the underlying consideration could be (outright sale or title transfer collateral), and (2) the means of providing collateral under a security financial collateral arrangement, which operate to vest possession and/or control of the subject securities in the collateral taker and limit an account holder's or third parties' access to those securities. In the former case, the circumstances under which an Account Holder's ownership rights would arise and cease would be clarified. In the latter case, AFME believe this would further the twin objectives of (a) ensuring investor protection through clarity in respect of when ownership is actually transferred on the enforcement of a security interest by a collateral taker granted under a collateral arrangement and (b) clarifying that title does not transfer on the provision of securities as collateral under a security financial collateral arrangement under the Financial Collateral Directive. AFME believes that the specificities of the manner in which securities may be effectively provided as collateral should be left to national law and the Financial Collateral Directive and, consequently, should be considered beyond the scope of the SLL.

➢ The laws, regulations, rules and procedures governing the operation of an SSS should be clearly stated, understandable, internally coherent and unambiguous. They should be public and accessible to system participants.

➢ The legal framework should include principles that support appropriate contractual choices of law in the context of both domestic and cross-border operations. In many cases, where otherwise appropriate, the law chosen will be that of the location of the central counterparty or a CSD

- Key aspects of the settlement process that the legal framework should support include: enforceability of transactions, protection of customer assets (particularly against insolvency of custodians), immobilization or dematerialization of securities, netting arrangements, securities lending (including repurchase agreements and other economical equivalent transactions), finality of settlement, arrangements for achieving delivery versus payment, default rules, liquidation of assets pledged or transferred as collateral, and protection of the interests of beneficial owners
- In relation to collateral it should be made clear that an account holder's creditor may enforce its rights against an account holder only in relation to the securities held by the account holder's relevant intermediary, and not in the books of an upper-tier account provider, including where that account provider holds the debtor's securities in segregated accounts.
- The recognition of different holding structures (including via nominees and intermediaries, whether on a segregated or omnibus account basis), of foreign legal systems, without need of each legal system having to incorporate other structures and legal concepts into its own legal system, is indispensable to overcoming perceived legal barriers and to achieving increased efficiency and cost effectiveness; however, further steps of harmonization will be required to enable the unhindered exercise of rights attached to securities.
- In respect of corporate actions-related requirements, any SLL should be compatible with developing market standards and guidance from market implementation groups.
- In relation to corporate actions, as well as in relation to any instruction for the debit and or credit of a securities account, it must be made clear that the account provider may accept instructions only from the account holder or any person designated for that purpose by the account holder.
- The Legal Certainty Group's recommendations (in particular, recommendation 3) in respect of "core duties" of intermediaries, as set out in its Second Advice and as embodied in the Geneva Securities Convention, Article 10, should be adopted.
- The EU Commission should adopt the legislative form of a Regulation, especially in respect of those parts of the legislation that must not suffer from incoherent transposition into national laws.
- The proposed regulation of charges levied by an account provider is inopportune as the comparison with the payment area is inappropriate given the continued fragmentation, e.g., in the fields of company law and fiscal regimes.
- Insolvency rules should be harmonised, between Member States, so that there is clear recognition of the segregation of financial instruments held by: (a) a firm for its clients, when acting in a custodial capacity; or (b) a CCP, in respect of client collateral. Minimal intervention would be required to settle a rule that would give greater assurance to investors in the Union and support the obligations already imposed on firms to achieve segregation. While title transfer and security interest arrangements should continue to be recognised, the presumption should be that a firm acting in a custodial capacity, which is under a legal obligation (whether statutory or contractual) to segregate client financial instruments, has done so. Accordingly, upon the insolvency of the firm, client financial instruments would be available to be returned, irrespective of the legal system under which they are held, in a consistent and certain manner.

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EC Directive 2006/49/EC of 14 June 2006 on the capital adequacy of investment firms and credit institutions.
EC Directive 2004/39/EC of 21 April 2004 on markets in financial instruments.
EC Directive 2006/73/EC of 10 August 2006 implementing directive 2004/39/EC of the European Parliament and the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purpose of that directive.
Securities Act of 1933
Securities Exchange Act of 1934
Securities Act 1978.
Securities Act R.S.O. 1990.
Unidroit convention on substantive rules for intermediated securities, also known as the Geneva Securities Convention, was adopted on 9 October 2009.

Abbreviation

AFME	(Association for Financial Markets in Europe)
ATS	Alternative Trading System
CAR	Capital Adequacy Requirement
CDS	Credit Default Swaps
SEC	The Securities and Exchange Commission
CESR	Committee of European Securities Regulators
DJIA	Dow Jones Industrial Average
ECN	Electronic Communication Network
EC	European Commission
EU	European Union
MiFID	Market in Financial Instruments Directive 2004/39/EC
FESE	Federation of European Securities Exchanges
MiFID	Market in Financial Instruments Directive 2004/39/EC
NMS	National Market System
Reg NMS	Regulation National Market System
SEC	Securities and Exchange Commission
SRO	Self-Regulatory Organization