

Title: Buying and holding through CREST

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Posted this earlier to SuperstonkUK:

I wasn't sure whether the below is widely known, so this post is for your information. Everything here is from the CREST International Manual dated December 2020, in case anyone would like to read it themselves: [CREST International Manual](<https://www.crh.com/media/3360/crest-international-manual-including-crest-deed-poll-december-2020.pdf>)

It explains that the brokers we use are members of CREST, and the way the system was set up is that CREST was designed to hold domestic stocks. So for foreign stocks (e.g. GME) CREST Depository Interests (CDIs) are issued to represent shares/securities in a CREST Nominee's DTCC account (page 9):

> **Holding international securities in the CREST system**

The UK Regulations only facilitate the holding and transfer of securities in the CREST system where those securities are constituted under the laws of England and Wales, Scotland or Northern Ireland. It is for this reason that equivalent regulations have been made in Ireland, the Isle of Man, Jersey and Guernsey to enable securities constituted under the laws of those jurisdictions to be held in the CREST system. The UK Regulations do not provide for securities constituted under the laws of other countries to be held or transferred in the CREST system directly.

However, the UK Regulations allow securities constituted under English law but which represent an interest in other securities (which may be securities constituted under the laws of other countries) to be issued into, held and transferred in the CREST system². This provides a basis under which the CREST Depository, acting as a depository in respect of international securities, may issue dematerialised depository interests (CDIs) representing international securities, as independent securities. The CREST Depository will therefore issue CDIs to CREST members which will represent an entitlement in relation to the underlying international securities. The CDIs issued by the CREST Depository will be constituted under English law by virtue of the Deed Poll and will be 'participating securities' within the meaning of the UK Regulations. In consequence the CDIs will be transferable by means of the CREST system to other CREST members in the same way as other participating securities.

Clause 8.5 of the Terms and Conditions is specifically drawn to the attention of participants using the International Settlement Links Service. In particular, participants should note that the defined term "international securities" encompasses both non-participating domestic securities and foreign securities.

And about the CREST Nominee (page 9): (CSD is a central securities depository e.g. DTCC)

> **The nature of the CREST member's interest in international securities**

The CREST Nominee is a participant in other CSDs and holds rights to securities held within the other CSDs on behalf of the CREST Depository for the account of CREST members. The CREST Depository's relationship with CREST members is governed by the Deed Poll entered into under and governed by English law. The form of the Deed entered into by the CREST Depository appears in Chapter 8. It will be seen that the CREST Depository holds its rights to international securities (such rights being held on its behalf by the CREST Nominee) upon trust for the holders of the related CDIs.

The CREST Nominee's participation in the CSD

The CREST Nominee, acting on behalf of the CREST Depository, participates in each CSD and therefore is subject to the laws relevant to that CSD and to its rules (suitably amended in some instances). Consequently, different laws and rules will govern its holdings of securities in each jurisdiction. These laws and rules (and the laws and rules relevant to rights in and transfers of the relevant international securities, which may include laws of jurisdictions other than that of the CSD) affect the nature of the rights (or 'title') which the CREST Nominee has in relation to the securities which it holds, transfers of those securities and the arrangements to be applied in the event of an insolvency, including the insolvency of a counterparty which is also a participant in the CSD.

I think the above is straightforward, and that most, if not all of us are aware that at least for the UK (+EU?),

aside from DRS and directly buying from ComputerShare, we can only buy CDIs from our brokers. I read somewhere that IBKR are one of a few exceptions to this because they have a US arm (which is why it's possible to DRS through them). Could be wrong, there could be others but I don't know.

Anyway, what got me a bit concerned is the section on the legal framework for cross-border settlement. From Page 25-26 of the manual:

>****New York law matters****

In relation to the link with DTCC, the practical viability of the principal assumptions should be considered in the context of the following matters. Under New York law, securities clearance and settlement systems, including DTCC, are termed 'securities intermediaries', which hold 'financial assets' and create 'securities entitlements' in favour of their 'entitlement holders'.

■ DTCC does not operate reserve balance accounts and therefore when a credit is made to the CREST Nominee's account in DTCC the assumption made by EUI is that it is this credit which is unconditional and irreversible.

■ It is thought that New York law (being the law which governs the relationship between DTCC and its participants) will regard the CREST Nominee as the owner of the security entitlements against DTCC, which is a securities intermediary, and also as a securities intermediary itself in its relationship with DTCC. (The effect of this status is thought to be that an unsecured creditor of the CREST Nominee would not have rights to the security entitlements held by the CREST Nominee at DTCC to the extent that the CREST Nominee requires the security entitlements to satisfy the claims of CREST members.) It is also thought that New York law generally will not recognise the claims of CREST members as claims against DTCC.

■ New York law confers on the CREST Nominee, as a participant in DTCC, a pro rata property interest in all interests in the particular financial asset held by DTCC, but does not afford the CREST Nominee any direct rights to that particular financial asset except in very narrow circumstances related to the failure of DTCC. Whilst DTCC has certain duties to exercise due care in accordance with reasonable commercial standards to maintain financial assets which correspond to the entitlements of its participants, there could be circumstances in which DTCC participants holding security entitlements corresponding to a particular issue may have to bear a shortfall pro rata, in which case the CREST Depository would be compelled to exercise its powers under the Deed Poll to cancel CDIs and/or require cash payments by CDI holders.

■ DTCC may itself in some circumstances pledge to third parties, or claim to satisfy liabilities owed to it, securities which are credited to the CREST Nominee's account, reducing the CREST Nominee's entitlements accordingly. This is a further example of a circumstance in which the CREST Depository would be compelled to exercise its powers under the Deed Poll to cancel CDIs and/or require cash payments by CDI holders.

I'm no lawyer, but these points make it sound as though (regardless of whether the shares in the CREST Nominee's account are real or synthetic, and whether they are lent out or not), the DTCC has the right to basically claim them back 'in some circumstances'!?! Which I suppose is an even better reason to have the shares in your name. Anyway, I decided to post this just to spread the word.