



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

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

**Committee on emerging markets issues,
follow-up and implementation
Second Meeting
Rio de Janeiro, 27 and 28 March 2012**

UNIDROIT 2011
S78B/CEM/2/Doc. 2
Original: English
November 2011

**UNIDROIT Convention on Substantive Rules for Intermediated
Securities ("Geneva Securities Convention")**

*Information for Contracting States in respect of the **Convention's references to sources
of law outside the Convention***

prepared by the Secretariat

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INTRODUCTION

1. This document addresses a certain number of practical matters that Contracting States are advised to consider in connection with the ratification, acceptance, approval of, or accession to, the UNIDROIT Convention on Substantive Rules for Intermediated Securities (official shorthand: "Geneva Securities Convention"; hereinafter: the "Convention").¹ The purpose of this document is to assist legislators, regulators and policymakers of Contracting States consider the legislative and treaty actions that may be needed to implement the Convention in a manner consistent with its provisions and with the policy choices it offers to Contracting States.

2. The complexity of the subject-matter covered by the Geneva Securities Convention, and the delicate balance between uniform rules and domestic law, prompted the Secretariat to make suggestions on how to tackle issues not dealt with in the Convention or which Contracting States are free to deal with in their own way. In particular, this document identifies matters that are not harmonised by the Convention. It presents those issues where the Convention refers to sources of law outside the Convention. States implementing the Convention are invited to consider the manner in which their domestic laws address these issues, in order to create a comprehensive and coherent set of legal rules for intermediated securities.

3. This guidance document is intended to be a first step towards the development of a legislative guide on principles and rules capable of enhancing trading in securities in emerging markets. It is in the nature of a roadmap, setting out different options developed in the legislative guide the scope of which should also be examined in the light of various related legal aspects that had been tentatively identified at an early stage of the work on the project.²

4. It should be noted that this document is not intended to offer comprehensive interpretation of the Convention or to assist judges, arbitrators or practitioners understand its principles or implications. Comprehensive guidance of such nature is provided in the *Official Commentary* to the Convention, to which this document refers.

¹ For the text of the Convention and official documents and information issued in relation thereto, see www.unidroit.org/english/conventions/2009intermediatedsecurities/main.htm.

² Such as (a) Nature and types of securities, including fungible and dematerialised securities; (b) Transactional structure of bond issues; (c) Transactional structure of share issues (IPOs); (d) Organisational and transactional provisions to enhance liquidity on secondary markets; (e) General contract law and special rules relating to trading in securities; (f) Legal issues relating to trading and settlement; (g) Legal issues relating to collateralised transactions; (h) Regulatory framework (see <http://www.unidroit.org/english/studies/study78b/main.htm>).

References to sources of law outside the Convention

Section 1. General remarks

5. The Convention contains harmonised rules for intermediated securities in respect of a number of issues. Where the Convention does not envisage full harmonisation, but leaves specific issues to sources of law outside the Convention, it uses concepts such as the “non-Convention law” and the “applicable law”. The principal goal of this document is to give Contracting States an insight into the issues that are not covered by the Convention and which should be regulated by the Contracting State itself.

6. Section 2 provides an overview of the different types of references in the Convention to sources of law outside the Convention.

7. Section 3 outlines the issues which are not or only partially harmonised by the Convention and which should therefore be considered by a Contracting State when implementing the Convention.

Section 2. Different sources of law outside the Convention referred to in the Convention

8. Generally, the Convention takes a ***minimum harmonisation approach***. This means that the Convention provides harmonised rules in respect of a number of key issues that reduce legal or systemic risk or promote market efficiency, but also leaves a considerable number of issues to be determined by other law outside of the Convention (depending on the context, the “non-Convention law” or “applicable law”). This approach recognises that, however desirable it is in principle to achieve fully harmonised rules, this is a complex process in practice, requiring technical compatibility and political consensus. Notably, the Convention contains harmonised rules in relation to the rights of the account holder, the transfer of intermediated securities, the integrity of the intermediated holding system and collateral transactions. Corporate law issues and rules on supervision of financial markets are left almost entirely unregulated. In all cases where the Convention does not envisage full harmonisation of a certain issue, there may be interaction between Convention rules and different types of legal rules outside the Convention.

A. Terminology used in the Convention

9. The first and most frequently mentioned category of law outside of the Convention is the “***non-Convention law***”. In Article 1(m), the “non-Convention law” is defined as “the law in force in the Contracting State referred to in Article 2, other than the provisions in this Convention”. In many instances, the non-Convention law works as a complement to a Convention rule. A list of references to “non-Convention law” made in the Convention is contained in **Appendix A**.

