



**DIPLOMATIC CONFERENCE TO ADOPT A
CONVENTION ON SUBSTANTIVE RULES
REGARDING INTERMEDIATED SECURITIES
Final session**
Geneva, 5 to 7/9 October 2009

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Comments

(submitted by the Government of France)

The French delegation thanks the UNIDROIT Secretariat for the occasion given to comment in advance of the coming negotiations, at the final session of the diplomatic Geneva Conference, on the draft Convention on Intermediated Securities as well as on the draft Official Commentary.

1. Organisation of the final session of the diplomatic Conference to adopt a Convention on Substantive Rules regarding Intermediated Securities

1.1 The duration currently contemplated for the final session of the diplomatic Conference to adopt a Convention on Substantive Rules regarding Intermediated Securities is 3 days (from 5 to 7 October 2009) with a possible extension of 2 days. During this final session, the delegations will be invited to

- negotiate the final draft of the Convention by solving substantive questions that remain unresolved,
- study the impact on this draft of the Official Commentary and propose revision to this Commentary if need be,
- discuss the memorandum regarding suggestions for the revision of the draft Convention,
- check the compatibility of the English and French version of the Convention,
- follow the diplomatic protocol leading to the adoption of the draft Convention.

1.2 Given the work programme of this final session, the French delegation considers that this duration is not sufficient. Consequently, we propose an extension of the final session from 3-5 days to 10 days.

1.3 We consider that such proposal would allow to ensure that the drafting of a final text will achieve both targets of producing a document that will - meet the interests of a large majority of the delegations and, - reflect the high quality of the contributions given by the experts involved in the process.

2. Memorandum regarding suggestions for revision of the text of the draft Convention (submitted by the Editors of the draft Official Commentary)

2.1 The French delegation welcomes the Memorandum submitted by the Editors aiming at suggesting some revisions of the draft Convention and broadly approves all the suggestions made in this Memorandum.

2.2 We especially welcome the suggestion regarding a clarification of the meaning of Articles 7, 14 and 21 on the relationship between the Convention and insolvency specific rules such as avoidance and procedural rules in insolvency proceedings. Such clarification is essential in order to reduce the legal uncertainty and protect, in insolvency proceedings, the rights and interests of an account holder that have become effective against third parties under Article 11 or Article 12 of the Convention.

2.3 Consequently, we think necessary to thoroughly discuss this issue at the final session in order to elaborate a new draft that will avoid the potential misunderstandings flagged by the Editors.

3. Draft Convention on Substantive Rules regarding Intermediated Securities

3.1 *The issue of regulation of intermediaries (request for revision of Article 4)*

3.1.1 The French delegation would like to reiterate its request regarding the need to limit the scope of the Convention to “authorised” or “regulated” entities and to define harmonised criteria regarding the core duties of intermediaries covered by the draft Convention. The role of intermediaries is at the core of the scope of the draft Convention. This is the direct consequence of the intermediated holding system. The integrity of the system that the draft Convention tries to promote is based on the robustness of its components and a consistent set of rules applicable to the latter, i.e. the intermediaries. Therefore, there is a clear need to address this issue in the Convention. And it may not be left either to the non-Convention law nor to the contractual arrangements between the parties as it is currently provided in Article 28.

3.1.2 The current UNIDROIT draft Convention has been drawn up as a convention governing private law relationships on matters concerning the legal arrangements for the acquisition and disposal of financial instruments. The draft does not cover the regulatory aspects of these matters, which are left to the Contracting States' discretion.

3.1.3 In the text, this takes the form of a provision in the last recital of the Preamble of the draft Convention: "*Recognising that this Convention does not limit or otherwise affect the powers of Contracting States to regulate, supervise or oversee the holding and disposition of intermediated securities or any other matters expressly covered by the Convention, except in so far as such regulation, supervision or oversight would contravene the provisions of this Convention*". Under this provision, the draft Convention does not affect the Contracting States' regulatory powers, which confirms that regulatory issues are not harmonised by this draft. Moreover, Contracting States' regulatory provisions must not call the provisions of the draft into question, for example by impinging on the rights established for individuals or legal persons by the draft.

3.1.4 However, due to (i) the interdependency of custody systems and (ii) the impact on clients' rights of observing a basic level of rules of a regulatory nature, it could on the contrary be concluded that the regulation of intermediaries cannot be left to the discretion of Contracting States alone and that the integrity of the system requires a common approach.

