INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
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UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT CONVENTION ON SUBSTANTIVE RULES REGARDING INTERMEDIATED SECURITIES
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COMMENTS BY GOVERNMENTS AND INTERNATIONAL ORGANISATIONS

(Comments by the Government of Germany)

[...] We are strongly convinced that especially the changes made to Articles 4, 9, 10, and 18 to 20 show the great steps forward made during the last meeting. The current draft puts many aspects into consideration which are very important for Germany and other countries having similar substantive rules on intermediated securities (as Germany) whilst connecting different approaches of various jurisdictions without neglecting the differences. However, in view of international capital markets, a high level of harmonisation is of great importance. [...]

In view of what has been articulated by Germany in its written as well as oral statements at the previous Conferences 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

Referring to the discussion at the second meeting of governmental experts in March 2006 of the definition of "intermediated securities" in Article 1(f) we submit the following wording in support of the proposal of the delegation of the United States:

> "(f) "intermediated securities" means what is conferred on an account holder under Article 9 by a credit of securities to a securities account;"

2. *Re* Article 2

It should be made clear that the Convention has not the intention to change corporate law. Therefore, we propose to insert the following sentence:

> "This Convention does not govern corporate law matters and the relationship between companies and their shareholders."

3. *Re* Article 7

Article 7 (4) lit. b and Article 7 (6) where it says

> "...and deliberately avoids information that would establish the existence of the adverse claim."

should not be construed to mean that the collateral taker has an obligation to conduct investigations. Since the terminology may reflect basic notions of specific jurisdictions but may be alien to others it should therefore be pointed out in an Explanatory Report that the aforementioned phrasing under Article 7 (4) lit. b and Article 7 (6) does not give rise to any such investigation obligation.

The same applies to the last half sentence added under Article 7 (4) lit. b which refers to the attribution of knowledge received by an "organisation". The term organisation can be construed in a very broad sense so that it may even give rise to a group-wide knowledge attribution.

4. *Re* Article 8

Article 8(2) replaces the provision previously contained in Article 7(4) which specifically allowed to impose certain conditionalities on the debit or credit. However, this provision does not have the same clarity as the previous one. For reasons of transparency, we would suggest including this wording as an example in the Convention. It could, for instance, be modelled on the language of Article 7 (4) of the previous draft. At least, however, there should be a statement of motivation concerning Article 8 (2) which ought to point out that the scope of Article 8 (2) shall also cover the case of conditional debits or credits.

5. *Re* Article 9

Supporting the proposal of the United States Article 9(1)(d) should be redrafted as follows:

> "(d) unless otherwise provided in this Convention, such other rights, including rights in securities, as may be conferred by the domestic non-Convention law."

As regards the reasoning behind this, we would like to refer to the proposal of the delegation of the United States made concerning Article 9(1)(d).

To avoid conflicts with existing corporate laws we suggest to extend Article 9(1)(a) by the following words:

> "the right to receive and exercise the rights attached to the securities, including in particular dividends, other distributions and voting rights in accordance with this Convention, the law under which the securities are constituted and the terms of the securities ..."

6. *Re* Article 17

The first paragraph of Article 17 (1) contains an addition in brackets ("for account holders"). This addition should be deleted. A qualification of the intermediary's duty to hold sufficient cover assets only for those securities credited to securities account holders would, in theory, mean that the intermediary could continue to credit more securities to itself than it actually holds. Whilst this would in any case not incur any legal consequences, it remains unclear what the point would be if the intermediary were to credit securities to accounts which it maintained for itself.

7. *Re* Article 20

In the event of an insolvency of the intermediary, Article 20 (1) lit. a provides that the loss shall generally have to be borne on a *pro rata* basis by all securities account holders. We feel that this principle is at least inappropriate in those cases where the lack of cover assets resulted from the fact that an individual securities account holder has received a credit for which the intermediary failed to set up the necessary cover assets. In such an event, we are still of the opinion it would be fairer if the loss given the lack of cover assets were exclusively allocated to the respective

securities account holder unless said securities account holder acted in good faith during the acquisition.

Therefore, the addition in brackets under Article 20 (2) which allows derogations from this regulation under domestic non-Convention law, should be maintained.

8. *Re* Article 24

The term "collateral securities" introduced under Article 23 2 (b) is redundant. Hence, Article 24 (1) could also read as follows:

> "... the collateral taker may realise the intermediated securities delivered under the collateral agreement: (a) by selling them ... (b) by appropriating them as the collateral taker’s own property ...".

Article 24 (2) could then continue:

> "Intermediated securities may be realised under paragraph 1 ..."

9. *Re* Article 25

In Article 25(2), it would be preferable to use the definition "of the same description" (Article 1 (l)). This way, in Article 25 (2) in line 4, the words "of the same issuer or debtor, forming part of the same issue..." will become redundant.

10. *Re* Article 26

The recognition of any circumstances giving rise to an increase in the credit risk incurred by the collateral taker as contemplated by Article 26 lit. a exceeds the provisions under the EU Financial Collateral Directive. The limited recognition of borrower related top-up entitlements under the provisions of the Financial Collateral Directive has already come under strong criticism. Hence, the initiative of the UNIDROIT Convention's Drafting Committee reflected in Article 26 lit. a is to be strongly welcomed.

11. *Re* Article 27

One lesson learnt among the EU member states during the implementation of the EU Financial Collateral Directive is that the provision of choice poses a lasting threat to the harmonisation of law even at a moderate level. Hence, the right to choose in Article 27 (2) lit. a should either be removed altogether or it should be limited to consumers only. This is especially true for the elective rights stipulated under the provisions of Article 27 (2) lit. b and lit. c, where the lack of any real need is particularly conspicuous.