

**UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS
FOR THE PREPARATION OF A DRAFT CONVENTION ON
SUBSTANTIVE RULES REGARDING INTERMEDIATED
SECURITIES**

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Supplementary Working Paper regarding so-called “Transparent Systems”

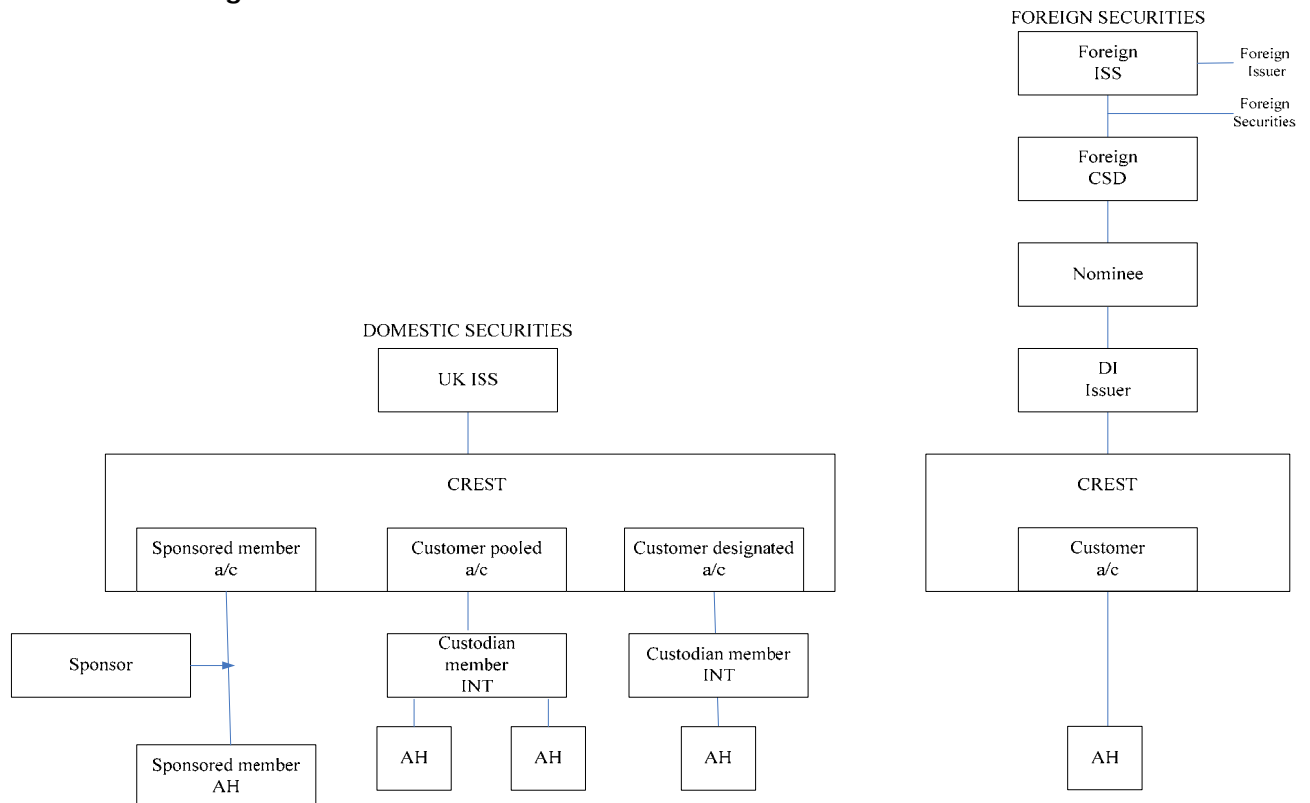
(prepared by the Secretariat on the basis of contributions submitted by delegations)

Introduction

At the Committee’s third session, a few delegations indicated that descriptions and diagrams in Doc. 44 did not fully reflect the features of their respective systems. The Secretariat provides herewith additional examples and illustrations of existing transparent systems.

Examples

A. United Kingdom - CREST



I. With respect to UK securities

1. CREST maintains an operator register. For UK securities (but not for Irish securities) the operator register is the legal root of title.
2. CREST operates a settlement system.
3. CREST maintains its participants' accounts. Its participants may either be members that have access to the system themselves or 'sponsored members' (persons using someone else's (i.e. a sponsor's) IT gateway to access the system). The sponsor is not an intermediary for the sponsored member and neither holds or maintains accounts for the sponsored member, i.e. CREST maintains the account in the name of the sponsored member (not its sponsor's name). Members and sponsored members may be holding securities in CREST for their own account or as intermediaries for clients.
4. Where a CREST participant holds as an intermediary, CREST maintains that members' (= those who perform custodian functions) clients (=AH) accounts (a) either in pooled custodian's accounts; or (b) custodian's designated clients accounts. The accounts in favour of AHs are maintained by the member/custodian, not by CREST.