10. In addition to the term “non-Convention law,” the term “***applicable law***” is used in the Convention. The applicable law is the law applicable by virtue of the private international law rules of the forum. The applicable law may, or may not be, the non-Convention law. A list of references to the applicable law made in the Convention is contained in **Appendix B**.

11. Furthermore, the Convention contains several references to rules outside the Convention which may apply in the context of ***insolvency***. Of course, insolvency law would be part of the non-Convention law or the applicable law, but insolvency is dealt with as a separate category because

the commencement of insolvency proceeding may trigger the mandatory application of special rules of law of the jurisdiction where those proceedings are conducted that displace, or deviate from, the rules that would otherwise be applicable. The particularity of insolvency law in relation to some of the matters covered by the Convention justifies its treatment as a special category, for purposes of clarity. In some instances the Convention sets out harmonised rules intended to apply also in insolvency proceedings (see, for example, Articles 11(2), 12(2), 14(1) and 21(1)). In other cases, the application of insolvency law as part of the non-Convention law has been preserved (see, for example, Articles 14(2), 21(2) and 26(1)). A list of references to rules relating to insolvency made in the Convention is contained in **Appendix C**.

12. In a number of instances, the Convention gives recognition to the **uniform rules of securities clearing systems (SCSs) and securities settlement systems (SSSs)** (see Article 1(n)-(p)). These may derogate from or supplement the content of the rules of the Convention.³ It should be noted that Contracting States will in many cases have only limited or indirect influence on the content of the uniform rules of SCSs and SSSs. Such rules are often promulgated by private entities, which are, however, in many instances subject to regulation, supervision or oversight. Through such regulation, etc., for which the Convention provides no rules, a Contracting State could influence the content of the rules of SCSs and SSSs. For an overview of the references in the Convention to the rules of SCSs and SSSs, see **Appendix D**.

13. **Other references** in the Convention to rules outside the Convention will not be examined in this document. For example, references to account agreements will not be discussed, because an account agreement is a contractual arrangement between an account holder and its intermediary, the contents of which, in principle, are not determined by a Contracting State.⁴ This also applies to other sources of contractual rules referred to in the Convention, such as the references to “control agreement” (for the definition thereof, see Article 1(k)), to “the terms of the securities” (e.g., in Articles 9(1)(c) and 9(2)(b)), etc.

B. Information on sources of law outside the Convention

14. The Convention does not require Contracting States to provide the Depositary with information on their domestic laws and policies. However, information on domestic laws and policies relating to intermediated securities could potentially promote the understanding of the application of the Convention in a particular Contracting State. UNIDROIT therefore welcomes any information that a Contracting State, at its discretion, may choose to provide to it about its laws and policies relating to the matters covered by the Convention. Any such information provided to UNIDROIT by a Contracting State would be separate and distinct from any declarations that the Contracting State may make under the Convention. The following format is recommended for the transmission of any such information to UNIDROIT:

“[Name of State] makes available to UNIDROIT the following information about the laws and policies relating to the matters covered by the Convention:”

³ For example, whereas the Convention assumes that securities, as a principle, cannot be taken out of the intermediated holding system, the uniform rules of a SSS may permit doing so (Article 9(1)(c)). The importance of SCS and SSS rules is also apparent from Article 1(l) (designating entries), Article 10 (measures to enable the exercise of rights), Article 15 (unauthorised dispositions), Article 16 (invalidity, reversal and conditions), Article 18 (acquisition by an innocent person), Article 23 (instructions to the intermediary), Article 24 (holding or availability of sufficient securities), Article 26 (loss sharing in case of insolvency of the intermediary), Article 27 (insolvency of system operator or participant) and Article 28 (obligations and liability of intermediaries).

⁴ See the definition of “account agreement” in Article 1(f), and the references in Articles 1(l), 7(2)(b)(ii), 9(1)(c), 10(2)(c), 10(2)(e), 10(2)(f), 15(2), 16, 18(5), 23(2)(a), 24(4), 28(1), 28(2) and 28(3).

15. Such information, which may include references to, or copies of, laws and policies and which may be either general or specific to a particular topic or issue covered by the Convention, would be made available on the UNIDROIT website in order to provide Contracting States with an opportunity to promote understanding of the situation with respect to their rights and obligations under the Convention.

Section 3. Analysis of the Convention

A. Preamble

16. Recitals 9, 10 and 11 of the Preamble highlight a number of issues in relation to intermediated securities, which are not dealt with in the Convention (or dealt with only to a limited extent) and which Contracting States will therefore need to address themselves.

