INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

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

UNIDROIT 2009
CONF. 11/2 – Doc. 16
Original: English
24 August 2009

Comments

(submitted by the Government of Italy)

1. The Italian delegation strongly appreciates the high quality efforts made by all delegations participating into the work, the Drafting Committee and the other *ad hoc* committees, as well as the Secretariat of UNIDROIT to improve the quality of the text of the draft Convention on Substantive Rules regarding Intermediated Securities (hereinafter, the "Convention") and to reach a general consensus on its contents.

2. To this end, the Italian delegation intends to offer a contribution to these efforts by presenting the following observations, which are in line with positions that were already expressed by the various members of the delegation at different times in the course of the work, and that in its belief would contribute to reach a final common agreement on the text of the Convention.

Comments on Articles 1(d), 4, 24, 28 - Proposal for a new Article 20bis

3. Italy holds that the Convention would not pursue its main objectives as identified in the Preamble (protection of acquirers/holders, reduction of legal and systemic risks, enhancement of international compatibility and soundness of systems) if some regulatory aspects concerning the status and the role of intermediaries in intermediated securities holdings are not properly taken into account. The current approach, which leaves to Contracting States any regulatory issue, is not satisfactory in this respect.

4. Intermediaries have a central role in holding and settlement of securities: they are involved in the acquisition/disposition process, are vital for the implementation of rights of investors against the issuer, safe-keep securities to the benefit of account holders/investors. Having regard to their extremely sensitive role and to the risks involved by their activity, in many countries intermediaries are subject to an authorization to entry, as well as regulation and a supervisory regime.

5. The Convention should thus recognize that in order to reduce legal and systemic risks, protect the investors and enhance international compatibility, a minimum harmonization concerning regulatory aspects should be warranted.

6. In the absence of such an harmonization, the adoption of the Convention may have even detrimental effects, since the existence of global substantive rules would increase cross-border transactions involving intermediaries which are part of the same holding chain but are subject to very different regulatory regimes. Intermediaries which are subject to a light regulatory regime or even non-regulated intermediaries would weaken the soundness of the whole holding chain and increase the risk for investors and systemic stability.

7. Since the regulatory regime would not be harmonized and remain subject to Contracting States' power, it would also be necessary that core duties of intermediaries aimed at preserving the rights of the account holders and a related liability regime be better specified in the Convention, notwithstanding the current reference to the non-Convention law set out by Article 28.

8. On this basis, Italy proposes the following amendments to the draft Convention and calls for a discussion on these issues in the Plenary. Drafting suggestions are evidenced in italics:

- **The Convention should apply only to securities accounts maintained by regulated intermediaries**. The Convention would not reach its objective of increasing the safety and soundness of holding intermediated securities if it includes within its scope of application securities accounts maintained by intermediaries which are not subject to authorization, regulation and supervision by a competent authority. In this field a full separation between regulatory and substantive law is not conceivable. Credits and debits should produce substantive law effects only insofar as securities accounts are maintained by intermediaries that are given by the State a special function based on a strict regulatory regime.

  Article 4 should be deleted and the definition of intermediary should be amended as follows:

  " "intermediary" means a person …. and is acting in that capacity (unchanged) *and is subject to authorization, regulation, supervision or oversight by a government or public authority in respect of the activity of maintaining securities accounts, or is a central bank*".

  We are aware that the main objection against the above proposition relates to the need to protect investors who open accounts with non authorized intermediaries. Although it could be replied that the law does not necessarily protect negligent investors, it is understood that this argument may find broad support within negotiating delegations. If this is still the case, in order to ensure that *as a rule* the Convention apply to holding chains composed only by authorized intermediaries and that only *by exception* it can apply in some Contracting States to non authorized intermediaries, as a way to reach compromise Italy may accept as a (second best) alternative that Article 4 remains unchanged and that the Preamble of the Convention recognizes both the importance of regulation in the field of intermediated securities and the commitment of Contracting States to subject the securities account activity to authorization, regulation and supervision.

- **Intermediaries should report to account holders on securities movements relating to their securities accounts and their holdings.** A new provision (Article 20bis) should be inserted with the following content:

  "*An intermediary must report to its account holders on the movements and holdings on their securities accounts in a manner, and with a scope and regularity as it is prescribed by the non-Convention law and, to the extent permitted by the non-Convention law, by the account agreement or the uniform rules of a securities settlement system applying to it*".

