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Item No. 7 on the agenda: Transactions on Transnational and Connected Capital Markets - Principles and Rules Capable of Enhancing Trading in Securities in Emerging Markets

(prepared by the Secretariat)

<i>Summary</i>	<i>Examination of steps to develop a future legislative Guide on principles and rules capable of enhancing trading in securities in emerging markets and to prepare for the fourth meeting of the Committee on Emerging Markets Issues, Follow-Up and Implementation</i>
<i>Action to be taken</i>	<i>Take note of the activities undertaken by the Secretariat</i>
<i>Mandate</i>	<i>Work Programme 2014-2016</i>
<i>Priority level</i>	<i>Medium</i>
<i>Related documents</i>	<i>Annual Report 2014 (C.D. (94) 2)</i>

INTRODUCTION

1. The final session of the diplomatic Conference to adopt a Convention on Substantive Rules regarding Intermediated Securities (the Convention), Geneva 5-9 October 2009, established a *Committee on Emerging Markets Issues, Follow-Up and Implementation* (the Committee) to assist with the Convention's promotion and implementation.

2. Thereafter, the UNIDROIT General Assembly, at its 65th session in 2009, included work on drafting a Legislative Guide containing principles and rules capable of enhancing trading in emerging markets (the Legislative Guide) in the UNIDROIT Work Programme (A.G. (65) 10). The Governing Council, at its 89th session in 2010, then took note of steps planned by the Secretariat with a view to preparing the Legislative Guide, but assigned medium/low priority to this work until completion of the Principles on Close-Out Netting.

3. Upon adoption of the Principles on Close-Out Netting, the Governing Council, at its 92nd session in 2013, elevated the priority given to the work on drafting the Legislative Guide (from Medium/Low to Medium). This decision was approved by the General Assembly at its 72nd session (December 2013) and the Legislative Guide was included in the Work Programme of the Organisation for the 2014-2016 triennium at this higher level of priority (UNIDROIT 2013 - A.G. (72) 4).

PREPARATORY WORK AND MEETINGS OF THE COMMITTEE

4. Since the conclusion of the diplomatic Conference, the Committee has met three times. The first meeting was held in Rome (6-8 September 2010) at UNIDROIT's headquarters, the second in Rio de Janeiro (27-28 March 2012), and the third in Istanbul (11-13 November 2013).

5. Initially, the Secretariat prepared in advance of the Committee's first meeting a draft Accession Kit, as a first step toward the development of a Legislative Guide on Principles and Rules capable of enhancing trading in securities in emerging markets (UNIDROIT 2010 - S78B/CEM/1/Doc. 3). It was intended to provide advice for countries that intend to become party to the Geneva Securities Convention on how best to incorporate and integrate it into their domestic legal systems.

6. At the first meeting, the Committee decided to divide the draft document in two. The first part containing an explanatory memorandum for the assistance of States and Regional Economic Integration Organisations on the system of declarations under the Convention ultimately became a UNIDROIT document in its capacity as Depositary of the Geneva Securities Convention (UNIDROIT 2011 – DC11/DEP/Doc. 1 rev.). The second part containing references to sources of law outside the Convention was subsequently prepared and provided to the Committee in advance of its meeting in Rio de Janeiro as a potential basis for further work on the future Legislative Guide (UNIDROIT 2011 – S78B/CEM/2/Doc. 2).

7. At the second meeting, the Committee discussed, among other things, the Legislative Guide's potential scope, content, and structure. The Committee stressed the importance of formulating principles focusing on private law aspects of securities trading, but participants indicated that given the complexity of the subject matter, consideration and close coordination with other aspects (including regulatory law) and other Organisations would be required. Inputs received by the Committee also indicated that the future Guide should not be a uniform law text, but a document setting out various options on a number of issues fundamental generally to securities trading and particularly to the Convention's proper implementation. The Committee then set up an informal working group to draft a proposal on these issues for consideration by the full Committee at its next meeting.

8. At the third meeting, the Committee focused its attention on the Legislative Guide's scope and structure by discussing the annotated outline presented by the Secretariat (UNIDROIT 2013 – S78B/CEM/3/Doc. 2). This document, prepared in consultation with the informal working group, covered the universe of public and private law subjects related to securities trading in emerging markets. The intent of the broad outline was to provide the Committee with a full picture of transactional, private law topics, as well as regulatory and public law topics, from which to select those that the Legislative Guide should cover. To narrow the expected content for an initial draft, a group of States presented a proposal focused mainly on private law issues, but which included some regulatory aspects with direct relevance to party transactions. The proposal called for three substantive sections (see Annexe 1) and was accepted by consensus by the Committee to serve as the basis for setting the scope of the Legislative Guide and organising the content and structure of the initial draft.

STATUS OF THE PROJECT

9. Following the Committee's third meeting, the Governing Council, at its 93rd session (2014), expressed its appreciation for the work completed thus far on the project to prepare the Legislative Guide, notwithstanding the staff shortage at that time. Although delays were experienced on the project, work fully recommenced during the fall of 2014 with the arrival of new staff and the engagement of an expert to prepare an initial draft of the Legislative Guide.