17. **Recital 9** sets out the basic approach that the Convention is not intended to harmonise or otherwise affect **insolvency law** except to the extent necessary to provide for the effectiveness of rights and interests governed by the Convention. Examples of harmonised provisions which guarantee the effectiveness of rights and interests governed by the Convention in insolvency are Articles 11(2), 12(2), 14(1) and 21(1). Insolvency rules which are not fully harmonised can be found in Articles 14(2), 14(4), 21(2), 21(3) and 26(1). For a further discussion of the latter provisions, see below.

18. **Recitals 10 and 11** relate to **regulation, supervision and oversight**. It follows from recital 10 that, generally, the Convention does not limit or otherwise affect the powers of Contracting States to regulate, supervise or oversee the holding and disposition of intermediated securities or any other matters expressly covered by the Convention. The Convention only limits or affects such powers in so far as regulation, supervision or oversight would contravene the provisions of the Convention. More specifically, recital 11 stresses the importance of the role of intermediaries and the need to regulate, supervise or oversee their activities. However, the regulation of intermediaries is not further addressed in the Convention, and would need to be dealt with by each individual Contracting State.

B. Chapter I: Sphere of application

19. Apart from the declarations envisaged in Article 1(n)(iii), 1(o)(iii), 5 and 7, there are a few other provisions in Chapter I that may require Contracting States to take action to complement the Convention.

1. Article 1(k) and (l) – “control agreement” / “designating entry”

20. **Article 1(k)** contemplates the possibility for the non-Convention law to recognise not only a “tripartite” control agreement⁵ (i.e. between an account holder, the relevant intermediary and another person) but also two “bilateral” forms of control agreements (i.e., between an account

⁵ A “control agreement” is defined in Article 1(k) of the Geneva Convention as “[...] an agreement in relation to intermediated securities between an account holder, the relevant intermediary and another person or, if so provided by the non-Convention law, between an account holder and the relevant intermediary or between an account holder and another person of which the relevant intermediary receives notice, which includes either or both of the following provisions: (i) that the relevant intermediary is not permitted to comply with any instructions given by the account holder in relation to the intermediated securities to which the agreement relates without the consent of that other person; (ii) that the relevant intermediary is obliged to comply with any instructions given by that other person in relation to the intermediated securities to which the agreement relates in such circumstances and as to such matters as may be provided by the agreement, without any further consent of the account holder”.

holder and the relevant intermediary or between an account holder and another person of which the relevant intermediary receives notice).

21. **Article 1(I)** provides that the effects of a designating entry⁶ are determined by the account agreement, a control agreement, the uniform rules of an SSS or the non-Convention law. In particular, these non-Convention methods of determining the effects of a designating entry may specify: (i) that the relevant intermediary may not comply with instructions from the account holder without the consent of the grantee of an interest (so-called “negative control”; see Article 1(I)(i)); (ii) that the grantee can give instructions to the relevant intermediary without any further consent of the account holder (“positive control”; see Article 1(I)(ii)); or (iii) both. Pursuant to Article 12(6), a Contracting State that makes a declaration in relation to Article 12(3)(b) must specify one of these effects of a designating entry in a declaration.

2. **Articles 2 (Sphere of application) and 3 (Applicability of declarations)**

22. Pursuant to **Article 2**, the Convention applies whenever the conflict of laws rules of the forum State point to the law in force in a Contracting State as the applicable law. However, as indicated in the Official Commentary, the Convention is not a private international law convention and does not set out the conflict of laws rules that a Contracting State will apply. These rules are left to be determined by the law of the Contracting State outside the Convention (*Official Commentary*, section 2-8). As a corollary to that principle, **Article 3** provides that whenever the law of the forum State is not the applicable law, the forum State must apply the Convention and the declarations, if any, made by the Contracting State the law of which applies.

23. Not all States have specific conflict of laws rules dealing with the law applicable to rights in respect of intermediated securities. Contracting States may therefore wish to consider the desirability of ascertaining whether their existing conflict of laws rules would lead to satisfactory results for the purpose of determining the applicable law as regards the subject matters governed by the Convention.

3. **Article 8 (Relationship with issuer)**

24. In relation to Article 8, the Official Commentary provides the following clarification:

“Article 8(1) provides that the Convention does not affect any right of the account holder against the issuer of the securities. This rule is subject to an exception located in Article 29(2), which requires Contracting States to recognise a so-called nominee holding structures and the splitting of voting and other rights related to the securities held in the intermediated holding system. [...]”

