



DIPLOMATIC CONFERENCE TO ADOPT A  
CONVENTION ON SUBSTANTIVE RULES REGARDING  
INTERMEDIATED SECURITIES

**Committee on emerging markets issues,  
follow-up and implementation  
First Meeting  
Rome, 6 to 8 September 2010**

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## REPORT

(prepared by the UNIDROIT Secretariat)

### ***Agenda item No. 1: Opening of the meeting***

1. The first meeting of the Committee on Emerging Markets Issues, Follow-up and Implementation (hereafter *the Committee*) was held at the headquarters of UNIDROIT in Rome from 6 to 8 September 2010 under the co-chairmanship of Ms Niu Wenjie (China) and Mr Alexandre Pinheiro dos Santos (Brazil) and was attended by representatives of 39 States <sup>1</sup>, 5 intergovernmental organisations, 7 non governmental organisations and 14 other participants (cf. the list of participants in Appendix I).

2. The *Secretary-General* recalled that there had been a strong feeling at the diplomatic Conference to adopt the *UNIDROIT Convention on Substantive Rules for Intermediated Securities* that the work not only on promoting understanding of the Convention but also on legal issues related to financial markets, was not finished and completed simply with the adoption of the Convention. It was felt that the structure of consultation that had been established with the Committee on Emerging Markets deserved to be continued, and that this body should play a role also in connection with Resolution 3 of the diplomatic Conference, which called on the Secretariat to organise meetings intended to promote the Convention and its early entry into force, and invited this Committee to play an active role in that regard, and UNIDROIT member States to co-operate in that connection.

### ***Agenda item No. 2: Adoption of the Agenda***

3. The agenda proposed by the UNIDROIT Secretariat has been adopted (cf. Appendix II to this report).

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<sup>1</sup> Members of the Committee, pursuant to the Final Act of the final session of the diplomatic Conference are the following: Argentina, Cameroon, Chile, France, Greece, India, Japan, Nigeria, Republic of Korea, South Africa, United States of America, European Community. The Observers are: Indonesia, European Central Bank, Hague Conference of International Private Law (HCCH), European Issuers, Trade Association for the Emerging Markets.

***Agenda item No. 3 – Colloquium on Financial Markets Law***

4. The Colloquium entitled “The Law of Securities Trading in Emerging Markets – Lessons Learned from the Financial Crisis and Long-Term Trends” took place on 6 and 7 September 2010. Participation in the Colloquium was open to UNIDROIT member States, as well as to invited guests and speakers (see Appendix I to this report). The purpose of the Colloquium on Financial Markets Law was to consider legal issues on financial markets law and related areas of the law which are not specifically dealt with in the UNIDROIT Convention on Substantive Rules for Intermediated Securities, but which are essential for the proper functioning of financial markets and an adequate incorporation of the Convention into the legal system of a Contracting State. The programme of the Colloquium is reproduced as Appendix III to this report and the presentations, as far as authorised by the speakers, are to be found on the UNIDROIT website at the following page: <<http://www.unidroit.org/english/cem1/programme.pdf>>.

***Agenda item No. 4: Review of the draft “Accession Kit” to the UNIDROIT Convention on Substantive Rules for Intermediated Securities***

5. The *Secretary-General* recalled that the Cape Town Convention, although a very sophisticated and elaborate tool, was by far a less complex instrument than the Geneva Securities Convention. In its function as Depositary, UNIDROIT had produced a guidance document for countries that ratified the Cape Town Convention which most Contracting States had found very helpful in assisting them to prepare their declarations under the Cape Town Convention. It was felt to be a good idea to provide similar guidance for the Geneva Securities Convention that would explain what kind of declarations were possible, what they could cover, how they should be formulated, in which cases one would use them, and that would reproduce the forms that countries might wish to use in doing so. The Secretariat could produce such a document under its own authority, issue it as a Secretariat document, and the Secretary-General would have the power to amend it as necessary.

6. It differed from the declarations memorandum under the Cape Town Convention in two ways. The first was that it provided more information on the background for the declarations, basically in order to try to explain why a declaration was possible in a particular situation, and what a country would achieve by submitting any given declaration. In presenting that background, the document relied heavily on the Official Commentary to the Geneva Securities Convention which explained the policy choices made in the Convention, and it should most emphatically not be regarded as a document to interpret the Convention. Its purpose was solely to assist legislators in implementing the Convention.

7. The second difference regarded a part that did not exist in the Cape Town declarations memorandum and was intended to draw the legislators’ attention to areas of the law not dealt with in the Convention but to which the Convention itself referred. It was simply an invitation to those in charge of implementing the Convention to bear in mind that in the process of implementing the Convention they might need to have a look at this or another area of the law to make sure that the relevant provision of the Convention was properly connected to the domestic law.

8. This part of the document was presented in a rather summary manner, so as to invite discussion by the Committee as to whether it considered this kind of document useful, whether it was right in its present form or whether it should have more, or less, detail. If the consensus in the Committee were to be that this second part was not needed, it would be dropped. If, on the other hand, the consensus were to be that the second part should actually become a separate document and be developed further, or even that the second part should become a completely different, separate project, for example a legislative guide, this choice would be brought to the attention of the Institute’s governing bodies. In the meantime, this particular document might perhaps serve as an initial roadmap.

