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 the Republic of Latvia)

I. SUMMARY OF THE DRAFT LEGAL ACT / ISSUE UNDER CONSIDERATION

The Preliminary Draft Convention on Substantive Rules Regarding Intermediated Securities (hereafter – the Convention) applies where rules of private international law of the forum state designate the law of a Contracting State.

The Convention governs transfer of intermediated securities as collateral, rights of an account holder, integrity of holding system of intermediaries, as well as other issues regarding intermediated securities.

II. SITUATION IN LATVIA

In the Republic of Latvia the issues covered in the Convention are partially regulated by the Law "On Settlement Finality in Payment and Financial Instruments Settlement Systems", the Securities Market Law, the Financial Collateral Law, as well as other legal acts, according to the requirements of the European Union Directive 98/26/EC on settlement finality in payment and securities settlement systems, which determines the finality of transfer orders and protects specific collateral activities, and requirements of the Directive 2002/47/EC on financial collateral arrangements.

The regulation of the securities market of the Republic of Latvia at the level of national laws and regulations corresponds to the EU legal regulation and owing to this it has achieved a positive level of development.

At the same time the Republic of Latvia is considering the possibility to join the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities, which also partially concerns the issues of the present Convention.

III. LATVIA'S COMMENTS

Title of the Convention

Having acquainted with the text of the Convention a question arises - whether it governs situations only concerning *''collateral securities''* or also concerning other securities held by the intermediary for the benefit of its customer.

If the Convention governs the situation only concerning *''collateral securities''*, then this should be indicated already in the title of the Convention, so that already from the title of the Convention it is clear to what exactly the Convention refers. The title of the Convention collides with the contents and terminology used in the Convention.

Structure of the Convention

The current structure of the text of the Convention is not logical and encumbers understanding of the text of the Convention; therefore we propose to review the structure of the text of the Convention.

Sphere of application of the Convention

It is necessary to define more precisely the securities to which the Convention applies (whether it applies only to securities in public circulation or to any securities).

Article 1(a)

Latvian and EU legal acts use the term „financial instruments", which is a broader concept than "securities". Latvia proposes to make the definition more precise by explaining what financial instruments are.

Article 1(b)

If the proposal at Article 1(a) is taken into consideration, Article 1(b) should be also correspondingly made more precise.

Article 1(c)

Without comments.

Article 1(d)

Without comments.

Article 1(e)

Without comments.

Article 1(f)

It is proposed to make the definition more precise by laying down that intermediated securities are securities held in accounts opened with an intermediary.

Article 1(g)

Without comments.

Article 1(h)

It is proposed to delete the words ''*whether outright or by way of security''* or to explain the essence of and need for this formulation.

The explanation of the term includes the concept *''security interest''*. We consider that this concept should be explained in Article 1 under a separate paragraph.

Article 1(i)

It is necessary to clarify the difference between the concepts “adverse claim” and “security interest”.

Article 1(j)

Should “interim proceeding” be considered a stage in the insolvency proceeding? The Law “On Settlement Finality in Payment and Financial Instruments Settlement Systems” provides a definition of “insolvency proceeding”, which can be a successful example according to which this paragraph of the Convention could be defined more precisely.

Article 1(k)

It is necessary to clarify what is understood with the text in parentheses.

Article 1(l)

Latvia proposes to simplify this definition by laying down that financial instruments issued by the same issuer and having identical characteristics have identical issuer, nominal value, voting rights, alienation rights etc.

Article 1(m)

There is no clear difference between ''control agreement” and “collateral agreement” mentioned under paragraph t). It should be explained, how (and if) these two agreements differ in substance, including in respect of change of title.

It is proposed not to give a list of persons who have to sign the ''control agreement”.

Article 1(n)

From the given term it can be understood that “designating entry” is making of a note in the securities account of the collateral provider for the benefit of the collateral taker, as a result of which the title does not change. Thus this term is essentially in conflict with Article 5(2) of the Convention, from which it can be derived that when providing a collateral there is still a change of title.

Article 1(o)

Without comments.

Article 1(p)

It is proposed to explain *''non-consensual''* separately as a term (and, as already indicated before, to explain “security interest” also separately as a term).

Article 1(q)

Without comments.

Article 1(r)

Without comments on condition that the term “security interest” is explained.

Article 1(s)

Without comments on condition that the term “security interest” is explained.

Article 1(t)

It cannot be understood how the agreement mentioned under this paragraph differs in substance from the agreement mentioned under paragraph m). It should be noted that the explanation of the term provided under this paragraph is more successful than the explanation provided under paragraph m).

If the two agreements do not differ in substance, it is proposed to use only one name of the agreement throughout the whole text of the Convention, correspondingly adjusting the term to be used or choosing one of the already mentioned terms.

In addition, it is proposed to explain in Article 1 under a separate paragraph the term mentioned under Article 23(2) sub-paragraph b) *"collateral securities"*. If this proposal is taken into consideration, it is proposed to use the term *''collateral securities''* in all articles of the Convention (not only chapter V), where activities or rules with regard to securities provided as collateral are governed.

Article 2

Without comments.

Article 3

Without comments.

Article 4(4)

It is necessary to define more precisely in the Convention the legal consequences of crediting of the account of the account holder, as well as legal status (title) of the credited securities.

Article 5

It is proposed to explain the term “security interest” separately.

In this article both names of the contract are used alternately - “collateral agreement” (mentioned in Article 1(t)) and ''control agreement” (mentioned in Article 1(m)). It is necessary to explain the purpose of alternate use of both these terms in the same article.