“Article 8(2) puts another limitation on the scope of the subject matter covered by the Convention by providing that the Convention does not determine whom the issuer of the securities is required to recognise: (i) as the shareholder, bondholder or other person

⁶ A “designating entry” is defined in Article 1(I) of the Geneva Convention as “an entry in a securities account made in favour of a person (including the relevant intermediary) other than the account holder in relation to intermediated securities, which, under the account agreement, a control agreement, the uniform rules of a securities settlement system or the non-Convention law, has either or both of the following effects: (i) that the relevant intermediary is not permitted to comply with any instructions given by the account holder in relation to the intermediated securities as to which the entry is made without the consent of that person; (ii) that the relevant intermediary is obliged to comply with any instructions given by that person in relation to the intermediated securities as to which the entry is made in such circumstances and as to such matters as may be provided by the account agreement, a control agreement or the uniform rules of a securities settlement system, without any further consent of the account holder”.

entitled to the rights attached to the securities, which are specifically spelled out in Article 9(1)(a); or (ii) for any other purposes. Note that Article 8(1) is subject to Article 29(2) but Article 29(2) cannot override Article 8(2) [...].” (*Official Commentary*, sections 8-7 and 8-8)

25. This limitation has to be understood against the broad scope of application of the Convention.

26. As explained in the *Official Commentary*, the definition of “securities” includes “any financial assets which are capable of being held in the intermediated holding system and governed by the Convention” (*Official Commentary*, section 1-7), provided that they are “capable of being credited to securities accounts (Article 1(c)) maintained by an intermediary (Article 1(d))” and “capable of being acquired and disposed of in accordance with the provisions of the Convention, in particular Articles 11 and 12.” (*Official Commentary*, section 1-8)

27. Securities come in many different forms, including bonds and other debt instruments traded in the capital markets; shares and other equity instruments, whether or not they are traded on an exchange; and transferable units (other than shares) in collective investment schemes (unit trusts, *fonds communs de placement*, *Anlagefonds*, etc.). They may also include some forms of securitised derivative instruments (*Official Commentary*, section 1-10). While several types of securities may primarily represent a financial asset owned by their holder, some types of securities place the holder in a particular relationship with the issuer of the securities under a body of law that, for purposes of convenience, may be referred to as “corporate law”.

28. The Convention is not generally concerned with “corporate law” matters. However, as indicated in the *Official Commentary*, “[i]t is not easy to draw a line in precise language between what is covered and what is not covered by the Convention in this respect. In particular, it is obvious that using the notion of “corporate law” would not have been useful, because the coverage of corporate law varies from jurisdiction to jurisdiction. The Convention, therefore, follows a functional approach. It delineates the coverage of the subject matter not by using the notion of “corporate law” but by directly spelling out (in functional terms) what is not covered by the Convention” in this area (*Official Commentary*, section 8-2).

C. Chapter II: Rights of the account holder

29. As to the rights of account holders **Articles 9 and 10** harmonise a number of issues relating to the rights flowing from a credit (see Article 9(1)); the person against whom such rights may be exercised (see Article 9(2)); and measures that an intermediary must take in order to enable its account holders to exercise the rights conferred by Article 9(1) (see Article 10). There are, however, a number of issues that have not been harmonised by the Convention. Contracting States are invited to consider whether those issues are adequately addressed by their non-Convention law.

30. Generally, the Convention does not harmonise the **legal qualification of the rights of account holders**. The Convention, therefore, does not determine whether, for example, an account holder has a proprietary interest against its intermediary, such as an ownership or a co-ownership interest, whether the account holder qualifies as a beneficiary under a trust, has a contractual claim against the intermediary or has a *sui generis* interest. The UNIDROIT Committee of Governmental Experts eventually adopted a **functional approach** so as to accommodate these different doctrines, as explained in the *Official Commentary*:

“As the Convention is built on the functional approach it cannot have recourse to terms like “acquisition of property” or “ownership”, which would have a different value in each jurisdiction as soon as it comes to detailed analysis. Therefore, Article 9(1) of the Convention sets out, in functional terms, what should be the features of the legal position acquired under the applicable law (be the concrete legal position in that Contracting State “property”, “joint shared property in a pool of securities”, “equitable interest”, “security entitlement”, etc.)” (*Official Commentary*, section 9-1).

31. In addition, Articles 9 and 10 refer to a number of other issues that are also left to sources of law outside the Convention:

(a) Article 9(1)(a)(ii): cases of credit of securities to a securities account other than those mentioned in Article 9(1)(a)(i), where a credit confers on the account holder the right to receive and exercise any rights attached to the securities (e.g. income and voting rights) (see *Official Commentary*, section 9-16);

(b) Article 9(1)(c): the right to cause securities to be held otherwise than through a securities account, i.e., the right to take securities out of the intermediated system (see *Official Commentary*, sections 9-21 – 9-26);

(c) Article 9(1)(d): the exercise of other rights than those mentioned in Article 9(1)(a)-(c) (see *Official Commentary*, sections 9-27 – 9-30);

