AUTORITÉ DES MARCHÉS FINANCIERS

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What are the obligations of the account keeper and its client when a securities transaction results in a debit cash balance?

From time to time, investors fail to anticipate the effects of a securities transaction on their holdings correctly. However, with withholding tax, a securities transaction may lead to a debit balance that will have to be regularised by the investor.

In such a situation, the custody account-keeper has a role to play insofar as it is obliged to inform the client of the cash debit situation before taking any action to regularise the situation if this is not done promptly by the investor himself.

At the same time, as we shall see in this mediation case, clients must remain attentive to the information provided by their custody account-keeper, especially in the case of a joint account

The facts

Mr and Mrs B are both joint holders of a joint securities account, opened in the books of institution X, in which they hold V shares.

After the merger of issuer V with a separate group, W, both listed on Euronext Paris, Mr and Mrs B. had their V shares converted into Y shares of the merged group, also listed on

Euronext Paris.

Mr B. then learnt that after an upcoming Extraordinary General Meeting (EGM) of group Y, its shareholders would receive an exceptional dividend of €0.096677 for each Y share held, and shares in company Z in which the Y group holds a stake, at a rate of 0.017029 Z shares for each Y share.

Mr B. therefore expected to receive, at the end of this EGM, bonus Z shares, compensation for a fractional share and an exceptional dividend.

However, after reading his joint securities account transactions history, Mr B. realised that the distribution of Z shares approved at the end of the EGM had not produced the expected outcome.

The joint account had recorded a debit of €2,974.44 - related to the distribution of Z shares - and a credit of an equivalent amount - related to the payment of the detachment of the dividend coupon. At the same time, an amount of €892.31 was also debited from the joint cash account, resulting in a negative balance.

It was only several days later that Mr B. noticed, while consulting the history of his last transactions on his online client area, that in order to settle the debit balance of his joint securities account, his financial intermediary had sold nine T shares without his authorisation.

Surprised by the unforeseen effects of the distribution of Z shares, as well as the unauthorised sale of T shares, Mr B. contacted his financial intermediary to inform him that he had in no way opted to subscribe for Z shares for a fee and that, in his opinion, the distribution of Z shares should have been free of charge.

Mr B. also informed institution X that he should have been warned by a personal message - other than on his online customer area - that his account was in debit. Thus, according to Mr B., if no such a message had been sent, the institution should not have carried out the sale of the T shares without his authorisation.

Institution X responded to his complaint by informing him that this securities transaction was not optional and therefore did not require his consent. It also added that since the transaction was carried out on a securities account that was subject to withholding tax, it was liable to taxation. The institution told Mr B. that he had been notified of the debit situation of the joint account and that he had been given 48 hours before the institution

intervened to absorb the overdraft consisting of the sale of securities held on the same securities account.

Mr B. challenged the response given by institution X and requested the rectification of the transactions related to both the distribution of Z shares and the sale of T shares, then referred this dispute to me.

Investigation

I questioned institution X which informed me of its observations, with supporting documents. Institution X confirmed to me that the EGM of Group Y shareholders had approved the exceptional distribution of shares in Z, as well as an exceptional cash distribution to shareholders of Y. These transactions were disclosed to the public. This transaction was therefore automatic and did not require any action on the part of the institution or Mr B. However, this allocation was taxed in accordance with the common law on dividend distributions, even though in this case the distribution concerned securities.

When the transaction was processed, Mr B. did not have enough cash in his account to bear the cost of the tax on the transaction, so the institution sent him an electronic message on his customer area to warn him that his account had been debited, giving him 48 hours to regularise the situation.

In the absence of any regularisation from Mrs and Mr B. within the allotted time, the institution intervened, in accordance with its general terms and conditions, on the securities account in order to regularise the situation of the account.

As a result, institution X explained to me that it considered that it had fulfilled its various obligations.

Recommendation

After receiving these answers, I carefully analysed the case and noted various points.

First of all, regarding the exceptional distribution of Z shares and the exceptional distribution of a dividend to the shareholders of Y: in this respect, I reminded Mr B. that I had no jurisdiction over tax disputes, as my remit was limited to financial disputes.

