



**UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR
THE PREPARATION OF A DRAFT CONVENTION ON
SUBSTANTIVE RULES REGARDING INTERMEDIATED
SECURITIES**

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**Working Group on so called Transparent Systems – Intersessional Work
Comments of the Brazilian delegation to the Working Group on so called Transparent
Systems**

(submitted by the Government of the Federative Republic of Brazil)

There are some similarities between the Brazilian system and the patterns described by Finland and Colombia, especially concerning the capacity of final investors' identification by the CSD. However, differently from these countries' proposal, Brazil does not consider necessary to make substantial changes in the structure of the Convention.

Concerning their transparent systems, Finland and Colombia consider that:

- the CSD maintains the securities account for the account holder and therefore it is the relevant intermediary for the purposes of the Convention;
- there is a middle entity called "account operator" which makes entries in the securities accounts in accordance with the instructions of the account holder; and
- the responsibility for maintaining the securities account is shared between the CSD and the "account operator".

The Brazilian transparent system¹ has a different approach:

- the role performed by those middle entities which have a direct relationship with final investors (in the Brazilian case, the CSD participants), in whose name they maintain securities accounts and on whose behalf they execute all instructions, qualifies them as the relevant intermediaries²;

¹ All this comments were made based on DOC 60 and are applicable for (i) the Brazilian stock holding systems; and for (ii) local and foreign investors registered in Brazil. They are not applicable for securities accounts that are maintained abroad.

² As an example, it should be clarified that in the Brazilian stock holding system (already described in Doc. 44), at the CSD "the securities (even the participants' own accounts) are registered in individual sub-accounts under the responsibility of a participant (intermediary). Corporate Law and Securities Commission Rules provide the legal basis for this account structure and require the CSD to directly inform the investors on their holdings, although the CSD does not have a direct operational or contractual relationship with them. Only participants (person that maintains the account for the account holders) can instruct debit or credit entries or can instruct non-mandatory corporate actions on behalf of their clients (from whom they receive orders). These participants are the ones that maintain the securities accounts for the account holders under a direct relationship".

- the CSD does not maintain a direct relationship with account holders; and
- only the CSD participants maintain a relationship with the CSD on behalf of the account holders; therefore, they can be considered relevant intermediaries for the purposes of the Convention .

In such context, the fact that the CSD has the capacity to identify the final investors (account holders) does not change the nature of the legal relationship between investors and intermediaries nor does make the CSD a relevant intermediary.

For this reason, it does not seem to us that adding a new “player” into the structure of the Convention – the “account operator” – would be the best solution.

Firstly, because the “account operator” – as stated above – would also have liabilities and obligations typical of an intermediary.

Secondly, because the insertion of this definition in the Convention seems to have the sole purpose of obtaining the qualification of the CSD as a relevant intermediary.

And lastly because both the addition of a new “player” and the qualification of the CSD as a relevant intermediary may cause legal uncertainties to all other countries which, having middle entities, might have to review their own systems and operational arrangements.

Even from a functional approach, Brazil does not believe that it is necessary to modify the structure of the Convention. Aiming at harmonizing the different securities holding systems, the following premises were considered important to describe the role of the CSD in a transparent system:

- (i) identification of property rights of intermediated securities and their legal situation (especially concerning acquisitions, dispositions and creation of interests in securities);
- (ii) records of interests in and attachments on intermediated securities; and
- (iii) provision of legal certainty, with a view to assuring the finality and non-reversibility of the acquisition, disposition of and grant of interests in intermediated securities.

In the Brazilian transparent system, the CSD performs some activities in a centralized manner, that provides to the intermediated securities the necessary publicity concerning their legal situation (title, existence of liens, attachments etc.)

However, some provisions of the Convention, consider the above-mentioned activities as an exclusive responsibility of relevant intermediaries.

Should those provisions not be modified, they will provoke the Brazilian holding system a step backward in its level of transparency.

The problem could be addressed by tackling some specific issues and, as a starting point, through an analysis of the activities performed by the CSD in the Brazilian transparent system. So, in what consist such activities?