- **An intermediary must hold sufficient securities, *i.e.* it must maintain a number of securities and intermediated securities that correspond to the aggregate number of securities credited to the account of its account holders *plus* the securities held by an intermediary for its own account.** The current text of the draft convention (Article 24) limits this obligation to securities credited to the accounts of the account holders. However, it is essential that the obligation to hold sufficient securities include also securities credited by intermediaries on securities accounts maintained in their names and for their own account. In the absence of this extension of the obligation, there may be a permanent imbalance between the number of securities originally issued and

securities credited on securities accounts maintained by intermediaries. This imbalance prejudices the integrity of the issue which may create operational and legal uncertainty, e.g. as regards the payment of dividends and the exercise of voting rights. Moreover, since many Contracting States have already this rule in place within their own jurisdictions, the current text would determine a relevant change in their own legislation. Article 24(1) should be therefore amended as follows: "An intermediary must, for each description of securities, hold or have available for the benefit of its account holders, *including itself*, securities and intermediated securities…."

- **The Convention should state the duty of intermediaries to act according to professional diligence. Non-Convention law should not exclude liability of intermediaries for wilful misconduct or gross negligence in the performance of their core duties.** Articles 10, 15, 24 and the above mentioned proposed Article 20bis provide for some core duties of intermediaries at any level of the holding chain, which are necessary to protect the rights of the account holders and to ensure the continuity of the relationship between the issuer and the investor. According to Article 28, the obligations of an intermediary under the Convention may be further specified by the non-Convention law. Article 28(2) provides that the liability of an intermediary in respect of its obligation, *including* those set by the Convention, is governed by the non-Convention law and, to the extent permitted by the non-Convention law, the account agreement of the uniform rules of a securities settlement system. In our opinion, the liability regime should be subject to a minimum harmonization regime within the Convention in order to avoid that duties of intermediaries under the Convention and the non-Convention law are circumvented through contractual clauses which unduly limit liability. Indeed, intermediaries should comply with their duties with professional diligence and should not be able to limit their liability. In the light of the different views expressed on this issue, the Convention should at least rule that non-Convention law may not fully exclude liability for wilful misconduct or gross negligence.

  We consequently propose to amend Article 28 by:

  (a) introducing at the beginning of paragraph 1 "*Subject to paragraph 2…*",

  (b) adding at the beginning of paragraph 2 "*An intermediary shall perform the obligations under paragraph 1 according to professional diligence*", and

  (c) by adding the following sentence at the end of paragraph 2: "*but liability may not be fully excluded in the event of wilful misconduct or gross negligence*".

Comments on Article 9

9. **In Article 9(3), the reference to non-Convention law should be replaced with "applicable law"** since to our knowledge some of the issues at hand (*e.g.*, who is entitled to vote in the general assembly, whether the grantor or the acquirer of a security interest) may be settled by corporate law (*lex societatis*), i.e., the law of the issuer, which might not be the non-Convention law.

Comments on Article 12

10. **Article 12 should apply only to creation of limited interests.** Article 12 lists the optional methods by which an account holder grants an interest in intermediated securities, including a security interest or a limited interest other than a security interest. It has been clarified in the course of discussions and by the draft Official Commentary that "the methods provided in Article 12 are capable of granting any type of interest in intermediated securities under the non-Convention law, including a full interest". The draft Commentary (section 12-13) adds that "it is

generally understood that purchasers of intermediated securities will typically want to have them credited to their account, but there is no policy reason to prohibit the use of one of Article 12 methods".

11. We understand that methods under Article 12 may be used to transfer interests in repurchase transactions or by way of usufruct since these interests have a temporary nature and the account holder granting such interests has still a claim on the securities and may be happy to keep them credited on his securities account. However, there is no logical reason why, in the event of outright purchase of securities, the transferor should still keep the securities on his own securities account. If there is no policy reason to prohibit that, there is neither any sense for that option. We therefore suggest the following redrafting of Article 12(1):

> "Subject to Article 16, an account holder grants *a security interest, or a limited interest other than a security interest,* to another person…".

- END -