However, I explained to Mr B. that it seemed to me that this distribution was indeed free of charge but, nevertheless, taxed according to the regime applicable to dividends, the single

flat-rate levy (flat tax) of 30%, comprised of income tax at a rate of 12.8% and social security contributions at a rate of 17.2%.

It was therefore this immediate flat tax provided for under French law that had caused the debit balance of Mr B.'s cash account.

As regards the information on the Z share distribution, I informed Mr B. that his account keeper had a duty to provide information.

> Article 322- 12, II of the General Regulations of the Autorité des Marchés Financiers (hereinafter AMF General Regulation) provides for two assumptions that require the custody account-keeper to provide information: *"II- The custody account-keeper shall send, as quickly as possible, to each holder of a securities account the following information:*
>
> *1° Information relating to operations in financial securities which require a response from the account holder, which it receives individually from the issuers of financial securities;*
>
> *2° Information relating to the other operations in financial securities which give rise to a modification to the assets recorded on the client's account, which it receives individually from the issuers of financial securities; […]"*

Furthermore, it is important to note that custody account-keepers are only obliged to pass on the information provided by the issuer without having to provide tax advice.

In this case, it was therefore not up to institution X to inform Mr B. of the tax consequences of the Z share distribution.

Concerning the T shares sold without Mr B.'s prior authorisation: I have noted that the general terms and conditions of institution X specify that the joint and ordinary securities accounts held in the institution are based on cash accounts which cannot be in debit.

It further states that, when one of these cash accounts goes into debit balance, the account keeper undertakes to inform the customer, by any means, of his obligation to regularise the debit balance within 48 hours.

Should the situation not be regularised, institution X specifies that it will proceed, without prior notice, to the sale of the financial instruments registered in the client's securities account, by choosing the securities, at the client's expense and risk.

In this case, Mr B. told me that he had received a message from institution X in his online customer area, informing him of the state of his account and asking him to regularise the situation within 48 hours of this message being sent.

Nevertheless, I considered that simply providing an electronic message on Mr B.'s online customer area did not provide a satisfactory level of information delivery.

Given these circumstances, I therefore sought to find out whether the information had actually been provided to Mr B. or only made available to him on his dedicated area.

The cash account in question was a joint account. I have noted that when this joint account was set up, as is the rule for this type of account, Mrs. and Mr. B. designated a main account holder, who receives alerts relating to the life of this account. I then noted that Mrs B had been designated as such and that she was therefore the only one who received alerts relating to the life of this joint account.

When I analysed the file and questioned institution X, I observed that the institution had indeed informed Mrs and Mr B. of the state of the account by sending a message to regularise the situation via two channels :

- Through the "on-line" channel, by sending a message to the customer area linked to the account

- and by sending an e-mail to Mrs B..

In view of these elements, it appears that the information provided by the institution was sent directly and personally - in this case, via a personal e-mail box - to one of the joint account holders - Mrs B. - in accordance with the account agreement, and that institution X did not simply make the information available in the customer area.

Mr B. is therefore deemed to have been informed, since the creation of a joint account implies joint and several management of the account between the joint account holders.

I therefore noted that institution X had behaved proactively, also setting out in its alert message the various ways in which the account could be regularised and the consequences of the failure to do so in a timely manner.

Since the account had not been settled within the time allowed, institution X was authorised to sell any securities it wished to cover the debit amount.

In view of the above, I informed Mr B that there was no evidence to suggest that there was any shortcoming on the part of institution X in this particular case and that I could not therefore give a favourable opinion on his request.

Lessons to be learned

It is important to remember that in the case of a securities transaction, the custody account-keeper's obligation to inform investors is limited in scope: it is only responsible for transmitting the information provided by the issuer, without having to provide any advice whatsoever.

Furthermore, when a joint securities account is opened, it is the responsibility of each of the joint holders to pay attention to the information provided by the custodian-account keeper, since it is assumed that the joint holders are jointly and severally liable for the management of the account.

Finally, a distinction should be made between the actual provision of information and the mere availability of such information. Thus, when an account holder wishes to alert an investor that he or she needs to make an adjustment to his or her securities account, the institution should seek to communicate this information to the client through any personal channel (telephone, e-mail) and should not be content with merely posting this information on the client's online area.

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