9. The *representative of South Africa* thanked the Secretariat for having prepared the document, which was felt to provide useful practical guidance, for instance, as it explained the implications of the different types of declaration. The *representative of the European Commission* endorsed this statement, reiterating that this was an extremely useful exercise, in particular the first part which enhanced easy handling of the declaration mechanism, as well as its plain reference to the Official Commentary, which allowed users to have the guidance together with the declaration document in the right place and so avoid constant backwards and forwards reference. As to the second part, this was also useful in principle, but it was still only a draft and the European Commission would expect it to be fleshed out so as to enhance its guiding force. At this point in time, it asked questions rather than gave answers. It might be useful, possibly as an ongoing process, that the answers be given with examples attached. In principle, however, the Commission felt that both parts were extremely useful and would also appreciate being taken through the document chapter by chapter. The *representative of France* agreed, but referring to Part Two of the document, wondered as to the way in which it could be revised. There could be a concern that Part Two would be a sort of Official Commentary in brief, and care should be taken to prevent a situation where what was written in Part Two actually prevented legislators from taking a serious look at the Official Commentary itself.

10. Commenting on the nature of the document, the *Secretary-General* stated that were the Committee to consider that the document should ideally be subject to some form of approval, it might consider perhaps splitting the document in two. For the declarations part, he would strongly urge the Committee to leave it as a Secretariat document since in practical terms, this was the most efficient way of proceeding. As to Part Two of the document, it might either be studied independently by the Secretariat or become something of a different nature that would have to go through a process of intergovernmental discussion, negotiation and approval. That was entirely in the hands of the member States and the governing bodies of UNIDROIT to decide.

11. In the ensuing discussion, the *representative of France* expressed a preference for the document to be split into two parts. It was absolutely relevant, considering UNIDROIT's depositary role, to have flexibility in the first part for the declaration process. The *representative of Brazil* inquired whether this model of declaration / accession kit had already been used in the Cape Town Convention, and if so, whether reference was made therein to sources of law outside the Convention. The *representative of India* praised the document as giving useful guidance to States wishing to join the Convention, and agreed with earlier speakers that the Secretariat should have greater control over Part One of the document, so that it might be best to split it into two separate documents.

12. Replying to the question put by Brazil, the *Secretary-General* stated that Part Two was in a way new territory for the Secretariat. The Cape Town declarations memorandum merely indicated that there were references to other applicable law but did not enter into detail of what that law entailed, what it involved, and what kind of policy options it made. However, a repeated criticism in connection with this Convention had been that there were so many references to non-convention law, that the harmonisation effort had not been taken far enough, that too many things had been left unregulated and for other law outside the Convention, and this was why it had been suggested that it might be useful to have a document that would discuss just what were the other areas of the law, how much was left for them to regulate, etc.

13. The *representative of Switzerland* declared that his country also supported the idea that Part One was fully within the province of the Secretariat and that it should be updated when the Secretary-General deemed it necessary. Part Two, in turn, involved highly complex, expert work which he would not advocate go through any kind of political process; it should remain within the responsibility of the Secretary-General, but would certainly benefit from more expert input on a broad basis, not in terms of coming to consensus, but rather in terms of producing a document whose purpose was not to create a nice piece of legal doctrine, or a nice sophisticated paper for a great law review, but to be a helpful guide for States that contemplated signing or ratifying the Convention, so as to ensure that what they were adopting as an international instrument

dovetailed with their domestic legal system and allow them where appropriate to make the necessary changes to their legal provisions. The *representative of the United Kingdom* praised the document and supported the comments made by the representative of Switzerland. He had found both parts of the document very helpful and did not think that it would be appropriate for some formal process devised for Part Two to restrict the flexibility that now existed.

14. The *representative of the European Commission* agreed that the Official Commentary and the actual Convention were the official texts agreed in the appropriate political process. All international organisations had highly official texts living side by side with additional texts. He agreed with the representative of France that none of the follow-up documents could in any way trump the Official Commentary or the official Convention. He was therefore in favour of leaving it within the authority of the Secretariat to produce such a document. This applied to both parts of the text.

15. The *representative of the Russian Federation* recommended that Parts One and Two be split into separate documents.

16. The *representative of the United Nations Commission on International Trade Law (UNCITRAL)* complimented the UNIDROIT Secretariat both for preparing this useful document and for the very useful clarifications in presenting it. UNCITRAL had mandated its Secretariat to co-operate with the UNIDROIT Secretariat, in particular in matters of secured transactions, and the UNCITRAL Secretariat would be glad to be of assistance within its own area of expertise.

17. The *Secretary-General* noted that while there seemed to be a preponderance of views in one direction as to how to handle Part Two, it would probably be useful to return to that issue once the Committee had gone through the text of Part Two itself. As a prologue to that discussion, he gave a brief explanation of the structure followed throughout the document, detailing the nature and use of the declaration forms and the types of declarations (opt-in, opt-out, and declarations relating to the Contracting States' own law). He stressed that the Secretariat had been at pains to quote straight from the Official Commentary where possible, only adding language of its own where absolutely necessary, and suggested that, since the document was so closely related to the draft Official Commentary, that the draft Official Commentary had been released in its revised version, that member States had until December to submit comments thereon, those States that had already had an opportunity to look at the document might wish to say something at this stage, whereas those who preferred to have more time to study the document would in any event have the same timeframe as existed for the submission of comments on the Official Commentary to make their views known. As to the most appropriate way of moving forward on this particular matter, there were clearly different views on how best to proceed with Part Two. He pointed out in that connection that the UNIDROIT Work Programme included a topic, the so-called *Legislative Guide to enhance trading in emerging markets*, and likewise a proposal for a project on netting that had been recommended by the Governing Council. The General Assembly of UNIDROIT would be called upon to approve the Work Programme for the next triennium, and the Committee members might wish to consider contacting the focal point for UNIDROIT matters within their respective Governments to make known their views on both topics, in order for them to be presented to the General Assembly at the time when the General Assembly approved the Work Programme on 1 December 2010.