(d) Article 9(2)(b): the determination of against whom the rights mentioned in Article 9(1)(a) may be exercised, i.e., against the relevant intermediary, the issuer, or both (see *Official Commentary*, section 9-17);

(e) Article 9(3): the limits on the rights mentioned in Article 9(1)(a) in those cases where an account holder acquires a security interest or a **limited interest** other than a security interest (see *Official Commentary*, sections 9-31 – 9-33);

(f) Article 10(2)(c): the **effect to be given by an intermediary to instructions** given by the account holder or other authorised person;

(g) Article 10(2)(e): the regular passing on of **information relating to intermediated securities** by an intermediary to account holders, including information necessary for account holders to exercise rights;

(h) Article 10(2)(f): the regular **passing on of dividends and other distributions** received in relation to intermediated securities by an intermediary to account holders.

D. Chapter III: Transfer of intermediated securities

32. **Article 11(5)** provides that nothing in the Convention limits the effectiveness of **debits and credits** to securities accounts which are effected **on a net basis** in relation to securities of the same description. This means that a Contracting State is free to decide whether to allow net book entries or not.

33. Article 12 addresses a number of issues that may be subject to declarations by a Contracting State. Apart from these issues, the applicable law determines the circumstances in which a **non-consensual security interest** in intermediated securities may arise and become effective against third parties (**Article 12(8)**), and Contracting States should therefore consider how that issue is dealt with by the non-Convention law.

34. **Article 13** relates to **acquisition and disposition in line with non-Convention law methods**. It allows for the non-Convention law to provide for methods for acquisition and disposition other than those set out in Articles 11 and 12:

“Because the Convention aims at minimal harmonisation rather than full harmonisation, the methods provided by Articles 11 and 12 for the transfer of intermediated securities or for the grant of an interest in the same are not exclusive of other methods available under the non-Convention law. Acquisitions made and interests granted according to such other methods are not eligible for the protection of an innocent acquirer under Article 18, though they may be protected by a similar provision of the non-Convention law. Their priorities are determined by the non-Convention law, except that they are subordinated to all interests that become effective against third parties under Article 12. See Article 19(5).”(*Official Commentary*, section 13-5).

35. While Article 14(1) contains the baseline rule that rights and interests that have become effective against third parties under Article 11 or 12 are effective against the insolvency administrator and creditors in any insolvency proceeding, **Article 14(2)** contains an important carve-out from this rule. It lists a number of examples of **substantive or procedural rules of law applicable by virtue of an insolvency proceeding** that are not affected by Article 14(1). The examples mentioned are rules relating to: (a) the ranking of categories of claims; (b) the avoidance of a transaction as a preference or a transfer in fraud of creditors; and (c) the enforcement of rights to property that is under the control or supervision of the insolvency administrator. This means that a Contracting State would not need to change any existing rules on those matters when implementing the Convention, and may enact or alter them afterwards.

36. **Article 14(4)** states that nothing in the Convention impairs the effectiveness of an interest in intermediated securities against the insolvency administrator and creditors in any insolvency proceeding if that interest has become effective by any method referred to in Article 13. These methods are (a) the acquisition or disposition of intermediated securities or of an interest in intermediated securities or (b) the creation of an interest in intermediated securities and for making such an interest effective against third parties, other than the methods provided by Articles 11 and 12. A Contracting State in which the methods for an interest to become effective include **Article 13 methods** should review its laws with a view to clarifying the effectiveness of interests acquired by such a method in case of an **insolvency** (see the comparable rule in Article 21(3) which applies in the specific situation of the insolvency of the relevant intermediary).

37. In respect of the **authorisation of dispositions by an intermediary** (Article 15) Contracting States are invited to consider two issues. First, under **Article 15(1)(e)** a Contracting State should consider whether the non-Convention law does or should authorise an intermediary to make a debit of securities to a securities account, to make or remove a designating entry or to otherwise dispose of intermediated securities. Any such authorisation provided for in the non-Convention law would be in addition to the modes of authorisation referred to in Article 15(1)(a)-(d) (For more information, see the *Official Commentary*, section 15-17). Second, on the basis of **Article 15(2)**, a Contracting State should give consideration to the consequences of unauthorised dispositions, which are to be determined by the non-Convention law and, to the extent permitted by the non-Convention law, by the account agreement or the uniform rules of a securities settlement system. The consequences of an unauthorised designating entry are to be determined subject to Article 18(2) (For more information, see the *Official Commentary*, section 15-18 – 15-21).

