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
Geneva, 1 to 13 September 2008

UNIDROIT 2008
CONF. 11 – Doc. 26
Original: English
4 September 2008

REPORT OF THE INFORMAL WORKING GROUP ON ARTICLES 2 AND 4

The Informal Working Group was charged with looking at the last clause of Article 1(d) and the relationship between Articles 2, 4 and comment 101 to Article 21 in the Explanatory Report. At this time the Working Group has deferred consideration of whether Article 2 is still necessary or whether its scope is too broad pursuant to a request by one delegation to make a presentation on this Article at a later time and we report on Articles 1(d), 4 and comment 101 of Article 21.

Article 1(d) Definition of Intermediary

The Working Group considered the last part of the definition of "intermediary" which states "and includes a central securities depository if and to the extent that it acts in that capacity". Some delegations raised the issue that the reference to a CSD is not functional and introduces an undefined term. The Working Group concluded that while the clause departs somewhat from the functional approach, it is important to retain this language to clarify that, for many systems, including several transparent systems, a CSD is an intermediary when it engages in the business of maintaining securities accounts. We also concluded that many well known publications by IOSCO and other central banks discuss the activities and functions of CSDs, so that it is not an unknown term and is thus not problematic to include this clause without defining the term CSD in this context. The Working Group also asks the Drafting Committee to consider whether the words at the end "in that capacity" clearly refers to the capacity of maintaining securities accounts and not to other capacities.

Article 4 Central securities depositories

The Working Group discussed the meaning of Article 4 and concluded that with respect to the activity of "creation… of securities vis-à-vis the issuer", the intent is to cover the function or activity of the CSD and the issuer engaging in the process of introducing the securities into the system. The process of securities creation and the issuance of the securities into a system usually contains multiple steps, a number of which take place before the entry of the securities into the system. For example, these may contain the formal decision of the issuer under the applicable law to issue securities. This decision will normally be complemented by additional formal requirements that might be required. Next, the issuer or its lead manager introduces the issue into the CSD which credits it on an issuer account. Different jurisdictions may treat this entry differently from a legal point of view. For some jurisdictions, such entry simply constitutes the evidence of the receipt of the securities by the CSD. For others, however such entry constitutes one of the necessary steps for the creation of securities. Notwithstanding that, the Working Group concluded that the word

"creation" should be retained and that the Official Commentary can provide further illustration of this process. For this purpose, the Legal Certainty Group Report (Recommendation 15) could be consulted.

In addition to creation, Article 4 also refers to performing the functions of recording and reconciling the position of securities holders vis-à-vis the issuer. In that regard the Working Group concluded that all these functions can be performed by CSD, central banks, transfer agents, and registrars in that these types of entities could all be listed by way of example, which would leave open the possibility that other types of persons in the future may perform these excluded functions. Finally, the Working Group would ask the Drafting Committee to consider whether the word "perform" rather that "conduct" and whether "functions" rather than "activities" would better express the concept of this article and notes that Article 5 also uses the word "perform" and "functions". Finally, the Working Group concluded that the title of this Article should be changed to reflect its substance, that is functions excluded from the scope of the Convention.

Comment 101 of Article 21, holding or availability of sufficient securities

The Working Group concluded that the text of Article 21 and its interaction with Article 4 are not problematic. However, the explanation given in comment 101 may lead to incorrect conclusions in this regard since it states that it reaches issuer accounts and uses very specific language in the regard.

However, the Working Group considers that the appropriate interpretation of the interaction of Articles 4 and 21 does not cause any conflict.

Article 4 exempts certain issue related functions performed by CSDs, or other entities from the scope of the Convention, including the maintenance of the original records of an issue towards the issuer and the reconciliation on such register.

Article 21, on the other hand, provides the methods by which an intermediary may comply with the requirement to hold sufficient securities for the benefits of its account holders. The details of this compliance are left to non-Convention law and may take the form of legislation and / or regulation. To the extent that the highest/tier intermediary such as a CSD is concerned, these methods may include coverage resulting from entries in the issuer record, however, this does not imply an extension of the application of the Convention to such records. All that is provided for by Article 21(4) and (2) is an obligation of a CSD in its *intermediary* capacity to provide for sufficient coverage.

- END -