18. The Committee agreed to the Secretary-General's proposal to have a period to comment on the document on the draft accession kit.

***Agenda item No. 5: Consideration of the reception given to the Convention in the various countries and proposals for its promotion***

19. The *Secretary-General* invited the Committee to comment on the status of the domestic discussion in their countries as regarded the Convention, and perhaps to formulate some proposals as to what might be done to promote awareness of the Convention, as envisaged by Resolution 3 of the diplomatic Conference, with a view to promoting its early entry into force.

20. The representative of France having inquired whether in future the meetings of the Emerging Markets Committee and the evaluation meetings on the UNIDROIT Convention would be systematically organised at regular intervals, the *Secretary-General* replied that Resolution No. 3 of the diplomatic Conference expressed the understanding of the Conference that, following the entry into force of the Convention, UNIDROIT would take reasonable steps to convene evaluation meetings, in principle every 24 months. As soon as the Convention was effectively in force, it was hoped that the evaluation meetings and the Emerging Markets Committee meetings would become one and the same thing. Paragraph 1 of Resolution No. 3 requested the Depositary to make efforts to organise meetings to promote awareness and understanding of the Convention and to assess its continued effectiveness in line with relevant contemporary developments. This was the nature of this meeting.

21. The *representative of South Africa* declared that the Convention had been well received in her country. South Africa had started to draft legislation to align it with the principles contemplated in the Convention and was set to go through the parliamentary process. No work had as yet been undertaken on declarations pending the meeting of the Emerging Markets Committee.

22. The *representative of India* informed the delegates that India had already had a process of interdepartmental consultations, and stated that the initial examination had shown Indian legislation to be fully in line with the Convention and that no new legislation would be required for India to become a Party to the Convention. Consultations within the Government were proceeding satisfactorily and might soon be completed, after which the matter would be brought before the Cabinet for approval for signature and ratification. Like South Africa, India had not yet started work on the question of declarations, but with the Secretariat document now available it was clear what expected and what needed to be done.

23. The *representative of Nigeria* explained that Nigeria had a committee looking into the Convention and appropriate ministerial briefing had begun. It had also started pondering declarations, but was looking for guidance from the UNIDROIT Secretariat on this first.

24. The *representative of Cameroon* stated that the Convention had been well received in his country and that the only problem now facing the Government was one of guidance. Cameroon intended to incorporate this very important instrument into its domestic legal system as well as promoting it in the Central African sub-region. Cameroon was the only representative on the Emerging Markets Committee of the CEMAC region which encompassed Chad, Cameroon, the Central African Republic, Gabon and Equatorial Guinea, and Cameroon also represented the Economic Community of Central African States (ECCAS) . Their main concern at this point in time was to receive appropriate guidance from UNIDROIT in raising awareness of and disseminating the instrument in the sub-region on the domestic front, as well as technical support in the field of training and new technologies in the financial sector. Cameroon fully supports the proposal made by the Secretary-General to have regular meetings of the Emerging Markets Committee which could but enhance the instrument's chances in his country and sub-region.

25. The *Secretary-General* invited comments from participants on the usefulness of the Colloquium that had preceded the Committee meeting and to indicate whether it might be useful to turn this into an integral part of the Committee's discussions in the future, if they decided to meet regularly themselves. He would welcome their views, given informally, on the Colloquium and whether they felt the discussions there had helped not only to understand the Convention but laid the ground for a possible line of future work for UNIDROIT in the area of financial markets.

26. The *representative of Brazil* reported that Brazil was still organising all the documents, recommendations and opinions for its Foreign Ministry so that they might be submitted to Parliament in due course. It was not expected that any amendments would be needed to clear the way for ratification but the parliamentary procedure might take some time. Brazil was also hoping to stage an event in 2011, in close co-operation with UNIDROIT, with a view to presenting the Convention.

27. The *representative of France* sought confirmation that these meetings were not technically the evaluation meetings set by the Convention, since the Convention was not yet in force, but indicated that France strongly supported the idea of such meetings being held on a very regular basis. While the Convention mentioned intervals of 24 months, with a view to keeping costs down, France considered that budgetary constraints permitting, a period of 12 months would be appropriate. The previous two days' discussion had shown how extremely useful such meetings were, and France strongly supported that such a model be adopted for the future.

28. The *representative of Switzerland* agreed with the idea of regular meetings to promote the Convention and to discuss any issues that arose in the process of examining the Convention, examining domestic laws, and going through the signature and ratification process. While this was resource-intensive, and the resources of UNIDROIT would probably not suffice, other resources might be mobilised for that purpose.

29. The *representative of Nigeria* likewise declared the Colloquium to have been very interesting and relevant to understanding the Convention. He was in favour of more such sessions being held, and felt that most of the areas covered were quite germane to the issues raised in the Convention.

