



**DIPLOMATIC CONFERENCE TO ADOPT A
CONVENTION ON SUBSTANTIVE RULES
REGARDING INTERMEDIATED SECURITIES**
Geneva, 1 to 13 September 2008

UNIDROIT 2008
CONF. 11 – Doc. 16
Original: English
July 2008

Comments

(submitted by the Government of France)

The French delegation thanks the UNIDROIT Secretariat for the occasion given to comment in advance on the coming works, at the Geneva Conference, on the draft text on Intermediated Securities. The French delegation reserves the right to submit additional observations in the future.

1. The issues discussed by the informal intersessional Working Groups are still entirely to be determined and constitute a condition to the success of the coming meetings

1.1 The French delegation wants to underline that many substantive questions remain unresolved yet. In particular, a consensus has still to be reached on the three major issues which had to be referred to the informal intersessional Working Groups, i.e.:

- Good faith acquirer;
- Insolvency;
- Securities Settlement Systems (SSSs) designation / rules of Central Securities Depositories (CSDs).

Each of these issues is of particular importance for our delegation. According to which solution will be eventually adopted by the Conference, the general functioning and therefore the acceptability of the draft Convention could be impacted.

1.2 An annex hereto is dedicated to the good faith acquisition rule, which is of particular importance for the French delegation. A satisfying solution has to be found on this question. The test of knowledge provided for in this article is unnecessarily complicated, without providing solutions to the most important question of evidencing knowledge ("facts sufficient" and "a significant probability" are useless provisions).

1.3 The French delegation will be attentive to the final choice regarding the treatment of the CSD rules. CSD are entities. Therefore, an inclusion of their rules by way of amending the definition of SSSs or Securities Clearing Systems (SCSs), or by an explicit reference to them, would, according to our delegation, contradict the principle of the functional approach which is at the basis of the Convention. We therefore favour a clarification of the role of the CSD rules through the Official Commentary to the Convention. This raises the additional issue of the lack of such an Official Commentary of the Convention, while there is an obvious necessity to adopt such a Commentary at the same time as the adoption of the text of the Convention itself.

2. Compatibility of the UNIDROIT draft Convention and the future European instrument based on the Legal Certainty Group's recommendations

2.1 The compatibility between the Convention and the future European instrument dealing with the same issues is, for our delegation, of the utmost importance. It has to be underlined that the drafting of this instrument will most probably be finalised by the last quarter of 2009, taking into account the final advice from the consultative group ("Legal Certainty Group"), received by the European Commission in August 2008.

Therefore, the French delegation will be attentive on compatibility of the solutions adopted by the Conference with the current work of the European Legal Certainty Group (LCG). Indeed, the report of the LCG that is about to be published contains solutions on various issues that depart from the ones contemplated in the draft Convention.

2.2 This is especially the case for the above-mentioned subject of the good faith acquirer, the definition as well as the scope of the protection (crediting and earmarking), but also for the scope of the intermediaries (authorised or not) that are covered by the draft Convention or for the rules regarding the priority between competing interests.

2.3 The French delegation will be especially attentive to the question of the scope of application and considers that only authorised intermediaries should benefit from the Convention in their aim to provide services worldwide. If it is notwithstanding agreed that non-authorised account providers could benefit from the Convention, then a set of minimal "core duties" should by all means be imposed on them, as it should be the case in the final advice to the European Commission by the Legal Certainty Group. An annex hereto provides, for discussion, an example of such a list of core duties, which is necessary to ensure the well-functioning of the cross-border chain of intermediation.

3. Final clauses: issues of inclusion of a "disconnection clause" and of a review clause

3.1 *Disconnection clause.* During the preparatory meetings to this Conference, some European Member States have recently proposed to add in the draft Convention a "disconnection clause". Such a clause would allow Contracting States (for instance: EU Member States) to exclude several or all provisions of the Convention for the relationships within the European Union, that will still be governed by the European legislation. Thus, the draft Convention would only govern the relationships with non-European States.

Given that this draft Convention is aiming at governing not only international relationships but also domestic relationships, the impact of such a disconnection clause will have to be thoroughly assessed when the Conference will review the final clauses.

3.2 *Review clause.* Considering the fast evolution of financial markets and globalisation, it is absolutely necessary to include a review clause, allowing periodic (if asked by a Contracting State) review of the Convention.

4. Drafting and adoption of an Official Commentary of the Convention

4.1 The French delegation, during all Committees of Governmental Experts sessions, repeatedly asked for the drafting and the adoption, together with the text of the Convention itself, of an Official Commentary to the provisions of the Convention.