38. **Article 16** relates to **invalidity, reversal and conditionality**, which are left almost entirely for other law outside the Convention. Subject to Article 18, the non-Convention law and, to the extent permitted by the non-Convention law, the account agreement or the uniform rules of a securities settlement system, determine whether and in what circumstances a debit, credit, designating entry or removal of a designating entry is invalid, liable to be reversed or may be subject to a condition, and the consequences thereof. When implementing the Convention, a Contracting State should therefore give consideration to how those issues are dealt with in its law.

39. Article 18(1)-(3) provides a minimum level of harmonisation in relation to the protection of the rights of an innocent acquirer. It follows from **Article 18(4)** that these “safe harbour” protections may be further supplemented by the applicable law, for example by the applicable law providing that an innocent acquirer is also protected in cases that are not covered by the Convention. Contracting States should also consider whether the non-Convention law should, as Article 18(5) says it may, permit deviation from the protection offered by Article 18(2) in the uniform rules of an SSS or an account agreement (see **Article 18(5)**).

40. **Article 19(5) and (6)** is relevant for the **priority status of non-consensual security interests**. Article 19(5) determines that a non-consensual security interest in intermediated securities arising under the applicable law has such priority as is afforded to it by that law. Article 19(6) states, in relation to non-consensual security interests, that the priority afforded under Article 19(5) may be varied by the parties by agreement, but only if the applicable law permits doing so. When implementing the Convention, Contracting States are therefore advised to consider not only the circumstances in which a non-consensual security interest in respect of intermediated securities may arise and become effective against third parties, but also to determine the priority regime in respect of such security interests.

41. **Article 20(1)** provides that the issue of the priority of the relative rights and interests between the account holders of an intermediary and interests granted by that intermediary so as to be effective against third parties under Article 12 or 13 is not determined by the Convention. Although Article 20(2) contains an important exception to this rule in relation to interests granted by an intermediary so as to become effective under Article 12, it leaves at least the **priority contest between account holders of an intermediary and those to whom the intermediary granted an Article 13 interests** unregulated. This is, therefore, one of the issues that a Contracting State whose non-Convention law allows Article 13 interests should consider.

E. Chapter IV: Integrity of the intermediated holding system

42. **Article 21(2)** contains two exceptions to the general rule of Article 21(1) that rights and interests that have become effective under Articles 11 or 12 are enforceable in the event of the insolvency of the relevant intermediary. Those two exceptions are: (a) rules of law applicable in the insolvency proceeding relating to the **avoidance of a transaction** as a preference or a transfer in fraud of creditors; and (b) any rule of procedure relating to the **enforcement of rights to property that is under the control or supervision of the insolvency administrator**. A Contracting State is not free to decide to introduce any exceptions to Article 21(1) in addition to the two exceptions mentioned in Article 21(2), but it may review or modify any of its rules that fall within Article 21(2)(a) and (b). Cf. the rule set out in Article 14(2), discussed above.

43. **Article 21(3)** provides that Article 21 does not impair the effectiveness of **Article 13 interests** in the event of the **insolvency of the relevant intermediary**. A Contracting State in which Article 13 methods exist, should therefore clarify the effectiveness of interests acquired by such a method in case of the insolvency of a relevant intermediary. Cf. the comparable rule set out in Article 14(4), discussed above.

44. Article 23(1) sets out the general rule that an intermediary is neither bound nor entitled to **give effect to** any **instructions** in relation to intermediated securities of an account holder given by any person other than that account holder. **Article 23(2)** contains several exceptions to this rule, of which the exceptions relating to the non-Convention law (subsection (d)) and the uniform rules of an SSS (subsection (e)) should be considered by Contracting States when determining how

to implement the Convention (for more information, see the *Official Commentary*, sections 23-16 – 23-28).

45. Article 24 essentially requires that an intermediary must hold or have available sufficient securities for its account holders other than itself, and, if applicable, for itself. The following issues in relation to this requirement have not been harmonised by the Convention: the **method of complying with the requirement to hold or have available sufficient securities** (see **Articles 24(2)(e) and 24(4)**); the **time permitted to take action** to ensure such compliance (**Article 24(3)**); and the **allocation of the cost** of ensuring compliance or otherwise relating to the consequences of failure to comply (**Article 24(4)**) (For more information, see the *Official Commentary*, sections 24-16 – 24-22). Contracting States should therefore consider how these issues are dealt with by their non-Convention law.

46. Article 25 relating to the allocation of securities to account holders' rights addresses several issues that should be considered by Contracting States. On the basis of **Article 25(3)** a Contracting State should determine how the non-Convention law affects **the allocation of securities to account holders' rights** (and whether the non-Convention law requires or allows the relevant intermediary to affect the allocation). Article 25(4) provides a non-exhaustive list of examples possible arrangements to effect the allocation.