30. Comments having been invited on the proposal made by the representative of France and the Secretary-General regarding the meetings, and on details such as the periods and scope of the meetings, the *representative of South Africa* pronounced herself in favour of more meetings but urged the Committee to signal very clearly that the follow-up work was just to enhance understanding of the subject-matter, not to break down or take anything away from what had already been accomplished with the Geneva Securities Convention.

31. *The Committee approved the proposal regarding the meeting of the following year and requested the Secretary-General, in consultation with interested member States, to explore the possibility of holding such a meeting in one of the emerging market countries members of the Committee.*

#### **Agenda item No. 6: Future work by UNIDROIT in the area of financial markets law**

32. The *Secretary-General* pointed out that this consisted of two aspects. One of those he had already referred to, concerning the possible scope of a legislative guide on principles and rules to enhance trading in emerging markets. This was a topic already in the UNIDROIT Work Programme, and although work had not effectively started since there was some work related to the Geneva Convention to complete, the idea was already to start an initial discussion on what such a legislative guide might possibly cover in the future.

33. The second aspect was covered by agenda item 6(b) which set out proposals for an international instrument on netting of financial instruments. In 2009, the Governing Council had requested the Secretariat to produce a more developed study on netting than the one it had seen before, and this study had been submitted to the Governing Council in 2010. The Governing Council had expressed strong support for this project and requested that it be included in the Institute's Work Programme with the highest priority ranking.

##### **(a) Scope of a possible legislative guide on principles and rules to enhance trading in emerging markets**

34. The *representative of Switzerland* agreed with other speakers that the Colloquium had been most interesting, but felt that some of the topics discussed were quite remote from UNIDROIT's core

expertise. They were definitely connected with trading of securities, market integrity, and so on – but they were not core issues on which UNIDROIT has a particular expertise to bring asked the Secretary-General – and possibly also other delegations – what was the scope contemplated for the guide. Was it something along the lines of Part Two of the Accession Kit, dealing with issues quite closely connected with the Convention? Where there was a great deal of explanation to give, help to bring, policy considerations to take into account, or was the intention broader, to include other issues dealing with trade?

35. The *representative of Qatar* returned to a point first raised by the representative of Switzerland. He took the view that at this stage, any future work undertaken by UNIDROIT with respect to securities markets should be linked very much to the Convention. In the Convention, intermediaries played a vital role, and all agreed that intermediaries were subject to regulation in all markets. But the degree of sophistication of such regulation differed very much from country to country, and it would be very convenient if in the future the project focused on regulating those aspects of intermediaries' activities provided for in the Convention, which was holding accounts. He felt that if the idea was to *enhance* trading in emerging markets, any activity that would foster confidence in the markets was bound to contribute very significantly to the objective stated here. Some sort of work regarding intermediaries, and the role expected of them, in this Convention would be very useful.

36. The *representative of the United States of America* shared the view of others that the Colloquium had been extremely useful. For example, it demonstrated beyond any serious question whatsoever that the structure of the Convention would work with a wide variety of legal systems. The discussions had, for example, clearly shown that the Convention structure worked perfectly well in systems as disparate as Japanese, Canadian, Spanish and English law on one of the most controversial and difficult issues during the negotiations, that of property and proprietary rights.

37. On the subject raised by the representative of Switzerland, that of the *scope* of the legislative guide, there would seem to be three broad categories. One category was the matters actually dealt with by the Convention itself, and that generally was the domain of the Official Commentary. That category would include such things as the relationship of the Convention to non-convention law. Another category was what it would refer to – and some of the Colloquium topics fitted into this – as loosely speaking, securities regulation, or financial institution regulation, both of the financial institutions, the entities, or of markets, or even of certain products, like collective investment schemes. This the US representative felt was a matter that would be outside the scope of a legislative guide. It might be useful to mention the range of regulatory frameworks seen around the world, for purposes of context, but the legislative guide should not really go into those areas of regulation, in terms of actually giving concrete examples and details about what States might choose to do. The third category, on the other hand, was within the proper domain of a legislative guide, i.e., private law, like the Convention, but private law which the Convention as a practical matter was unable to harmonise. This would distinguish it from a model law, because by definition those were matters that it had been concluded could not be harmonised, so there would have to be some menu approaches and alternatives presented. Finally, within the legislative guide's scope, there would seem to be two divisions. One was that relating to secured transactions with intermediated securities. The other was what UNCITRAL had on its radar screen, filling out its legislative guide on secured transactions dealing with certificated securities or dematerialised securities but those *not* in the intermediated securities system, i.e. outside the scope of the Geneva Convention. That still left a large range of private law matters that the Convention did not address, to which it deferred outside the Convention, that would not be within the scope of a secured transactions legislative guide. The United States would encourage the Committee to support the idea of moving promptly towards a legislative guide to supplement the Convention and the Official Commentary, and to at least give serious consideration to the possibility of collaborating on the secured transactions aspect of the project with UNCITRAL.

38. The *representative of Greece* also took up the point raised by the representative of Switzerland, concurring that there were issues which it would be very interesting to open the discussion on but which belonged to public rather than private law. However, the expertise needed exceeded the possibilities of UNIDROIT, and that of other organisations and bodies would be indispensable in discussing such matters as securities lending, timing of settlement, finality in the system or market usages, etc. So even if these topics were not properly speaking within the main scope of UNIDROIT, they might profitably be discussed.