10. Regarding the Legislative Guide, the expert consultant has commenced his work, taking the proposal accepted by consensus at the Committee's third meeting as a starting point. Adapting that proposal and maintaining the scope that it sets, he has outlined the Legislative Guide so that the parts on the alternative and paradigmatic structures and attributes of different intermediary holding systems come before the part on non-Convention law. For the latter part, he has suggested organising and addressing these issues from the perspective of various market participants, including account holders, intermediaries and collateral takers. He is currently preparing the initial draft in this order for review by the Secretariat, as well as the informal working group and ultimately the Committee.

11. An initial portion of the Legislative Guide has been submitted to the Secretariat for review and preliminary feedback has been provided. As soon as a significant, thorough portion of the initial draft is complete, it will be circulated to the members of the informal working group for review and feedback. Significant progress is expected in the coming months.

12. Given the progress on the Legislative Guide, preparations are underway to hold the fourth meeting no later than early 2016, to be held either in an emerging market or at UNIDROIT's Headquarters in Rome. Similar to the Committee's previous meetings, it is proposed to begin with a Colloquium on Financial Markets Law to which non-governmental organisations and private sector participants would be invited. Consideration of potential topics and coordination with potential speakers and panellists has already begun.

13. Following the Colloquium, the Committee would reconvene to consider the items on its agenda. At this time, it is expected that the Committee would consider the reception given to the Convention in various countries, including any related developments; review in detail the draft of the Legislative Guide; and discuss proposals for follow-up promotional activities and possible future work by UNIDROIT in the area of capital markets. This includes consideration of promotional activities for both the Convention and the Principles on Close-Out Netting. The Secretariat is planning to send invitations according to the Committee's prior practise of permitting other interested States to attend this meeting, even if they are not Committee Members, nor UNIDROIT Member States.

ACTION TO BE TAKEN

14. *The Secretariat invites the Governing Council to take note of the activities undertaken by the Secretariat, including steps taken to develop a Legislative Guide on principles and rules capable of enhancing trading in securities in emerging markets and to plan the upcoming meeting of the Committee by early 2016.*

ANNEXE 1**Proposal on the way forward**

accepted by consensus by the Committee on Emerging Markets Issues, Follow-Up and Implementation at its 3rd meeting (Istanbul, November 2013)

The initial goal should be to identify the major systemic and structural issues and policy choices involved in (i) establishing an intermediated securities holding system or (ii) evaluating existing systems. The effort should be confined to addressing issues and matters not resolved in the Geneva Securities Convention (GSC) but should be undertaken with the GSC text and Official Commentary firmly in mind. Also early on the insolvency law treatment of intermediated securities should be addressed. See Part VI.b. of the Secretariat's Annotated Draft Outline (see document S78B/CEM/3/Doc. 2).

As the work progresses the Secretariat's Draft Outline now before the Committee will prove to be enormously valuable in identifying details that must be addressed and the relationship of various system structures to the principles established by the GSC. It also provides an excellent checklist for the Committee's consideration of matters that should or should not fall within the scope of the project and for setting priorities for the project.

I. Non-Convention Law (national legal systems)

- A. Ownership rights
- B. Co-ownership rights
- C. Trust
- D. Securities entitlement
- E. Securities regulation and regulatory oversight
- F. Other

II. Alternative/Paradigmatic Structures of IM Holding System

- A. One IM (CSD) with non-IM managers between AHs and IM (CSD) and AHs identified at IM (CSD) level (China)
- B. Multiple IMs with ultimate AH identified at CSD level at end of every settlement cycle (Brazil)
- C. Each AH in chain (including IMs) identified only at level of relevant IM (US)
- D. B-type system but with periodic (as opposed to real-time) identification of AH at CSD/issuer level (Japan)
- E. Multiple IM With the ultimate AH identified at the level of the ultimate IM
- F. Etc.

III. Alternative/ Paradigmatic Attributes of IM Holding Systems

- A. Types of financial assets covered
- B. Nature of IMs
 - 1. Single IM with delegation of certain duties [China; Brazil]
 - 2. Any bank or securities firm
 - 3. Other
- C. Level in intermediated holding system at which account holder is identified
 - 1. Issuer
 - 2. CSD
 - 3. Ultimate intermediary
 - 4. Only the relevant intermediary
 - 5. Relation with the issuer in the various systems
- D. Nature of property interest resulting from credit (GSC Art. 11) or other transfer (GSC Art. 12)
 - 1. Interest in security to exclusion of any IM (i.e., IMs have no property interest, e.g. Japan)
 - 2. Bundle of rights against relevant IM or other IM (e.g., CSD) and interest in underlying security to extent necessary to satisfy rights against relevant IM and to exclusion of creditors of relevant IM (e.g. U.S.)
 - 3. Enforceability of proprietary rights against third parties
 - 4. Fungibility versus traceability of interests
- E. Scheme for providing distributions, voting, information, other corporate actions
 - 1. Pass through from issuer down chain of IMs
 - 2. Distributions from issuer/CSD directly to account holder
 - 3. Right (or not) of AH to prohibit disclosure of identity to CSD, issuer, or person other than relevant IM (or right of issuer to know identity of AHs)
 - 4. Person against which rights are enforceable (e.g., issuer, CSD, relevant IM)