



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

UNIDROIT 2007
Study LXXVIII – Doc. 64
English only
March 2007

**Working Group on so called Transparent Systems – Intersessional Work
Comments of the United Kingdom representative on the draft Working Paper on
Transparent Systems**

(submitted by the Government of the United Kingdom)

Categories of Transparent Systems

1.1 None of the three categories of transparent systems described in Document 44 adequately represent the particular structure of the CREST holding system in the United Kingdom. We refer you to our description of the UK and Irish holding systems sent to the Chairpersons of the Working Group Committee on 10 January 2007.

1.2 In summary, the principal distinction relates to the fact that CRESTco, the settlement system operator, maintains a securities account that constitutes the legal “issue register” (as that term is used in the document). The settlement system operator’s register replaces the issuer’s register as the legal root of title for UK securities.¹ Accordingly, while it maintains a securities account it does not have any proprietary interest in the securities credited to the register just as an issuer does not have a proprietary interest in the securities that are recorded on its register. The settlement system operator is therefore the transparent entity rather than any entity below it.

1.3 In keeping with this analysis, we fully concur with the following statement made at page 5 of the Working Paper:

Secondly, it is typical, at least for transparent systems, that the CSD acts merely as a registrar having no rights or interests in the issued securities. The CSD does not have the right to use such securities for its own purposes and they do not form part of the property of the CSD which could be distributed to its creditors.

1.4 We believe that the Working Paper would benefit from including a category of transparent systems that reflects the UK structure.

Role of an account operator

1.5 In the UK, it may be necessary for an account holder to connect to CREST through a CREST sponsor that has an interface with CREST. The CREST sponsor could be treated as constituting an account operator as the term is used in the Working Paper.

¹ In the case of Irish securities, the issuer register remains the root of legal title and the CRST register must be reconciled with it.

1.6 On page 3 of the Working Paper, it is suggested that the draft Convention could broadly interpret that the account operator is acting on behalf of the CSD.

1.7 We share the views of the Finnish and Colombian delegations on pages 8 and 9 of the Working Paper that this is not the correct analysis. We prefer the "compromise" solution proposed on page 9 - i.e. that the "account holder" should be regarded as giving the instruction to the CSD "through" the account operator. This accurately reflects how an account holder in CREST would be considered to send an instruction into CREST through the services of a CREST sponsor. The CREST sponsor is not an intermediary as it does not maintain the securities accounts operated by the CSD nor does it hold securities for account holders.

Sharing of intermediary function

1.8 We share the concern raised in the Working Paper at page 9 that the draft Convention does not recognise that "maintaining of the securities account" can be shared. We further support the view expressed that some clarification is needed to specify who should be considered the relevant intermediary in respect of certain functions of an intermediary.

1.9 In the UK, the sharing of intermediary functions can occur in relation to the holding of foreign securities by an intermediary within the CREST settlement system. The intermediary holds the foreign securities and issues Depositary Instruments (DIs) to its account holders. The account in which these DIs are recorded is maintained by CREST. As a result the 'holding' function (in relation to the underlying foreign securities) is performed by the intermediary while the account maintenance function (e.g. responding to instructions to sell or pledge the securities) is carried out by CREST. This appears to be the reverse of the situation referred to by Finland and Colombia where the account operator fulfils functions in relation to the book-entries but the CSD is the holder of the securities.

1.10 We share Finland and Colombia's wish to see the Convention accommodate the concept of sharing the intermediary function. We note, however, that the issue in the UK in relation to DIs does not involve sharing between the CSD and account operators (as described in the Working Paper) but between the CSD and intermediaries. Consequently, we do not think the solution can be reduced simply to a clarification of the role of account operators. Instead it requires a recognition of the two discrete functions of 'holding' securities (relevant to allocation of securities, shortfalls, passing on of dividends etc) and 'maintaining the records constituting the securities account' (relevant to instructions etc.) and an acknowledgment that these functions may be undertaken by separate entities under the rules of the settlement system. It would be necessary to consider further whether this clarification needs to be made on an Article by Article basis or whether it can be achieved by a general provision in the Convention.

Article 3: Exclusion of issuer facing role of a CSD

1.11 We agree that the current provision makes it unclear to what extent, if at all, the exclusion of recording and reconciliation functions *vis à vis* the issuer affects the CSD's responsibilities under the Convention towards its account holders. If, for example, a CSD must revise downwards its account holders' entitlements as a result of a reconciliation with an issuer account, does it have a liability under the Convention to its account holders?

1.12 We are unclear how the rules of the CSD are meant to be distinguished from the rules of the settlement system that it operates (see top of page 10).

Issuer accounts: Articles 1, 19, 21 and 22

1.13 As referred to in paragraph 1.2 above, the concept of an issuer account above the UK CSD is not a relevant concern for the UK' direct holding pattern. The number of securities in issue is, by necessity, the same as the aggregate number of securities of a particular ISIN credited to the members in the CREST register. This existence of a higher account above the CSD might be an issue, arguably, for the CREST *Irish* system – where the issuer account is the legal root of title and where reconciliations are made between the register and the CREST accounts.

1.14 We have two general concerns in relation to the application of Articles 19, 21 and 22. First, it should be made clear that these Articles do not apply to CSD's that do not hold securities. If a CSD does not hold securities, the obligation to hold sufficient securities, allocate them first to account holders and distribute losses to them pro rata can have no meaning and is consequently confusing. Again, we think a solution to this problem may require distinguishing the two functions of managing an account and holding securities (see paragraph 1.10 above).

1.15 Secondly, we agree that the status of "issue accounts" may need to be clarified. We agree with the Finnish and Colombians (at page 21) that Article 22 should not be applied at the CSD level on the basis that an "issue account" corresponds to the upper tier level.