39. The *representative of France* warned that the two families of issues should not be bundled: a legislative guide was definitely a separate kind of work from the evaluation meetings in particular and from the Colloquium after the adoption of the Convention. As a matter of principle, France favoured harmonisation by means of a legislative guide or a model law, which it felt were susceptible of accelerating the process. France was ready to provide input and relied on the Secretary-General to enlighten it on how to do so and suggest a timeframe for such work.

40. The *representative of Cameroon* stressed that the discussions at the Colloquium had been enlightening in terms of understanding the Convention. Cameroon was a relative newcomer to the world of financial market regulation and with a very young market at home, would need carefully targeted information focusing on capacity-building.

41. Responding to these various comments, the *Secretary-General*, turning first to the representative of France and his question as to the relationship between these meetings and other future work, stressed that in the future, it would be made quite clear that any meeting to discuss the legislative guide would be held for efficiency purposes back to back with the other meetings, but that they would continue to be two separate meetings. One would be a meeting in the formal framework of the diplomatic Conference, and the other would be a line of work established by UNIDROIT, recommended by the Governing Council and approved by the General Assembly, but germane and intellectually complementary to, but separate from, the Geneva Convention process.

42. A second point was the representative of the United States' reference to two of the legislative guides prepared by UNCITRAL, one on secured transactions and one on insolvency. What UNIDROIT conceives was something similar to that type of work and would present different options rather than a work of unification. The experts that would be involved in advising the Secretariat in the preparation of this legislative guide would probably advise this approach in respect of areas of the law that, as the delegate of Greece had pointed out, were central to but not really part of the Institute's mandate. It would then have to be decided with which level of detail these should be dealt with: would a reference be enough, would it be sufficient to refer to the work of standard-setting organisations, should there be a short or a broader discussion? Once work has started, these matters would become clearer. In any event, as the delegate from Switzerland had surmised, the point of departure were those areas of the law immediately connected to, but not directly or comprehensively dealt with in, the Geneva Securities Convention.

**(b) Proposal for an international instrument on the netting of financial instruments**

43. Mr *Philipp Paech*, Senior Research Fellow at the Institute for Law and Finance, University of Frankfurt, and former staff member of UNIDROIT, lately Seconded Expert to the European Commission, introduced this item. His presentation, which focused on the possible scope and objectives of an international instrument on the private law framework for netting, was based on his report on "Systemic risk, regulatory powers and insolvency law – The need for an international instrument on the private law framework for netting", which was submitted to the UNIDROIT Governing Council at its May 2010 session and transmitted to the members of the Committee prior to this meeting (UNIDROIT 2010 – S78B/CEM/1/Doc. 2).



44. In the discussion that ensued, representatives expressed overwhelming support for UNIDROIT taking up the project as a matter of priority and pointed out several important issues that would need to be considered as work proceeded. The *representative of Canada* noted, for instance, the fundamental policy question as to whether, in the event of insolvency of a bank with a number of outstanding financial contracts, the power of the regulator to stay termination for a couple of days and to transfer the financial contracts to another institution would apply to all financial contracts, preventing the regulator from cherry-picking.

45. The *representative of the United States* noted that to his knowledge, there was a 24-hour moratorium involved, the relevant institution being required to decide whether it wanted to assign to another person all the contracts with a particular counter-party, so it could cherry-pick among counter-parties. It did however have to decide that it was either going to keep or assign all the contracts with a particular counter-party. If it assigned them, it would be assumed that the counter-party in question would not be able to exercise the close-out netting. He felt that there might be some middle ground between, on the one hand, instantly closing out everything, with no automatic stay and complete protection, and, on the other hand, the normal solution that would result from the application of rules of private international law. There might need to be declaration mechanisms for various options that certain States would want to have, even though not necessarily strictly regulatory, and one would then have to know which State's law applied to a particular netting arrangement. It would be well to be prepared for something other than "all-or-nothing".

46. The *representative of Switzerland* noted that the derivative industry's concern here was not so much that the regulators might impose a stay, but rather that that time should not be available for cherry-picking. That is, if whoever was in charge of the resolution of the bank could use the time to decide which contract would survive and which contract would not, and hence cherry-pick – obviously always in favour of the failing bank –, that would be a problem. In his view, it was what happened during the stay that was important. Moving on to some questions of policy, he focused, first of all, on one variation on the argument of fairness developed by Mr Paech in his address. Although it was the big, sophisticated players that were active in the derivative market which had the ability to monitor their counter-party risk, the fact that they benefited from close-out netting contracts, master agreements, generally, created a disincentive to them to do so. They took more risk than was sensible since they had the possibility of netting. Secondly, he had noted that the European Banking Federation had recently added a protocol to its master agreement to bring into the netting mechanism loans and deposits, i.e. inter-bank loans and deposits, thus extending the close-out netting mechanism from derivative and repo-transactions to a broader scale of unsecured loans, inter-bank lending. UNIDROIT would, therefore, need to consider whether there were any natural limits to netting in terms of the type of operation or contract it should apply to, or whether basically it should be a mechanism applicable to all types of contract. And finally, if loans and deposits did qualify for netting, the earlier argument that the parties that were in the market and had the ability to require a close-out netting agreement were much better placed than ordinary depositors who would just resort to the usual setoff rules and the insolvency limits to setoff, raised a new fairness issue. The question therefore was whether there were, or should be, limits to the types of contract that were eligible for netting.