47. Article 26(2) contains a **loss sharing rule**. Two important exceptions apply in relation to this rule. **Article 26(1)** provides that any conflicting rule applicable in an insolvency proceeding prevails. Further, **Article 26(3)** provides that to the extent permitted by the non-Convention law, a shortfall shall be borne in accordance with the uniform rules of a SSS if the intermediary is the operator of the system. A Contracting State should therefore review its insolvency rules concerning shortfalls as well as the issue of whether the non-Convention law should allow rules of SSSs that deviate from the standard solution set out in Article 26(2).

48. **Article 27** contains rules relating to the **finality of instructions or resulting book entries in SCSs or SSSs**. These rules, however, apply only to the extent permitted by the law governing the system. A Contracting State should therefore review and possibly amend its laws depending on whether it wishes to ensure the finality of instructions and book entries in this context or not.

49. **Article 28(1) and (2)** relates to the **obligations of an intermediary** under the Convention. They make clear that the non-Convention law and, to the extent permitted by the non-Convention law, the account agreement or the uniform rules of an SSS may specify such obligations. If the substance of any such obligation is specified by the non-Convention law (or, if permitted, the account agreement or the uniform rules of the SSS), compliance therewith satisfies that obligation. These provisions would seem to provide considerable flexibility for Contracting States in structuring their non-Convention law, etc., in relation to how the obligations of an intermediary that are set out in the Convention may be satisfied. The basic Convention obligations of an intermediary, however, cannot be reduced or modified on the basis of this provision.

50. **Article 28(3) and (4)** relates to the **liability of intermediaries**. This issue should be regulated by Contracting States as it is referred by the Convention to the non-Convention law or, to the extent permitted by the non-Convention law, the account agreement or the uniform rules of a SSS. The non-Convention law would, however, need to take into account the harmonised minimum requirement that an intermediary may not exclude liability for its gross negligence or wilful misconduct.

51. **Article 29(1)** provides that the law of a Contracting State must permit the holding through one or more intermediaries of securities that are permitted to be traded on an exchange or regulated market, and the effective exercise in accordance with Article 9 of the rights attached to such securities that are so held, but need not require that all such securities be issued on terms that permit them to be held through intermediaries. A Contracting State should therefore consider whether its non-Convention law will require that all securities that are permitted to be traded on an exchange or regulated market should be **held through intermediaries** and, in that case, whether the rights attached to such securities can effectively be exercised in accordance with Article 9, or whether there may also be securities that need not be held through intermediaries. On the basis of **Article 29(2)** a Contracting State has the right to determine the conditions under which a person is authorised to exercise rights in the case of **nominee holding and split voting arrangements** (For more information, see the *Official Commentary*, sections 29-20 – 29-26).

52. The last provision of Chapter IV relates to **set-off** and this provision, too, leaves room for policy choices by Contracting States. The harmonised rule in **Article 30** is that the fact that securities are held in intermediated form should not, of itself, put the account holder in a less favourable position as regards rights of set-off in an insolvency proceeding against the issuer, in comparison to the situation where the securities would not have been held in intermediated form. The exact set-off regime is, however, to be determined by the non-Convention law.

F. Chapter V: Special provisions in relation to collateral transactions

53. In comparison with other parts of the Convention, Chapter V contains only few references to sources of law outside the Convention. This reflects the optional nature of this chapter: States can opt out of it entirely or in part (see Articles 36(2) and 38). This made it possible for the Convention text to contain precise rules without numerous references to sources of law outside of the Convention. Besides the declarations mentioned in Articles 36(2) and 38, the following issues should nonetheless be further considered by Contracting States.

54. First, **Article 31(2)** makes it clear that the provisions in Chapter V, while containing a **minimum level of harmonisation**, also allow the non-Convention law to determine whether a collateral taker has additional rights or powers and whether a collateral provider has additional obligations. Article 34(4) is similar in this respect: the exercise of a right of use shall not render invalid or unenforceable any right of the collateral taker under the relevant security collateral agreement or the non-Convention law. In the light of these provisions, it is clear that the non-Convention law may contain additional provisions favouring the position of collateral takers.

55. Second, **Article 35** provides that the non-Convention law may determine that the **realisation** or **valuation** of collateral securities or the **calculation** of any obligations pursuant to Articles 33 or 34 must be conducted **in a commercially reasonable manner**. With a view to assuring a balance between the interests of collateral takers and providers, it would seem advisable for Contracting States to consider imposing such a requirement, if it is not already in place.

