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Principles and Rules Capable of Enhancing Trading in Securities in Emerging Markets

(submitted by the Secretariat)

Summary	*Consideration of preparation of a Legislative Guide on Principles and Rules Capable of Enhancing Trading in Securities in Emerging Markets*
Action to be taken	*Future work*
Mandate	*Work Programme*
Priority level	*To be determined*
Related documents	*C.D. (88) 7; UNIDROIT 2005 – C.D. (84) 19 rev. 2, p. 6-7*

Introduction

1. At its 84th session, the Council briefly discussed a list of topics which might usefully be included in this project once the necessary resources in terms of staff capacity, time, and funding are available.

2. With respect to the preparation of principles and rules designed to enhance trading in securities on emerging markets, the Council was informed at the time that, at a series of fact-finding meetings conducted by the Secretariat for the preparation of the draft Convention regarding Securities Held with an Intermediary, it was our hosts (Governments, securities regulators, industry) in Asia and Latin America in particular who forcefully voiced their wish that this project be given priority status (UNIDROIT 2005 – C.D. (84) 19 rev. 2, p. 6-7).

3. Among the problem areas that might usefully be addressed, the following were suggested as appearing to merit further analysis:

- Nature and types of securities
- Fungibility of securities and (degree of) dematerialisation: immobilised, fully dematerialised securities, substitutes
- Transactional structure of bond issues: private-law restrictions on debt financing; direct placement by (specific types of) issuers; mandatory involvement of intermediaries; contractual and proprietary relationships between issuer, intermediaries/underwriters and investors (internal relationship between underwriters to the extent that local underwriters are involved and local law governs that internal relationship and/or their rights and obligations vis-à-vis the issuer); standard contract terms and their – *ex ante* or *ex post* – scrutiny; potential conflicts between applicable company law and applicable contract law; legal or contractual community of bond holders
- Transactional structure of share issues (IPOs) and in addition problem areas common to bond issues: enabling or limiting rules of underlying company law; methods for determining initial share price (fixed, bookbuilding, auctions) and respective transactional law; differentiation between private placement/public offering; allotment of shares, in particular equal treatment of investors/bidders; status and impact of codes of conduct for issuers and intermediaries; IPOs over the Internet, including conflict-of-laws issues; the issuer's prospectus as the basic information provided in the event of a public offering, its content and liability of the issuer and intermediaries for inaccuracies
- Stabilisation of share price, including greenshoe option for intermediaries; determination of borderline to illegal price manipulation
- Organisational and transactional provisions to enhance liquidity on secondary markets, including role and legal position of intermediaries and central counter parties; conflict-of-laws rules regarding foreign market participants
- General contract law or special regimes for trading in securities; impact of trade usages; impact of standard contract terms legislation; consumer/retail investor protection; special regimes for options, futures and other derivatives
- Contractual and proprietary issues of clearing, settlement and custody as well as use of securities as collateral (to the extent not sufficiently addressed in the preliminary draft Convention on Indirectly Held Securities for the needs of any specific emerging market)
- Securities lending
- Private law framework for disclosure, prevention of insider trading and other forms of market abuse and for the conduct of market participants

4. Recent additional informal consultations further suggest that UNIDROIT might usefully offer substantive guidelines for the incorporation of the UNIDROIT draft Convention on Substantive Rules regarding Intermediated Securities (the work on which is to be completed in October 2009) in the domestic legal system of Contracting States. As a result of its minimalist and functional approach, the draft Convention refrains from addressing a number of issues that are expressly left for the "non-Convention law". It has been suggested that the legislative guide might usefully discuss the interplay between such other law and the Convention. It has also been suggested that, depending on the outcome of the pertinent deliberations by the Governing Council, netting and rules on investor classification might also be included in the new project.

5. As was initially noted, a binding instrument (convention) or even a model law seem to be not only unrealistic but also undesirable, especially from the point of view of the many emerging securities markets, their varied stage of evolution and their interest in building their individual competitiveness. On the other hand, the formulation of *benchmark principles*, developed in a *legislative guide* that focused on the private law aspects, whilst challenging, would appear to be feasible. With respect to a number of issues such an instrument would provide relatively detailed guidance as to the available options for the transaction-related implementation of regulatory recommendations prepared by IOSCO and in other fora. To the extent that conflict-of-laws issues are to be addressed, co-operation with the Hague Conference on Private International Law would be desirable. To the extent that issues of secured transactions in general become topical, close co-operation with UNCITRAL would be sought.

6. At the 84th session of the Council there was support for the view that the item of the capital-markets related work concerned with trading in securities in emerging markets should have high priority as a future project, probably in the form of a legislative guide (UNIDROIT 2005 – C.D. (84) 22, p. 19). The Secretariat has since continued to discuss the project with Governments (in particular in developing countries and transition economies), intergovernmental Organisations and private stakeholders without, however, devoting resources especially to this item. In a memorandum submitted to the 87th session of the Council (UNIDROIT 2008 – C.D. (87) 12), the Secretariat made the following proposals in respect of this particular project:

> "Provided the Council accepts the offer by the Government of Luxembourg to establish jointly a Transnational Centre for Financial Markets Law as an extension of the Institute's resources (extended 'work-bench'), as recommended in the Strategic Plan update (C.D. (87) 6)), a practical and resource-saving way forward would be to (i) set up a Study Group for the preparation of an instrument on netting; (ii) mandate the Centre to conduct the necessary basic research with a view to enabling Council and member Governments to take definite decisions with respect to a legislative guide as early as possible within the triennium under consideration."

7. The report of the 87th session summarises the deliberations of the Council in this respect as follows:

> "(a) With respect to legislative activities, priority is to be accorded to […](iii) work on an instrument on netting in financial services, a legislative guide on principles and rules capable of enhancing trading in securities in emerging markets and, resources permitting and possibly included in that guide, rules facilitating convergence of national investor classification systems. The Council expressed its expectation that work on the aforementioned items will be carried out with the assistance of the envisaged Centre for Transnational Financial Markets Law and Industry." (UNIDROIT 2008 – C.D. (87) 23, para. 118).

8. The Secretariat points out that, as of the time of submission of this memorandum, the proposed Centre for Transnational Financial Markets Law and Industry does not appear to have been established.

9. The World Bank, the International Monetary Fund, UNCITRAL and The Hague Conference on Private International Law have expressed their keen interest to remain involved in the development of the project. The same applies for industry associations and the legal profession. There is potential in a co-operation between UNIDROIT and the International Development Law Organization (IDLO) (also based in Rome) in the carrying out of the project, in light of: (a) the UNIDROIT capital markets work programme and IDLO's economic growth and trade initiative; (b) the network of contacts in emerging markets of both organisations, which will be useful in developing the

legislative guide; (c) a possible future training programme offered by IDLO to emerging markets financial law specialists.

Conclusion

10. The Council may wish to confirm, in principle, the priority status of this project and request the Secretariat to carry out an in-depth feasibility study regarding the development of a legislative guide on emerging financial markets in light of the above considerations on the content of the guide and the recommendations by the Governing Council, for consideration at the Council's 89th session, in 2010.