Such a Commentary does not exist yet. Notwithstanding, we consider it is extremely important in order to reduce legal uncertainty by reducing the level of interpretation left to local judges or lawmakers (we already mentioned the necessity to refer to such an Official Commentary in the context of the rules of CSDs).

4.2 The French delegation therefore considers that the Conference should designate a “Drafting Committee of the Official Commentary” which would be in charge to provide the experts with a finalised text proposal.

Annex 1: Good faith acquisition

The French delegation remains most unsupportive of the insertion of a test as referred to in Article 14(4)(b).

- We are convinced that the Convention must include a rule protecting the crediting (and earmarking?) of book-entry securities against reversal.
- We do not have any problem with the draft of Article 14(1) and (2), as the content of the notion of bad faith insofar as it results from French case law is close to the idea expressed in this provision.

However, we think that the last LCG's draft proposal contains a new and interesting approach of this concept in a dematerialised context: "*An account holder should be protected against reversal of a credit unless it knew or ought to have known that the account should not have been credited*".

And, as we are very attached to the consistency of work conducted at European and international level, we would prefer to have the same solution in both projects. A dichotomy would create legal uncertainties for participants.

- We would have a real problem with the insertion of the test of knowledge provided by Article 14(4)(b), that is incompatible with our legal system.
 - The French legal system is built on general principles and concepts laid down by the legislator, and interpreted by courts. This generality gives our legal system some flexibility and allows it to evolve easily to adapt to new realities. The insertion of the test would appear like an aberration.
 - On the other hand, French law is designed as a coherent package. The test would introduce a split between the regime governing tangible assets and the regime governing intangible assets, leading to believe that the difference in nature would prevent applicability to intangible assets of principles applicable to tangible assets, depriving us of reasoning and solutions tested for a long time.
- Regarding the substance of the rule, the test is unnecessarily complicated, without providing solutions to the most important question of evidencing knowledge (what are "facts sufficient" and "a significant probability"?). We think that the current text is not able to improve legal certainty.

Annex 2: Core duties of intermediaries

The draft Convention intends to provide for basic interconnectivity between markets, thus facilitating the exercise of the activity of intermediaries. The French delegation strongly advocates that only “authorised” or “regulated” entities should benefit from the interconnectivity provided by the Convention.

The French delegation could accept that non-authorised account providers could benefit from the Convention, but only if a precise list of core duties (for the exercise of the activity of account providing) are embedded into the Convention. At least, such core duties would create some minimum basic global standards and prevent that entirely rule-less entities are able to use the Convention to compete with regulated account providers.

Article 8 (“Measures to enable account holders to receive and exercise rights”) appears to be the relevant place for such a list of core duties.

We propose therefore for discussion the following list, inspired by the latest known discussion to date (late July 2008) on the advice to the European Commission by the Legal Certainty Group.

This list, after discussion, would be inserted in the drafting of Article 8:

“An account provider must:

- safeguard account holders securities and intermediated securities registered into securities accounts provided by that account provider;
- execute account holders' instructions, on the conditions set out in the account agreement;
- not dispose of securities or intermediated securities registered into the securities account provided by the account provider to account holders, unless explicitly provided by the non-Convention law;
- provide information in relation to securities and intermediated securities affecting the account holders' rights on the same;
- pay to the account holder any income paid in relation to securities or intermediated securities, without the account provider being obliged to grant credit to the account holder;
- report to the account holder on any movements of securities or intermediated securities credited to the securities account provided by the account provider to the account holder on regular intervals, as provided for by non-Convention law.”

These provisions interact with Article 25 on the obligations and liability of an intermediary. The current drafting of Article 25 is not satisfactory. The possible exclusion under domestic law or an account agreement is a source of legal uncertainty and puts at risk the integrity of the chain of intermediation by creating potential “bottlenecks” in the transmission of rights along the intermediation chain. The possibility for intermediaries to reduce their obligations/liabilities

according to non-Convention law should in any case be kept in line with the execution of their core duties as defined in the new proposed Article 8.

Article 25 should therefore read (addition of 25(2) in reference to the new proposed drafting for Article 8 and Article 21, dealing with the integrity of the system):

“25(2). Notwithstanding the provisions of Article 25(1) above, an account provider may not exclude its liability for the obligations set forth under Article 8 of this Convention. An account provider may neither limit nor exclude liability for its obligations under Article 21 of this Convention.”

- END -