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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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Working Group on so called Transparent Systems – Intersessional Work

Comments of the Swiss Delegation on the draft Working Paper on Transparent Systems

(submitted by the Government of Switzerland)

The Swiss delegation warmly thanks the Chairs of the Working Group for their excellent working paper and, though Switzerland does not count among transparent systems, wishes to comment on some of the issues raised.

1.– The working paper makes clear that it is crucial for transparent systems that the intermediary be correctly identified and that non-Convention law may divide the typical tasks of an intermediary (and the respective responsibilities) between the CSD and account operators which are not intermediaries in their own right.

We find judicious the proposition that this need should be addressed by some language in Article 1 to clarify the definition of intermediaries in transparent systems and by some additional language in Article 3 dealing with specific aspects and functions of CSDs.

2.– The working paper raises a number of important issues specific to transparent systems. We believe however that **some of these issues are relevant to all central securities depositories generally and not only to transparent systems**.

This is true particularly of the working paper's discussion of Articles 19, 21 and 22. CSDs generally may maintain "issue accounts", i.e. accounts registering the totality of a dematerialised issue. Any CSD maintaining an issue account (and, if allowed by non-convention law, any other intermediary maintaining an issue account) needs to *reconcile* the total number or value of issued securities with the total number or value of securities credited to its account holders and, if necessary, to *correct* errors and discrepancies.

a) In Article 19, this concern seems to be covered by the language in paragraph 1 ("an intermediary must… hold securities…"), which in our view includes the securities recorded in issue accounts maintained by CSDs and other intermediaries. A clarification in the explanatory report might be useful.

b) The working paper rightly observes that when a mismatch occurs, it cannot usually be made good by increasing the issue, which is a fix quantity. It must be solved by correcting the entries in the securities accounts maintained by that CSD We believe that such measures are covered by the language in Article 19(2) ("must… take such action as is necessary to ensure…").

c) We support the working paper's view that the second interpretation offered at the bottom of page 21 is correct if it means that all the securities registered in the issue account must, to the extent necessary, be allocated to the account holders to whose accounts they are credited.

d) We do not believe however that CSDs are inherently immune from shortfalls, whether in transparent systems or not. As rightly observed on page 22, shortfalls are made good because "[e]rrors and discrepancies relating to entries to securities accounts are traced and corrected". Arguably CSDs are unlikely to go bankrupt so Article 22 should not apply frequently to CSDs.

3.– We agree with the general proposition that the **rules of a CSD** – whether in a transparent system or not – should in principle enjoy the same status and deference presently accorded by various provisions of the Draft to the rules of securities settlement systems and securities clearing systems. It may probably be already the case since CSDs generally are also securities settlement systems. We believe for example that SIS, the Swiss privately-owned CSD, meets the three criteria listed in **Article 1(n)**, namely that (i) SIS settles securities transactions, (ii) it is supervised by a governmental authority in respect of its rules, and (iii) it would be notified by Switzerland on the ground of the reduction of risk to the stability of the financial system.

4.– We do not understand the point made on **page 6** regarding the **notion of debits and credits**. As it stands, the Draft Convention is geared at intermediated systems for the holding of securities. It purports to harmonise in a sensible manner the laws governing the intermediation of securities. When intermediaries are not the relevant element in the transfer of securities because the securities are legally transferred only through book-entries made by the issuer (such as referred to in that paragraph or on page 7 in respect of certain situations in Colombia), then the harmonised rules are irrelevant, the convention should not apply. There is no need to modify the notion of credits and debits to accommodate similar operations made by issuers. We wish to note that the draft Intermediated Securities Act presently considered by the Swiss parliament expressly carves out these situations.

5.– In respect of the comments made on **page 23**, we believe that the three paragraphs of **Article 24** ought to be clearly distinguished. If issuers in transparent system have the choice (or possibly the obligation) to have their securities held at the top-tier by a CSD, paragraph 1 is fully satisfied.

Paragraph 2 deals with a different issue. It requires that all systems, transparent and non-transparent, recognise that, particularly in cross-border situations, nominees may acquire securities and exercise the rights attached to these them on behalf of other persons who are not and cannot be identified by the CSD. In such situations, the investor cannot be identified by CDSs even in transparent systems. It is notoriously already the case in most transparent jurisdictions where the transparency accorded by the legal rules and the operational arrangements does not extend to foreign investors.