47. The *representative of Greece* brought up the fact that during the financial crisis closed out banks had undergone stress tests and the perception had been that close-out financial transactions had worked quite well. However, the fragmentation and diversity of standard market documentation had raised many issues. One was the question whether standard market documentation should be harmonised, for example in the event of default, termination, notice, calculation of close-out amounts, procedures for dispute resolution, and so on. He wondered whether all these points would be evaluated, and if so, how, in the light of the close-out netting approach. He also inquired whether asset transfers within the same group of banks on non-commercial terms, as a remedial mechanism in bank re-structuring, would run counter to the proper conception of netting.

48. The *observer from the European Central Bank* congratulated UNIDROIT on taking up this highly topical issue in a situation of financial market crisis. As a general point, he felt it would probably be fair to reflect that while there was a clear focus on an insolvency situation, netting also had a certain justification in default situations which did not entail the actual insolvency of one of the parties. A second point was that, while it was clear that netting had certain beneficial effects and that there might be other implications that deserved close scrutiny on the part of the competent bodies, it would nevertheless also be relevant to look, for example, at the situation of what to do with a failing bank to ensure its orderly winding up. Certainly, it would not do to place too much emphasis on this aspect, which was properly the province of the appropriate regulatory and legislative bodies, but there was still a need for clarity on the positive and possibly adverse implications of netting. In the first place, however, there was not a sufficient degree of certainty on netting as such. For netting to function properly, and to lead to certain consequences in the default situation, first it needed to be certain and predictable, and here a key aspect was the recognition of netting as a tool in financial transactions.

49. The *representative of the Russian Federation* agreed that the question of netting and its regulation was important, especially that of close-out netting. Netting as such could be regulated largely within the contract, provided it did not violate the rights of third parties. Since such violation could occur first of all in an insolvency, Russia was now contemplating incorporating its laws on close-out netting into the insolvency law proper. While it did deal with set-off, Russian legislation currently recognised no such institution as close-out netting. Clearly, the regulation of close-out netting was necessary first of all to serve the interests of financial markets and institutions, but if the close-out netting regime was too liberal, it might leave the field open for fraudulent conduct. In drafting its law, Russia was therefore carefully considering a range of issues: to whom exactly close-out netting should be available (mostly financial institutions but also other legal persons and even physical persons); which contracts might be part of close-out netting and in which spheres (not only the derivative markets but also repo contracts and even simple securities contracts, although bank deposits were not currently being contemplated); to what extent transactions might be claimed and abolished; which was the part of close-out netting; and which should be the moment in time that would be regarded as the moment of expiry of claims and of the formation of the unique debt.

50. The representative of the Russian Federation then turned to another issue, that of preferential transactions and suspicious transactions entered into by the insolvent company just after or just prior to the moment of insolvency. The question was whether such transactions might be abolished even though they were part of close-out netting or whether there should be a degree of immunity. In Russia, the current view was that such immunity might be granted to exchange transactions (transactions on the Stock Exchange, the currency exchange, and so on) and to transactions contracted through a Central Government department. It was also felt that close-out netting should involve first of all the participants in the clearing system: where one of the participants in a clearing system became insolvent, the clearing system itself would fix the moment and initiate the close-out netting procedures. While it should be possible for two participants to have a general agreement between them under which they enter into derivative contracts, purchase contracts, securities contracts, and so on, if at least one of the parties to the agreement is a financial institution, such general agreements should nevertheless also be subject to some additional regulation, including certain general principles that were to be provided by the law (this would also apply to the master agreements used by international organisations). Likewise, where two banks or two brokers contract a general agreement which later becomes subject to close-out netting, that agreement – not each transaction flowing from it – must be registered either on the Stock Exchange or with the self-regulatory securities market organisations. This should be instrumental in stopping the practice of pre-dating contracts. Lastly, as to the moment at which close-out netting was deemed to start, Russia took the view that this should be the very last date before the insolvency was decided by the court, although the contract – and perhaps even the

rules of the clearing system – might provide for an earlier date. Finally, Russia would for the time being follow a prudent course with regard to the issue of the regulatory moratorium.

51. The *representative of the United Kingdom* pointed out that as regards the European Union, for example, netting protections had been established in relation to collateral agreements or collateral arrangements generally, but also settlement finality and payment finality of security settlement systems. Hence, when thinking about turning off the ability to net, the question should also be addressed as to whether there were situations where a distinction might be made between, on the one hand, a market counter-party and netting arrangements, and, on the other hand, those other systems that have enhanced the ability of, for example, central counter-parties to net. It should also be borne in mind that these various proposals about OTC derivatives being centrally cleared, etc., would increase the flow of transactions through some of these central counter-parties. In other words, even with the regulatory exception to the ability to net, a distinction should be made between different policy situations. And finally, a distinction should also be made between multilateral netting made in a context of systems, and multilateral netting made for general market counter-parties, because whereas in the case of systems, multilateral netting was so to say systemically justified, in the case of market counterparties, the issue of cross-affiliate netting had more serious policy implications. Care should be taken to make it very clear what type of netting was being permitted.