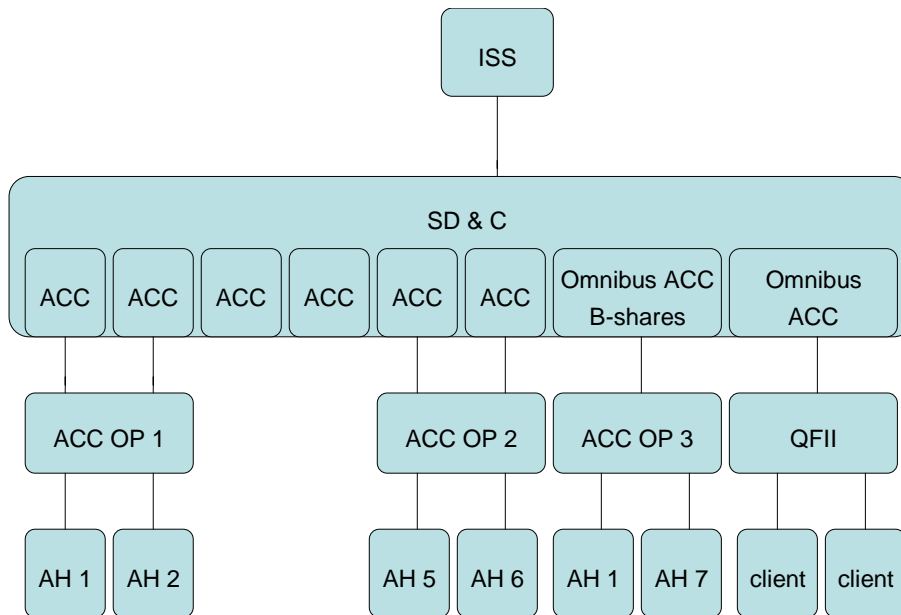
II. With respect to foreign securities

CREST may carry out the account *maintenance function* (e.g. respond to AH's instructions to sell or pledge Depository Instruments (=DIs)), whereas the member intermediary (which is usually a nominee company specifically established for the role) *holds* the underlying securities for which it has issued DIs to its AHs.

III. Analysis in terms of Doc. 44 categorisation

1. As regards the aspect of transparency, it is not the 'middle entity' but the CSD that is transparent.
2. Where a participant in CREST is a sponsored member, that participant gives instructions to the CSD 'through' the IT interface of its sponsor. The sponsor has an IT gateway to the CSD but need not be a participant in the system itself.
3. A member may carry out different functions: e.g., input instructions as a sponsor on behalf of sponsored members who have an account in CREST, act as custodian and operate either *pooled* or *designated clients'* accounts for its clients.
4. With respect to foreign securities, CREST remains transparent. CREST accounts record entitlements to DIs issued by a depository for whom foreign securities are held by a nominee.

B. People's Republic of China



I. Functions and status of SD&C and account operators

1. The China Securities Depository and Clearing Corporation (SD&C) is the sole CSD in China and performs the functions of maintaining on behalf of issuers the register of securities holders as well as their rights and interests, CCP, clearing and settlement. Registration on the register evidences the legal title to securities in all listed companies. For *A shares* (i.e. RMB denominated shares), corporate bonds and government bonds listed on the Shanghai and Shenzhen stock exchanges SD&C establishes and manages (i.e. credits and debits) the ultimate investors' (AH's) securities accounts and settlement accounts. The Chinese system is therefore primarily a direct holding system.

By contrast, *B shares* (i.e. foreign currency denominated shares) are indirectly held in omnibus accounts. Accounts opened with SD&C by Qualified Foreign Institutional Investors (QFIIs) on behalf of their clients are also considered to be indirectly held although regulations are not yet clear in this respect. The inter-bank system is also based on indirect holding.

Since the SD&C does not enter into any contractual relationship with the account holders, it would appear that rights, obligations and liabilities (if any) of the SD&C can only be based on regulatory law. The account agreement, thus, would appear to consist of the agreement between an account holder and the account operator (acting on behalf of SD&C), which thereby invokes the terms of the regulatory law.

2. Securities firms and banks perform the functions of account operators. They act for the investor in opening his account with SD&C as well as in trade and settlement. In addition, they provide communication and book-keeping services. Transactions between investors and account operators are settled through SD&C. However, the contractual relationship between AH and account operator is not an 'account agreement' (Article 1(f) draft Convention) because the securities firm or bank is not the 'relevant intermediary' (Article 1(g)).

Although the AH's accounts are kept with SD&C, it is practice that court officials seek identification of the debtor's account operator and then turn – contrary to the draft Convention's approach (Article 17) – to that firm for attachment. When securities have been credited to an account, only the account operator who acted as an agent in crediting the securities to that account may receive the order to effect a debit in respect of those securities and transmit that order to SD&C. It is that account operator that will be identified by SD&C at the court official's request for the purpose of attachment.

II. Foreign securities

Currently all issues listed in China are domestic. Qualified Domestic Institutional Investors (QDIIs) trade in foreign securities on foreign markets.