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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

(submitted by the Government of Italy)

Chapter II – Rights of the account holder

Article 5.3

In order to adapt the text to the suggested amendment of Article 7.4 (see below), the wording "or a limited interest other than a security interest" should be deleted.

This paragraph should also recognize that whenever the account holder grants an interest under Article 8, i.e. a limited interest, his rights, as described in paragraph 1 of Article 5, may be also limited by non-Convention law. The Italian delegation therefore suggests to insert, after "…under Article 7 (4)..", the following: "or has granted an interest under Article 8…" .

Chapter III - Transfer of intermediated securities

In order to achieve the objective of minimal harmonisation we believe that the original framework of the draft convention should be restored. Article 7 should only regulate transfer of legal title on intermediated securities, outright or by way of security, which would be effected by way of debit and credit. Article 8 should regulate creation of limited interests, by way of security and for other purposes, whereas the grantor of such interests maintains legal title on the intermediated securities.

Article 7.4

On the above line, the wording "…or a limited interest other than a security interest" should be deleted for the following reasons.

Article 7.4. requires that a limited interest (e.g. usufructus) may be created by way of credit. According to Article 5, par. 3, non-Convention law should determine any limits on the exercise of the rights described in paragraph 1 by the holder of the limited interest. We deem it is not appropriate that a limited interest other than a security interest be created by way of credit.

According to Article 5 1. (b) the credit of securities on a securities account confers on the account holder the right to dispose of securities. However the acquirer of an usufructus may dispose only of his interest and should respect the property rights of the grantor of the interest. Therefore in the event that the limited interest is evidenced by a credit on a securities account such credit would not confer a full right of disposal and should be always subject to restrictions and to *ad hoc* regulation in order to avoid violation of the property rights of the account holder and compliance with the general principle of "nemo plus iuris transferre potest quam ipse habet". It is true that such restrictions may adopted by non Convention law on the basis of Article 5, par. 2 but their implementation would complicate the functioning of the intermediated system and require additional obligations for intermediaries and consequent costs.

This legal construction is unknown to national jurisdictions whereby limited interests are created by way of a designating entry on the securities account of the account holder (the "legal owner" of the securities). Harmonisation may be based on such legal technique which better reflects the limited nature of the interests at hand. Therefore perfection of these limited interests should be regulated only by Article 8 (see the below comments on art. 8.2).

Article 8.1

The new draft ("An account holder grants an interest in intermediated securities, including a security interest or a limited interest other than a security interest,…") would allow Contracting States to provide that the account holder may grant a full interest by way of the legal techniques listed under par.2, subject to their declaration. However in the absence of a credit under Article 7 the holder of such interest is not entitled to exercise any of the rights listed by Article 5, he can neither dispose of securities nor exercise corporate or economic rights. The Italian delegation does not understand the purpose of the revised text since this kind of interest does not fit within the overall framework set by Chapter II and with the objective of harmonisation.

As a consequence, the Italian delegation proposes to restore the previous version of Article 8.1. The paragraph should be redrafted as follows: "An account holder grants a security interest or a limited interest other than a security interest to another person so as to be effective against third parties if:"

Article 8.2

For the sake of harmonisation the Italian delegation considers that the Convention should provide only one condition for perfection of a security interest under Article 8, together with the agreement as required by Article 8.1. (a). This condition should be the designating entry since it is necessary to preserve the rights of third parties that rights arising from transactions on intermediated securities are evidenced on securities accounts, in line with the approach followed by Article 7 as regards acquisition of securities by credit.

Chapter IV – Integrity of the intermediated holding system

Article 20

Article 20, par. 2, of the Convention sets out the non-contractual liability regime applying to the operator of a system or, alternatively, to any intermediary (including the operator) vis-à-vis a third party who has an interest in intermediated securities and whose rights are violated by the entry made by that operator/intermediary to a securities account.

It provides that, subject to Article 20.3, the operator/intermediary is not liable to the third party except for the cases set forth by Article 20.2, letters (a) and (b).

The scope of Article 20.2 (i.e., whether it should apply to any intermediary or to the sole operator of a system) will be discussed in the fourth session of the Committee of Governmental Experts.