Sub-paragraph (b) of Article 5(1)

This sub-paragraph prescribes that delivering of securities is needed which would always imply transactions of securities from one account into another. Instead, Article 1(n) of the Convention states that it is sufficient to provide collateral by a „designating entry” which means including an entry in the account without any transaction from one account to another. Thus, the provisions of sub-paragraph (b) of Article 5(1) are contrary to Article 1(n).

Article 5(2)

We see a collision between the provisions of Article 5(2) and sub-paragraphs (m) and (n) of Article 1 of the Convention as Article 5(2) sets forth that intermediated securities may be used as a collateral by transferring them from one account to another. Instead, Article 1(n) stipulates that only an entry is required without any transactions.

The provisions contained in this paragraph also contradict with sub-paragraph (b) of Article 23(2) which stipulates that collateral is provided by means of intermediated securities.

Article 5(7)

Latvia is unable to comment Article 5(7) until explanations are provided for the above-mentioned terms (*''non-consensual'', ''security interest''*).

Article 6(3)

It is necessary to explain how control agreements comply with the provision of designating entries and the definition contained in Article 1(n).

Article 7(3)

We see a collision between Article 7(3) and Article 5(2) which envisages delivering of securities – Article 7(3) prescribes that a designating entry may be made, i.e., just an entry in a respective account without transferring securities.

Article 8

Without comments.

Article 9

It is necessary to explain sub-paragraph (c) of Article 9(1) "*otherwise than through a securities account"*, while in the rest part of the Convention it is stated that securities are held by an intermediary in a securities account.

According to sub-paragraph (c) of Article 9(1) this Convention also applies to securities held otherwise than by an intermediary though no article of the Convention explains such cases.

Article 10

Without comments.

11. pants

Without comments.

12. pants

Without comments.

Article 13(2)

It is necessary to explain the term "*nominee*" and to more precisely define the person exercising voting rights (voting rights are exercised by holders of securities (or persons authorised by holders of securities)). The holder of the nominal account is just a holder of securities (and not their owner); therefore holders of nominal accounts may not vote at a meeting without authorisation by the owner.

Article 14

Article 14(1) (*"otherwise than through a securities account"*) leads to a conclusion that securities may be held otherwise than by an intermediary though the rest part of the Convention states that securities are held by an intermediary in a securities account and no article of the Convention provide for other ways for holding securities.

Article 15

No comments.

Article 16(1)

It is necessary to explain what actions are implied by „instructions" and what legal consequences are caused by an „instruction" (whether according to an „instruction" it is only required to provide an entry in the securities account on restrictions for securities held in the account or according to such an „instruction" the respective securities held in the account should be debited and transferred to another account, etc.).

Article 16(2)

Article 16(1) leads to a conclusion that intermediaries are bound to comply with instructions delivered by account holders. It is necessary to more precisely define whether Article 16(2) is an exception to the provisions of Article 16(1).

If this part of the Article is aimed at protecting the rights of collateral taker (i.e., when a collateral is provided no orders of other persons, including courts, should be fulfilled with regard to these securities), it is necessary to elaborate the respective definitions and applicability of the cases contained in Article 9(2) in respect of Article 9(1) and applicability of Article 9(2).

Article 17

This article should be considered in combination with Article 19. Both Articles of the Convention collide. Liability and duties are not defined clearly.

Article 18

The Article corresponds to the description of the current situation and complies with the relevant EU legal acts. However, upon signature of Hague Convention on the Law applicable to certain rights in respect of securities held with an intermediary, the Article may contradict with this Convention.

Article 19

It is necessary to explain the objective of Article 19 as its current wording does not provide any such explanation.

Article 19(1)

Article 19(1) does not stipulate in how many accounts, by how many intermediaries and in what way securities are held (i.e., it is necessary to more precisely define how securities are held *„with another intermediary"'*). We deem it necessary to elaborate Article 19(1) in order to prevent interpretation problems.

Article 19(4)

Article 19(1) leads to a conclusion that, when signing the Convention, the Contracting State may elect that Article 19(1) shall only apply to client's securities held by an intermediary and shall not apply to securities owned by the intermediary. If no such reservation is made, the Convention automatically applies to all securities.

In fact, without such reservation the relevant provisions would apply both to securities of account holder and to securities owned by the intermediary.

Latvia points out that such a reservation at the level of individual countries would impact equal application of Convention's provisions.

Article 20

Without comments.

Article 21

Without comments.

Article 22

Without comments.

Some thoughts and ideas about Chapter V of the Convention

Latvia will not exercise the rights of non-application of Chapter V of the Convention stipulated in Article 27 in view of the fact that this Chapter provides for essential ideas and objectives of the Convention. However, it is necessary to align the terminology used in Chapter V with the whole text of the Convention.

Article 23(1)

Article 23(1) leads to a conclusion that the special provisions contained in Chapter V only apply to a *''collateral agreement''* (i.e., to only one type of agreements mentioned in the Convention – the agreement mentioned in Article 1(t)). We deem it necessary to more precisely define whether Chapter V is applicable to a *„control agreement"* mentioned in Article 1(m) as *''control agreements''* also include provision of collateral. Therefore Latvia deems it necessary to elaborate the relevant terminology (if Chapter V applies to both types of agreements mentioned in the Convention) or to

stipulate that the provisions contained in Chapter V shall not apply to a *''control agreement''* even though this agreement includes provision of collateral.

Article 24

Without comments.

25. pants

Without comments.

26. pants

Without comments.

27. pants

Without comments.

Conclusion

Latvia does not support the current wording of the Convention.