The record of property rights and creation of interests in intermediated securities is an important activity performed by the CSD. These activities cannot be assigned to the relevant intermediary or another intermediary for several reasons:

- according to the Brazilian corporate law only the records of the CSD are legally binding for intermediated securities;
- the CSD operates a centralized system which permits access, guarantees knowledge and recognizes, *erga omnes*, the acquisition, disposition of and grant of interest in intermediated securities
- the system operated by the CSD reflects all the book-entries made by the relevant intermediaries and identifies the accounts and sub-accounts of the account holders which

are maintained exclusively by different intermediaries (CSD participants) that have been chosen by each account holder.

Moreover, regarding the central registration activity performed by the CSD, in Brazil, whenever the public authorities want to verify the existence and legal situation of intermediated securities, they may simply require such information from the CSD.

None of such legal provisions or criteria, which are currently in force in the Brazilian system, are inconsistent with the terms of the Convention. On the contrary, they support them, without undermining the local legal traditions which, if simply abandoned, could bring uncertainty and would be a clear retrocession of the sound and transparent environment in place.

The same rationale can be used to the prohibition of upper tier attachments. This prohibition should not apply for centralized attachments made through the CSD even if it is not the relevant intermediary. This is because the CSD is able to fully identify the final investors and, in this activity, it will refer only to the securities that are to be attached, preventing damages to the integrity of the system.

Another issue relates to the provision that permits netting at the level of the intermediaries. Such alternative, in practical terms, would not be consistent with the systems that have centralized registration of the final investors in the level of the CSD, in which the netting can only be made at the level of the final investors.

Considering these general comments, only three amendments are suggested in the wording of the Convention in order to reflect the reality of the CSD in the Brazilian transparent system. For the purposes of this work, we have not identified problems with the other provisions contained in the current text of the Convention.

Such amendments would be as follows:

A) Article 7, paragraphs 1, 2 and 3 (Doc. 57)

In Brazil, the transfer of ownership of securities is only perfected upon their registration with the issuer or with the CSD, whose books are complementary to the books of the issuer, due to a provision in the corporate law. The registration with the CSD is the only manner validly accepted in Brazil for registration of ownership of intermediated securities.

In order to preserve the integrity of the Brazilian transparent system, we believe that each contracting State should define how debits and credits are to be made as well as their specific requirements. In particular, the Brazilian holding system will provide for that debits and credits are to be reflected at the CSD in order to be legally binding³.

The lack of such provision has concrete effects in Brazil, on the characterization of ownership of securities (both in acquisition and disposition of securities), on the grant of interests in intermediated securities, and also, on the exercise of political rights (right to vote) and property rights (right to dividends or other corporate events), among others.

Therefore, we consider essential the inclusion of a provision stating that credits and debits, for the acquisition and disposition of securities, shall be those recognized as such by the non-Convention law.

A.1) Articles 1, paragraphs I and 8, item “b”

In transparent systems, inasmuch as the CSD does not directly maintain the securities accounts, the CSD is able to identify the account holders and has the legal attribution of keeping the records of earmarkings which will produce legal effects on the intermediated securities. Therefore, the

³ This will not prevent that in some states debits/credits are allowed to be made exclusively at the intermediary level.

designating entry in the CSD is the only method sufficient to render effectiveness against third parties⁴.

Accordingly, it is proposed that in transparent systems the designating entry should be made in accordance with the procedures established by the Non-Convention Law.

B) Article 7, Paragraph 5

Concerning this Article our proposal is to clarify that Paragraph 5 is not mandatory and is subject to non-Convention law.

C) Article 17, Paragraph "1" and 2

Further to the reasons presented in the general comments, we believe that there are tangible advantages of a centralized registry for attachments at the CSD:

- to avoid the possibility of attachment of more securities than necessary to comply with the judicial order. When the attachment occurs at the CSD (in an upper-tier level), only the exact quantity of securities as determined would be attached
- to assure an efficient control to the securities that have been attached; and
- to optimize the time required for compliance with judicial or administrative judgment, award or decision.

In order to preserve the mentioned advantages, our proposal is that the prohibition of the upper tier attachment would not apply in transparent systems where there is full knowledge and control of the account holders and of the disposition of securities maintained in securities accounts.

An alternative solution would be the adoption of an opt-out provision or declaration method for transparent systems.

⁴ The opposition against third parties aims at giving certainty to the other creditors of the account holder about the real situation of its securities and the exact moment of the granting of interest in the intermediated securities.