The Italian delegation understands that the harmonisation of the aspect of non-contractual liability, provided for by Article 20.2 of the Convention, goes beyond the purposes, both, of the Convention and of Chapter IV, which are, respectively, to harmonise substantive rules concerning holding and transfer of intermediated securities and to preserve the integrity of the system, not also to regulate the tort liability of system's operators and intermediaries.

The provision is therefore unnecessary.

Furthermore, Article 20.2 could be in contrast with national legislations, which provide as a general principle a wider tort liability regime upon the operators/intermediaries.

We support therefore the deletion of the entire Article 20.2 of the draft Convention, in either its wider or narrower scope.

In line with the general approach of the Convention of avoiding too much intrusion with respect to domestic legislation, the aspect of non-contractual liability is to be remitted to contracting States.

Chapter V - Relationship with issuers of securities

Article 24

In paragraph 2 it should be made clear that the second part of the provision (starting from "…and shall permit such a person…") intends to regulate the case of "split voting" which arises when the account holder is acting on behalf of other persons. On the contrary the exercise of voting rights whenever the account holder is acting on behalf of one person should not be regulated by the Convention and be left to national corporate law. The Italian delegation therefore proposes the following amendment, as evidenced in italics: "..and shall permit such a person, *when acting on behalf of other persons,* to exercise voting or other rights in different ways…."

Nature of the instrument

The Convention aims at harmonisation of national substantive law on intermediated securities in order to improve legal certainty and efficiency of the markets and reduce systemic risks. The scope of harmonisation should include those rules necessary to promote *internal soundness* within the domestic legal framework and, more importantly, *compatibility* of national laws in view of increasing legal certainty for cross-border holding and transactions.

A number of relevant rules aimed at ensuring compatibility is contained in Chapter III - Transfer of intermediated securities. The level of harmonisation of these rules has been further reduced following the last session of the governmental expert committee, because most of them broadly refer to non-Convention law. Therefore, in order to take into account the Convention, contracting States should adapt their existing legislation or adopt new legislation, but they would be able to preserve national peculiarities. The lack of harmonisation of the rules concerning the transfer of securities reflects the difficulties in building a wide consensus, so that the current draft is substantially far from the usual content of a (binding) Convention.

Chapter IV deals with the integrity of the intermediated holding systems: these rules are more focused, in general terms, on the safeguard of internal soundness of domestic holding system. This relates in particular to protection of the integrity of the issuance and of rights of investors. In this field the reasons supporting the adoption of a binding convention seem weaker (see the explanatory notes, doc. 19, p. 18). This chapter contains a number of provisions containing principles which are commonly accepted within most jurisdictions (protection of rights of account holders in the event of insolvency of the intermediary, prohibition of upper-tier attachment, duties of intermediaries to protect the integrity of the holding, etc.). However a detailed regulation of such matters tends to encroach upon the peculiarities of each holding system and regional legislation, as it is shown by the continuous references to domestic non-convention law.

Article 24, which is the most relevant provision of Chapter V, sets out a couple of important provisions, but which are already part of existing legislation in many countries and would not justify per se the adoption of a convention.

In conclusion, the Italian delegation recognises that a number of changes introduced in the draft Convention up to the last session of the governmental expert committee have increased the advantages of a general principles or "model law" approach. The rules related to the transfer of intermediated securities do not reach an adequate level of harmonisation whereby it would be more important, and other parts of the Convention contain rules whose harmonisation by way of a convention may be replaced by the use of a soft-law instrument containing general principles which are already well known to national jurisdictions. The same approach may be followed for Chapter VI whose adoption is already optional and may be transposed into a model law.

Transitional provisions

The Italian delegation, while acknowledging that each of the three alternative approaches for a transitional rule in the Convention suggested in the final report on Transitional Rules (doc. 84) has advantages and disadvantages, supports the full grandfathering approach as it seems the most consistent with the goal of strengthening legal certainty.

The grandfathering approach would also have the merit to protect the rights of existing collateral takers and avoid the costs of preservation actions.

The Italian delegation understands that the grandfathering solution would require potential acquirers of post-effective interests to bear the cost of investigation about pre-effective interests. Nonetheless, the rights of existing collateral takers should be considered at least equivalent to those of potential collateral takers.