56. Third, **Article 36(1)(a)(iii)** refers to the possibility that the non-Convention law may allow the **protection of top-up and substitution of collateral** against timing claw-back rules not only in case of, in short, price fluctuations on the financial markets (Article 36(1)(a)(i)) or changes in credit rating (Article 36(1)(a)(ii); see also Article 36(2)), but also in any other circumstances specified in the collateral agreement. For example, where an extension of credit relies on the current management of the debtor company or the presence of certain important assets, a change of the management or the sale of the assets may trigger a top-up provision in the collateral agreement.

57. As has been indicated above, the Convention leaves a number of issues in respect of intermediated securities unregulated, including issues relating to secured transactions concerning intermediated securities. When implementing the Convention, Contracting States should consider the extent to which the general framework for security interests adequately addresses the issues that are not governed by the Convention.⁷ Those issues include, for example, the following:

(a) the **creation of a security interest in intermediated securities so as to be effective between the parties**, which, depending on the jurisdiction involved, may require (i) an underlying security agreement, (ii) authority to dispose of the assets concerned and/or (iii) certain procedural steps to be fulfilled for vesting the security interest;

(b) the **ranking of Article 13 interests among themselves**. The Convention regulates the priority contest between an interest created under Articles 11 or 12 and an interest created under Article 13, as the Article 13 interest would be subordinate on the basis of the priority rule of Article 19(2) of the Convention. The Convention, however, does not regulate the ranking of Article 13 interests among themselves; and

(c) generally, the applicable framework for secured transactions involving intermediated securities when a Contracting State **opts out of Chapter V**.

⁷ An important source of inspiration for the development of a modern legal framework for secured transactions can be found in the *Legislative Guide on Secured Transactions* adopted by the United Nations Commission on International Trade Law in 2007 (United Nations publication, Sales No. E.09.V.12, New York, 2010; also available from <www.uncitral.org/uncitral/en/uncitral_texts.html>, hereafter referred to as the "Guide"). The Guide intends to give comprehensive legislative guidance in respect of transactions entailing the provision of security interests in all types of movable assets with limited exceptions. Securities are currently excluded from the Guide. In considering whether and to what extent the Guide can offer a meaningful supplement to the Convention, it is important to take into account that many of the rules in Chapter V of the Convention are exceptions to general rules and principles of civil or insolvency law (e.g. the Chapter V rules concerning title transfers, the right to "use" collateral assets, the methods for rapid enforcement of security interests without formalities and the exception to zero hour insolvency rules). These exceptions are justified by the goal of guaranteeing liquid securities markets. In particular insofar as the Guide contains recommendations that are tailored to comparable liquid assets, such recommendations would seem to have added value in this context.

Appendix A**References to “non-Convention law”**

Preamble, recital 7
Article 1(k)
Article 1(l)
Article 1(m)
Article 1(p)
Article 7(1)
Article 9(1)(a)(ii)
Article 9(1)(c)
Article 9(1)(d)
Article 9(3)
Article 10(2)(c)
Article 10(2)(e)
Article 10(2)(f)
Article 11(2)
Article 12(2)
Article 13
Article 15(1)(e)
Article 15(2), twice
Article 16, twice
Article 18(5)
Article 19(2)
Article 19(7)
Article 22(3)
Article 23(2)(d)
Article 24(3)
Article 24(4), twice
Article 25(3), twice
Article 25(5)
Article 26(3)
Article 28(1), twice
Article 28(2), twice
Article 28(3), twice
Article 31(2)
Article 34(4)
Article 35
Article 36(1)(a)(iii)

Appendix B**References to “applicable law”**

Article 2(a)
Article 3
Article 9(1)(c)
Article 9(2)(b)
Article 12(8)
Article 18(4)
Article 19(5)
Article 19(6)

Appendix C**References to rules relating to insolvency**

Preamble, recital 9

Article 11(2): “rule of law applicable in an insolvency proceeding”

Article 12(2): “rule of law applicable in an insolvency proceeding”

Article 14(2): “substantive or procedural rule of law applicable by virtue of an insolvency proceeding” and the examples in sub-paragraphs (a), (b) and (c)

Article 21(2)

Article 26(1): “any conflicting rule applicable in that [insolvency] proceeding”

Article 27: “any rule applicable in an insolvency proceeding”

Appendix D**References to uniform rules of SCSs and SSSs***References to the uniform rules of SCSs:*

Article 1(o)
Article 1(p)
Article 27(a)

References to uniform rules of SSSs:

Article 1(l), heading
Article 1(l)(ii)
Article 1(n)
Article 1(p)
Article 9(1)(c)
Article 10(2)(c)
Article 10(2)(e)
Article 10(2)(f)
Article 15(2)
Article 16
Article 18(5)
Article 23(2)(e)
Article 24(4)
Article 26(3)
Article 27(a)
Article 27(b)
Article 28(1)
Article 28(2)
Article 28(3)