



**UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR  
THE PREPARATION OF A DRAFT CONVENTION ON  
HARMONISED SUBSTANTIVE RULES REGARDING  
INTERMEDIATED SECURITIES  
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***COMMENTS BY GOVERNMENTS  
AND INTERNATIONAL ORGANISATIONS***

*(Comments by the Government of Germany)*

In view of what has been articulated by Germany in its written as well as oral statements at the first Conference of Governmental Experts and in light of increasing international trade in securities, there is a strong interest in harmonised rules regarding securities held with an intermediary.

With a view to moving this project forward, we submit the following comments from the German perspective:

**1. Re Article 1**

The definitions of “control agreement” in *Article 1(m)* and “designating entry” in *Article 1(n)* should be supplemented in the respective first subparagraphs, concerning the definitions relating to the duties of the intermediary towards the account holder, by the same restriction which is already part of the respective second subparagraphs, concerning the duties towards the collateral taker.

The first subparagraphs should therefore read as follows:

Article 1(m)(i): „that the relevant intermediary is not permitted to comply with any instruction given by the account holder in respect of the intermediated securities to which the agreement applies in such circumstances and as to such matters as may be provided by the account agreement or the domestic non-Convention law without having received the consent of the collateral taker;”

Article 1(n)(i): “that the relevant intermediary is not permitted to comply with any instruction given by the account holder in respect of the intermediated securities in relation to which the entry is made in such circumstances and as to such matters as may be provided by the account agreement or the domestic non-Convention law without having received the consent of the collateral taker;”

## 2. **Re Article 2**

The newly introduced Article 2, which defines the scope of application of the Convention, should be extended by an explanation clarifying that the Convention does not apply to securities held by an intermediary in individual custody for the investor.

## 3. **Re Article 4**

In *Article 4(2)* it should be made clear that not only the applicable corporate law under which the securities are constituted should decide on the rights of the intermediary. Moreover, reference should be made to the domestic non-Convention law concerning the acquisition and disposition of securities. I would therefore propose the following wording:

At the end of Article 4(2) the wording “and the law under which the securities are constituted.” should be amended to read: “the law under which the securities are constituted and the domestic non-Convention law.”

In other words, it is important that the regulation makes clear that the duty of the intermediary to assert the rights of the investor against the issuer or against a “higher-tier” intermediary should not only be set out in the account agreement, but that statutory regulations are also permissible.

*Article 4(3)* should be made clearer by explicitly stating that the rights referred to in Article 4(1) may be enforced only against the relevant issuer, if the domestic non-Convention law so provides. But the basic notion of this provision should not be changed.

As to the two proposals made for *Article 4(5) and (6)* we would suggest to consider only Version A for further discussion and to exclude Version B totally. Version B contains many terms that are hardly definable, which would make it very difficult to construe such a provision at a later stage of the law-making process when the rule has to be implemented into the laws of the contracting states. The aim of harmonisation could be endangered.

As far as Article 4(5) and (6) Version A is concerned we would suggest that only paragraph 5, Clause 1, should remain in the Convention. Article 4(5), Clause 2, and Article 4(6) should be deleted.

## 4. **Re Article 5**

In accordance with our previous statements, Article 5(4) should be more precise in what is meant by the wording “Without prejudice to any rule of the domestic non-Convention law”. As construed from our perspective, this paragraph means that the domestic non-Convention law may require that no credit or debit be made without a corresponding debit or credit. Although we would support this interpretation, we would nevertheless prefer more exact wording in view of the aim of better harmonisation.

Furthermore, it should be determined what is meant by the wording “because it is not possible to identify”. It should be determined whether “identification” in this sense means an allocation concerning the same transaction or concerning the aggregate number of securities in general.

## 5. **Re Article 6**

In my opinion, Article 6 in its current version would generally only need some clarification with regard to the corresponding definitions in Article 1 (see above re Article 1).

Nevertheless, I would like to point out that Article 6 of the Draft Convention is likely to be difficult to implement in practice. This rule has reached a degree of complexity that may make it difficult to deal with the issues involved; hence, there are doubts as to whether Article 6 in this form will actually simplify the existing laws concerning security interests in securities.

**6. Re Article 7**

It should be examined whether Article 7(4) could be extended in such a way that the involved parties themselves are able to define when a satisfied condition makes the transfer effective.

**7. Re Article 10**

All in all, I would still suggest examining whether this whole article is at all necessary. Fact patterns discussed at the first Committee of Governmental Experts have shown that it might be very difficult to deal with these priority rules in practice. The declaration of the contracting state under Article 6(4) and (5) on how security interests in intermediated securities are constituted seems to be a sufficient tool for the main purpose of this rule. It is to be presumed that in practice security interests would be constituted according to the declaration made by the contracting state. Further restrictions would not be acceptable. These enumerated methods may function as a standard among the contracting states. However, a conclusive list of methods may not meet practical demands in the longer term. This development should not be unduly restricted.

**8. Re Article 11**

I would once again like to focus attention on our point made earlier in the discussion that this provision should include a rule to the effect that mere erroneous book entries do not lead to innocent acquisition.

**9. Re Article 16**

The regulation dealing with the intermediary's duty to hold sufficient securities should be stricter. Instead of the mere rule, either a prohibition liable to criminal prosecution or control subject to supervisory or commercial law should be introduced.

In any case Article 16(1) should remain in the Convention and the square brackets should be deleted.

**10. Re Article 18**

Further discussion is needed regarding the clause on allocation of any shortfall. It is inconsistent with the principles of the German legal system. All account holders are permanently at risk of suffering the consequences of a single erroneous entry, even if their own acquisition has demonstrably been error-free and even if it dates back several years. Problems will also arise in practice regarding the exercise of membership or other rights attaching to securities (e.g. voting rights).

In situations where an under coverage can be attributed to book entries relating to clearly distinguishable investors it seems to be unreasonable to divide this shortfall among all investors holding securities with the same intermediary.

Additionally, an intermediary should not be able to divide losses between all investors holding securities with it where the intermediary itself is responsible for the short-fall.

**11. Re Article 19**

Germany supports the underlying policy objectives of Article 19 as it addresses important problems that occur in the course of cross border clearing and settlement.

The objective of this provision should be to prohibit restrictions on split voting and discrimination of foreign intermediaries holding securities indirectly compared to end investors holding them directly. In other words, investors who hold securities through an intermediary and those who hold securities directly should be treated equally.

Therefore, in our opinion the proposed wording of Article 19 goes much too far to achieve this aim in requiring that it is only possible to issue securities in such a form that they can be held by intermediaries. However, from Germany's viewpoint there are many reasons why shares should only be issued in other forms. The form of issue should be freely decided by the issuer. This also includes that national law may provide means for other ways of holding securities by statutory regulations.

Assuming Article 19(2)(b) is considered necessary for harmonising the law, further examination should be made regarding whether this subparagraph actually leads to adequate solutions concerning bearer shares. Furthermore, it could be considered to delete this subparagraph.

For further details concerning Articles of the Draft Convention that have not been changed at the first Committee of Governmental Experts I would like to refer to the comments made prior to that conference in April 2005.