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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Examination of the draft Convention *vis-á-vis* the Czech Legal Order

(submitted by the Government of the Czech Republic)

General

The Czech examination covers the book-entry securities holding scheme, which embraces both 1-tier and 2-tier holding system, regardless of the investor being domestic or foreign person. According to Czech legislation the holding scheme covers ultimate investor accounts as well as omnibus accounts therefore it is to be considered a mixed system where the 1-tier is transparent and the 2-tier non-transparent. Nevertheless, as for the 2-tier a transparent pattern could be introduced depending on future uniform rules of the CSD, whether those rules will establish permanent consolidation of account information.

The following examination of the draft Convention thus concerns only the 1- tier, which is no doubt transparent.

Article 1

We agree with Finland and Colombia that a generally worded provision related to the role of account operators and their definition is needed, as well as it will be helpful if the draft Convention states that a CSD is an intermediary and is the relevant intermediary in respect of maintaining investor specific accounts.

The Czech securities evidential system is based on a relationship between the CSD and its participants, who act as account operators, and on an agreement between account holders and the CSD participants. There is no contractual relationship between the account holder and the CSD, unless the account holder is a participant of the CSD. There is a problem with shared account maintaining, as account operators are not just processing information flow from account holders to the CSD. Account operators manage the ultimate investor accounts held by the CSD and are liable for any damage caused by a defective instructions etc.

We agree with the all solutions proposed by Finland and Colombia and find no difficulty in either of the suggested possibilities.

Article 3

It is to be agreed that the current provision about the CSD should be expanded so as to clarify that the CSD be an intermediary and that rules of the CSD be allowed to cover certain provisions of the draft Convention, as rules of a settlement or clearing system are. Contrariwise, an issue account kept by the CSD should not be regarded as an upper tier holding, because its purpose is much different from asset accounts and generally no entries can be made into this type of account except for the issuer.

Article 5

As the account operator also plays its role in the Czech holding scheme, the clarification of its role in this article is feasible. The relationship between Art. 5 and Art. 24 should also be examined.

Article 6

see comments to Art. 5

Article 7

In the Czech book-entry system, acquisition of securities becomes effective against third parties generally by credit of securities to the ultimate investor's account held within the CSD. Netting is not possible. We agree that clarification of paragraph 5 being not mandatory and subject to non-Convention law would help.

Article 8

Apart the method of credit and debit, only a designating entry in respect of a specified category, quantity, proportion or value renders a grant of interest in intermediated securities effective against third parties in the Czech book-entry system. Therefore an interest cannot be granted in respect of a whole account, but of specified securities.

Article 11

It would be worthy to recognise the role of account operators as well as the rules of the CSD, along the lines proposed by Finland and Colombia.

Article 12

According to the Czech law there are not specific problems in this article.

Article 17

We agree that it should be clear to which account the legally relevant entries are made so we endorses the Finnish and Colombian standpoint as to further clarification of the CSD as being an intermediary and exclusion of the relevance of books of account operators.

Article 18

We agree with the clarification regarding the role of account operators.

Article 19

We agree with clarification of the role of issue accounts as well as recognition of the uniform rules of the CSD. We think that the relationship between Art. 3 and Art. 19 should also be examined. Unlike Colombia, we believe, that the CSD should be required to hold securities in issue accounts in the same aggregate number as in asset accounts (vide reconciliation), otherwise inflation or deflation of securities might occur.

Article 20

In case of the Czech settlement system, securities are not recorded on the account of the system operator because it is directly connected to the CSD. So in case of settlement the system operator may be functionally regarded as an account operator of the accounts maintained by the CSD.

We agree with amending of the role of account operators along the lines of intermediaries and amending of paragraph 4 so as to cover also those operators of settlement systems to whose accounts securities are not credited during the settlement. Recognition of the rules of the CSD should be further discussed.

Article 21

In the Czech Republic, as well as in Finland and Colombia, there is no risk of commingling the assets of different account holders and that of the CSD. We think that the provisions of Art. 21 should be read along the lines of the 2nd proposed possibility to interpret this Article, i.e. that it should be applied at the CSD level, but only to asset accounts, not to issue accounts. We support the Finnish and Colombian proposal as to further discussion of the role of the CSD (and its uniform rules) as the highest tier.

Article 22

Pursuant to Section 132-3, 4 of the Capital Markets Undertakings Act 2004 the relevant intermediary's clients share the loss equally. The loss so shared is a claim to be submitted in the following insolvency proceedings against the relevant intermediary. Recognition of the uniform rules of the CSD along the lines proposed by Finland and Colombia might be useful.

Article 24

According to our reading the draft Convention does not oblige the Contracting States to recognise the holding of securities in nominee accounts in any case, but it might be further clarified. Czech law does not explicitly permit nominee accounts, they exists *praeter legem*.

Article 25

As in Finland and Colombia, intermediated holding of securities does not alter the relationship between the issuer and the ultimate investor according to Czech law.