Chapter V
The Holding and Transfer of Interests in Securities in England and Japan: Compared with the Holding and Transfer of Funds

Tomonori Fujiike
Hori & Partners, Japan

ABSTRACT

This chapter compares account-based securities settlement systems with payment systems in which funds are transferred through bank accounts in England and Japan and examines a desirable securities system to harmonize the relevant countries' jurisprudence considering U.S. securities system and relevant international trends. It argues that there should be two broad areas of similarity in both systems; compartmentalization of a legal relationship between related parties and the method of transfer of securities and funds. It also argues, however, that, due to the differences in the legal nature of both financial assets, there are some differences between both systems in order to response intermediary risk. The purpose of this chapter is not only to propose that similar legal issues in both systems should be resolved in the same ways as much as possible, but also to distinguish issues which could be resolved in commercial law from issues which should be resolved in the field of regulations by financial authorities in securities system.

INTRODUCTION

Traditionally, methods of holding and transferring securities have involved direct holding systems in which the owners of securities have a direct relationship with the issuers. Under such a system, in order to hold and transfer securities, the investor needs to be in physical possession of relevant certificates and then execute the physical delivery of them. However, such physical delivery is labor-intensive and time-consuming. There is also a risk that the certificates could be lost or stolen. These disadvantages triggered the evolution of securities systems under which the investor holds the
interests in respect of the underlying securities indirectly. In such a system, the investor’s interests are held via an account of an intermediary, which in turn has its interests recorded with another intermediary, and so on. This continues down the chain until some intermediary (CDS or central securities depositary) either: (1) is recorded as the owner of the securities on the issuer’s register or (2) holds the certificates representing the securities (Bernasconi, et al., 2002i). This system is often known as an “indirectly held securities system” (this system will be referred to hereinafter as a “securities system,” and the investor’s interests under such a system will be referred to as “interests in securities”). Under securities systems, securities certificates are “immobilized” or “dematerialized,” so that transfers of interests in securities are implemented through the adjustment of balances in relevant accounts instead of through the physical delivery of certificates.

The structure of securities systems appears similar to the system relating to the holding and transfer of funds. Deposits are recorded on the bank account. A funds transfer is made through a payment system to bypass the need to physically transport the money itself (the system of holding and transferring funds will be referred to hereinafter as “funds systems”).

Obviously, interests in securities are different from interests in deposits in some respects. Traditionally, the legal nature of interests in securities has been regarded as proprietary rights whereas monetary deposits amount to mere personal rights enforceable against banks.

Notwithstanding such a difference, from a commercial transaction law viewpoint, both systems share many related risks and legal issues. This chapter, therefore, focuses on comparing securities systems with funds systems to examine whether the similar related risks and legal issues can be solved in the same way in the field of private commercial law.

Additionally, due to the rapid internationalization of securities transaction, a number of intermediaries in different countries can be involved in securities systems. Thus, laws of different countries are likely to seek to intervene across borders in interests in securities. For this reason, this chapter also aims, in comparing the legal systems of relevant countries, to harmonize the relevant in order to avoid the inconsistency of laws in cross-border securities transactions. In comparing national legal systems, Japanese law and English law (including applicable EU law) will be mainly considered because the contrast between Japanese law and English law in this area is so stark; that is, under Japanese law, the investor has a proprietary claim directly against the issuer, whereas, under English law, the investor has proprietary rights in respect of underlying securities held by its own intermediary as a trustee. Furthermore, as the need arises, consideration will be given to U.S. securities systems, which have influenced English securities systems and relevant international trends.

The structure of this chapter will be as follows:

1. A review of several legal issues in securities systems as compared to funds systems in the English and Japanese legal systems together with an examination of the similarities and differences in the risks relating to each system; and
2. An analysis of desirable securities systems to harmonize the relevant countries’ jurisprudence.

EXAMINATION OF RISKS AND REVIEW OF LEGAL ISSUES

Intermediary Risk

Intermediary Credit Risk

Legal Nature of Interests in Securities

In both systems, the end-users, that is, depositors and investors, have their interests in deposits or securities through their immediate intermediari-