3.1.5 Therefore, we request the deletion of Article 4 and a revision of the definition of Intermediary in Article 1 as follows:

“intermediary” means a person (including a central securities depository) who in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity and is subject to authorisation, regulation, supervision or oversight by a government or public authority in respect of that activity or is a central bank.”

3.2 **The issue of core duties of intermediaries (request for revision of Article 10)**

3.2.1 The French delegation also considers that Intermediaries may be allowed to benefit from the Convention, but only if a precise list of core-duties (for the exercise of the activity account providing) is included in the Convention.

3.2.2 Such core-duties would create some minimum basic global standards in order to establish a level playing field between intermediaries.

3.2.3 Moreover, this is an essential condition in order to guarantee the integrity of cross-border intermediation and the protection of account holder rights since such integrity is based on the quality of each of the components of the intermediation chain.

3.2.4 Article 10 (Measures to enable account holders to receive and exercise rights) appears to be the relevant place for such a list of core-duties.

3.2.5 This list could be inserted in the drafting of Article 10 in the following way:

“1. An intermediary must take appropriate measures to enable its account holders to receive and exercise the rights specified in Article 9(1). To this aim, an intermediary must at least

- safeguard account holders securities and intermediated securities credited to an account as further provided for under article 24;*
- execute account holders' instructions, on the conditions set out in the account agreement as further provided for under article 23(1);*
- not dispose of or use securities or intermediated securities credited to a securities account provided by the relevant intermediary to account holders, unless explicitly provided by the non-Convention law or by the account agreement if permitted by the non-Convention law;*
- provide information in relation to securities and intermediated securities affecting the account holders' rights;*
- pay to the account holder any income paid in relation to securities or intermediated securities, without the relevant intermediary 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 relevant intermediary to the account holder on regular intervals, as provided for by non-Convention law.*

2. *This Convention does not require the relevant intermediary to establish a securities account with another intermediary or to take any action that is not within its power.*"

3.2.6 The effect of such list shall of course be assessed in light of Article 28 according to which Contracting States will keep their freedom to shape the details of these core duties under non-Convention law.

3.3 ***The issue of relationship with issuers (request for revision of Article 8)***

3.3.1 In light of the draft Official Commentary, it appears that the use of the terms "account holder" in Article 8(1) and of "holder of securities" in Article 8(2) is confusing. Section 8-13 in the draft commentary states that "Article 8(1) applies to the matters with respect to the relationship between the account holder and the issuer which are beyond what is spelled out in Article 9(1)(a)". In other words, it means that Article 8(1) is targeting the relationship between the holder of securities and the issuer.

3.3.2 Therefore, we suggest to replace in Article 8(1) the words "account holder" by the words "holder of securities" and to adapt the relevant draft Commentary.

3.4 ***The issue of holding of sufficient securities by each intermediary (request for revision of Article 24)***

3.4.1 The French delegation does not understand how an account holder can be protected if the obligation born by its intermediary to hold sufficient securities is limited to the securities of its clients and does not cover its own securities. If we consider that at the upper tier level the own securities of the intermediary are also registered together with the assets of its clients, the integrity of the relevant issue implies that the securities on the securities accounts maintained by each intermediary for itself shall be included in the reconciliation with the position held with the central securities depository.

3.4.2 Therefore, we request an amendment to this Article in order to enlarge the scope of this Article to the securities accounts that the intermediary maintains for own account.

3.4.3 It's noticeable that the second advice of the European Legal Certainty Group (August 2008) that is expected to lead to a future harmonised legislation on the subject DOES take into account in the obligation to hold sufficient securities "book-entry securities credited to the accounts of its account holders *plus* the book-entry securities held by the account provider for its own account" (see page 67-68 of the advice).¹

3.5 ***The issue of implementation of intermediaries duties into non-Convention law and of liability of intermediaries (request for revision of Article 28)***

3.5.1 Article 28(1) contains an ambiguity in the following sentence: "*If the substance of any such obligation is addressed by any provision of the non-Convention law, the account agreement or the uniform rules of a securities settlement system, compliance with that provision satisfies that obligations*".

3.5.2 The mere fact that the non-Convention law, an account agreement or the uniform rules of a securities settlement system address the substance of an obligation of intermediaries does not mean that the non-Convention law, the account agreement or the uniform rules of a securities settlement

¹ Cf. at page: http://ec.europa.eu/internal_market/financial-markets/docs/certainty/2ndadvice_final_en.pdf

system comply in substance with the Convention. This leaves the door open to Contracting States to allow intermediaries to comply with less than the obligations provided for in the Convention, which is contrary to the purposes of minimal and global harmonisation of the effects of the registration of securities into securities accounts and the need to offer a level playing field in a global competitive environment.