52. The *representative of Korea* raised the issue of the effects of settlement netting. Settlement netting or close-out netting was based on the contract, whereas insolvency was based on mandatory regulations. The question was one of contractual close-out netting pre-empting non-contractual but statutory settlement netting. As far as he could see this had not been resolved in other countries either.

53. The *representative of Spain* saw two main problems that should be addressed before the technical aspects of netting were discussed. The first was the question of whether a harmonised instrument was necessary, the second question what kind of instrument was needed, a binding or a non-binding one.

54. The *representative of the European Commission* stated that the crisis had demonstrated that it was necessary to reflect on what was already there in the internal regime and to consider whether extensions or modifications were necessary. In the Commission's view, discussions and efforts to arrive at an understanding at a global level in this area were very important and the time was ripe for them. The Commission would favour an international discussion leading to a non-binding instrument at this stage, making sure to avoid any conflict between the various Organisations that might be involved. It relied on this Committee to provide the necessary information in this respect so that all the other fora could be contacted to see how best to proceed in this matter.

55. The *Secretary-General* agreed that it was essential not only to avoid duplication of effort but not to start a process that might be perceived as interfering with productive work being done elsewhere, and that there was a very clear understanding as to how far each forum could go within the ambit of its mandate and expertise.

56. The *representative of South Africa* stressed the need to look very specifically at definitions and terminology. As an example, she mentioned the fact that the Convention itself defined the insolvency procedure as a much wider concept, not just insolvency in the very strict sense of the word. Also, there was the question of when in the settlement cycle the net was constituted. When talking about insolvency, was it the court order that would be important? Or would it be the stage before, but when the net was constituted? She reiterated that this was a topic that would deserve spending a great deal of time on, laying the general rules and principles, almost the basics and the fundamentals, before any decision to harmonise or not to harmonise were taken.

57. The *representative of France* took the view that the presentation had described something fundamental which in a single phrase he summarised as compensation being the queen of securities. He had no doubt but that harmonisation was called for, but cautioned that any project would have to be a simple one, addressing simple principles that would be easy to understand and to implement. National authorities would most likely balk at anything too complex and decline to ratify. He advocated pragmatism and sticking to essentials.

58. The *Secretary-General*, detecting a similar level of interest and enthusiasm for the project as had been evident at the Institute's last Governing Council session, stated that the Secretariat was assuming that this project would be going ahead. By the end of 2010, the Secretariat would have looked very carefully at both process and scope of the project, and would then submit to the Governing Council when it met in May 2011 a very concrete proposal as to how to move the project forward, the timeframe, and whose involvement would be sought from the beginning, and of course the nature of the project itself.

***Agenda item No. 7: Other business***

59. No other questions having been raised, the co-Chairpersons closed the meeting.

## APPENDIX I

LIST OF PARTICIPANTS /  
LISTE DES PARTICIPANTS

## STATES / ETATS \*

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Judge of the Federal Court of Australia

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\*\* Regional economic integration organisations and International Organisations indicated by a double asterisk are members of the Committee on emerging markets issues, follow-up and implementation; those indicated by a triple asterisk are Observers to the Committee / *Les Organisations régionales d'intégration économique et les Organisations internationales indiquées par une double astérisque sont membres du Comité sur les marchés émergents et les questions de suivi et de mise en œuvre; celles indiquées par une triple astérisque sont Observateurs auprès du Comité.*

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**APPENDIX II****AGENDA**

1. Opening of the meeting.
2. Adoption of the Agenda.
3. Colloquium on Financial Markets Law (open meeting on 6 and 7 September).
4. Review of the draft "Accession Kit" to the UNIDROIT Convention on Substantive Rules for Intermediated Securities.
5. Consideration of the reception given to the Convention in the various countries and proposals for its promotion.
6. Future work by UNIDROIT in the area of financial markets law, in particular:
  - (a) Scope of a possible legislative guide on principles and rules to enhance trading in emerging markets;
  - (b) Proposal for an international instrument on the netting of financial instruments.
7. Other business.

## APPENDIX III

## COLLOQUIUM

**THE LAW OF SECURITIES TRADING IN EMERGING MARKETS:  
LESSONS LEARNED FROM THE FINANCIAL CRISIS  
AND LONG-TERM TRENDS**

Villa Aldobrandini, Via Panisperna 28, 00184 Rome  
6 -7 September 2010

## PROGRAMME

**MONDAY 6 SEPTEMBER 2010**  
**ENHANCING TRANSPARENCY AND INVESTOR PROTECTION IN SECURITIES MARKETS**

9:00 am – 10:00 am Arrival and Registration of Participants

10:00 am – 10:15 am **Opening Session**

*Chairman* H.E. Ambassador Patrick HENNESSY, Chairman of the 65<sup>th</sup> session of the UNIDROIT General Assembly

*Welcome Address* - Mr José Angelo ESTRELLA FARIA, Secretary-General, UNIDROIT

*Opening remarks*

Mr Alexandre PINHEIRO DOS SANTOS, Attorney General, Brazilian Securities and Exchange Commission (CVM), Rio de Janeiro

Ms NIU Wenjie, Director, Legal Affairs Department, China Securities Depository and Clearing Corporation Ltd (SD&C), Beijing

10:30 am – 1:00 pm **1<sup>st</sup> Session - *Legal measures to deter manipulation and other unfair trading practices (including insider trading)***

*Chairman* Professor Herbert KRONKE, University of Heidelberg, former Secretary-General of UNIDROIT