3.5.3 Therefore, we advocate deletion of the quoted sentence.

3.5.4 Article 28(2) states that "*The liability of an intermediary in respect of its obligations is governed by the non-Convention law (...)*". We consider that the liability regime of intermediaries should be subject to a minimum harmonisation in order to avoid any circumvention of the Convention through contractual liability limitation or exclusion clauses. We understand that the purpose of this Convention is not to harmonize the law applicable to tortuous and contractual liability.

3.5.5 However, we think that the Convention should at least prevent a Contracting State from having the possibility to exclude liability for wilful misconduct or gross negligence.

3.5.6 Therefore, we suggest the following amendment: at the end of Article 28(2), the following words should be included:

"but liability may not be fully excluded in the event of wilful misconduct or gross negligence".

4. Draft Official Commentary on the draft Convention on Substantive Rules regarding Intermediated Securities

4.1 As stated in the comments sent before the first session of this diplomatic Conference, "The French delegation, during all Committees of Governmental Experts sessions, repeatedly asked for the drafting and the adoption, altogether with the text of the Convention itself, of an Official Commentary of the provisions of the Convention". Indeed, such Official Commentary will be an essential instrument to reduce legal uncertainty by reducing the level of interpretation left to local judges of lawmakers.

4.2 Therefore, we would like to thank all the contributors and the Secretariat of UNIDROIT that were involved in producing this draft Official Commentary and in making it available before the final session of the diplomatic Conference. We consider that both linguistic versions are of high quality standard and achieve the target of having an almost final draft before the end of the negotiations of the draft Convention.

4.3 The French delegation would like to supplement this draft with the following comments:

Article 1(m)

4.3.1 In section 1-49, it could be helpful to add Article 28(1) in the instances given for the ability of the non-Convention law to supplement the Convention. In the current text, only Article 13 is mentioned.

Article 10

4.3.2 In section 10-10, with the exception of the examples 10-1 and 10-2 that can't be seen as a justification by themselves, there is no justification for Article 10(2). Therefore, the French delegation requests a clarification of the explanation.

Article 17

4.3.3 In section 17-8, it is stated that “Sub-paragraph (b)(i) makes clear that the “ought to know” element is to be applied in light of the unique circumstances applicable to intermediated securities. Traditional notions of “good faith” or “innocence” are inappropriate in the sui generis context of intermediated securities systems. Courts should not seek guidance from the applicable law with respect to the good faith purchase of movables more generally.”

4.3.4 We consider that the draft of this section is too affirmative in excluding the application of traditional good faith concepts. Indeed, it can’t be excluded that, in certain jurisdictions, courts will not completely reject but adapt the traditional notions of good faith and innocence to the “unique circumstances” applicable to intermediated securities.

4.3.5 Therefore, the French delegation request a revision of the drafting in the following way:

“(…) Traditional notions of “good faith” or “innocence” may be seen as inappropriate in the sui generis context of intermediated securities systems. Courts should adapt to this specific context guidance from the applicable law with respect to the good faith purchase of movables more generally.”

Article 24

4.3.6 In section 24-13, the explanation provided for the phrase “to hold or have available” does not appear to be sufficient to understand what is meant by these two concepts. Therefore, we request a clarification of the explanation.

4.3.7 In section 24-17 on the different listed methods available to achieve the principle of Article 24(1), no reference is made to the main tool used in several countries and especially in continental Europe in order to protect account holders from any artificial creation of securities. This tool is the mandatory reconciliation between the accounts of each intermediary and the issuing account hold by the central securities depository. Therefore, we would like this protective tool to be included in the Official Commentary on Article 24.

Article 28

4.3.8 In example 28-2, the possibility given by law to permit temporary shortfalls seems contrary to the spirit of Article 24(3) where the shortfalls shall be of exceptional nature. Our interpretation is that a law allowing temporary shortfalls would be contrary to the substance of the obligation. By maintaining such example, there is a clear risk that the reader believes that the non conventional law may empty the obligations of the Convention.

4.3.9 Therefore, we request the deletion of example 28-2 and a revision of examples 28-5 and 28-6 (replacement of State X by State Z for instance).

Article 38

4.3.10 In sections 38-2 and 38-8, the possibility to combine, in the State’s declaration, the partial opt-outs of Article 38(2) is not clearly mentioned.

4.3.11 Therefore, we would like to include a sentence specifying that a State may declare a partial opt-out combining any of the issues covered in the three sub-paragraphs of Article 38(2).