Mandatory and Contract-based Ownership Disclosure – *Professor Luca ENRIQUES, Consob Commissioner, Rome*

The IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMoU): an International Benchmark for Securities Enforcement – *Ms Rita CUNHA, OICV-IOSCO, Madrid*

12:30 pm – 1:00 pm Comments/Questions by Participants

1:00 pm – 2:30 pm Lunch

2:30 pm – 6:30 pm <b>2<sup>nd</sup> Session</b>
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*Chairman* Mr Hans KUHN, Director, Swiss National Bank

2:30 pm – 4:00 pm ***Fair and equitable treatment of security holders (including take-over bids)***

Take-over Rules for Listed Companies, the Basic Issues – *Professor Peter DORALT, former Chairman, Austrian Takeover Commission*

Investor Protection in the context of Take-over Bids – *Professor Alain PIETRANCOSTA, University of Paris I*

Issuers Regulation after the Financial Crisis – *Mr Carmine DI NOIA, Vice Director General, Assonime*

4:00 pm – 4:30 pm Comments/Questions by Participants followed by refreshments

4:30 pm - 6:00 pm ***Collective investment schemes: protection of client assets, prevention of conflict of interests and liability***

UCIs: Prevention of Conflicts of Interest, Protection of Assets and Liability – *Ms Isabelle LEBBE, Arendt & Medernach Law Firm, Luxembourg*

The Geneva Convention Meets Securities Regulation: Beyond Intermediated Securities – *Professor Charles W. MOONEY, Jr., University of Pennsylvania, Philadelphia*

6:00 pm – 6:30 pm Comments/Questions by Participants

6:30 pm – 8:00 pm *Vin d'honneur*

**TUESDAY 7 SEPTEMBER 2010**  
**THE LEGAL FRAMEWORK FOR SECURITIES TRADING IN EMERGING MARKETS: THE GENEVA**  
**SECURITIES CONVENTION AND BEYOND**

9:00 am – 11:00 am **1<sup>st</sup> Session – *Securities trading meets corporate law: what are “securities” and who holds them?***

*Chairman* Professor Hideki KANDA, University of Tokyo

Corporate law and Geneva Convention: a Bone of Contention ? – *Mr Hubert de VAUPLANE, General Counsel Crédit Agricole S.A. Group, Paris*

Trends and Patterns in Brazilian Law – *Ms Nora RACHMAN, Securities Law Expert, São Paulo*

Who is the shareholder? Shareholders, account holders and nominees – *Professor Luc THÉVENOZ, University of Geneva*

10:30 am – 11:00 am Comments/Questions by Participants followed by refreshments

11:00 am– 1:00 pm **2<sup>nd</sup> Session – *Securities trading meets property law: holding patterns and rights of account holders***

*Chairman* Professor Charles W. MOONEY, Jr., University of Pennsylvania, Philadelphia

Book-entry Operations and Property Law – *Professor Hideki KANDA, University of Tokyo*

Acquisition and Disposition of Intermediated Securities: The Interplay between the Convention and National Law – *Professor Francisco J. GARCIMARTÍN ALFÉREZ, Universidad Rey Juan Carlos, Madrid*

Security interests under the Geneva Securities Convention – matters optional or left to law outside the Convention – *Mr Michel DESCHAMPS, McCarthy Tétrault, Montréal*

Fraud and error under the Convention and under English law – *Mr Guy MORTON, Freshfields Law Firm, London*

12:30 pm – 1:00 pm Comments/Questions by Participants

1:00 pm – 2:30 pm Lunch

2:30 pm – 4:30 pm **3<sup>rd</sup> Session - *Insolvency and liability of intermediaries***

*Chairman* Professor Luc THÉVENOZ, University of Geneva

Cross border Insolvency: Impact on Securities Holding and Settlement –  
*Mr Wouter BOSSU, Legal Department, International Monetary Fund*

Loss Sharing in the Insolvency of an Intermediary – *Mr José M. GARRIDO,*  
*Private Sector and Infrastructure Practice Group (LEGPS), World Bank*

Development of Intermediated Securities and Insolvency Laws in Transition  
Economies – *Professor Alexander BIRYUKOV, Kyiv National University*

4:00 pm – 4:30 pm Comments/Questions by Participants followed by refreshments

4:30 pm – 6:30 pm **4<sup>th</sup> Session – *Governance structures and regulation of securities settlement and clearing systems***

*Chairman* Mr Alexandre PINHEIRO DOS SANTOS, Attorney General, Brazilian Securities and  
Exchange Commission (CVM), Rio de Janeiro

The Implications for the Regulation of Securities Clearing and Settlement  
Systems in the U.S. from the Recent Financial Reform Legislation – *Mr Michael*  
*SCHUSSLER, Federal Reserve Bank of New York*

Some International Aspects of the Regulation on Financial Markets  
Infrastructures – *Mr Konstantinos TOMARAS, European Commission*

The Challenges of Establishing an Efficient Securities Settlement System in an  
Emerging Market – *Mr Kennedy AIGBEKAEN, Nigerian SEC*

6:00 pm – 6:30 pm Comments/Questions by Participants

6:30 pm – 7:00 pm **Closing remarks**

*Professor Berardino LIBONATI, President of UNIDROIT*

*Mr José Angelo ESTRELLA FARIA, Secretary-General, UNIDROIT*