

COMMENTS

on

UNIDROIT'S DRAFT CONVENTION ON SUBSTANTIVE RULES REGARDING INTERMEDIATED SECURITIES

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(with drafting Proposals by the Unidroit Secretariat to amend the text of the draft)

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EuropeanIssuers is a pan European organisation that represents the vast majority of publicly quoted companies in Europe. EuropeanIssuers was formed when EALIC, the European Association of Listed Companies, and UNIQUE, the Union of Issuers Quoted in Europe, combined their organisations in early 2008. Its members are national associations and companies from the following countries: Austria, Belgium, Bulgaria, Cyprus, Finland, France, Germany, Greece, Italy, the Netherlands, Poland, Portugal, Spain, Switzerland and the United Kingdom. These markets count some 9,200 listed companies with a combined market value of some € 8,500 billion. EuropeanIssuers is an International Non Profit Association under Belgian law with registered seat and permanent secretariat in Brussels.

I. INTRODUCTION

EuropeanIssuers wishes to reiterate the concerns it expressed in its previous papers on the subject dated 3 November 2006 and 20 April 2007 respectively. The main concern of issuers is related to the scope and purpose of the Convention that seem to have become substantially broader than initially envisaged. We understand and appreciate that the Convention has its merits where it aims to harmonize the situation of securities credited to a securities account. The rights and obligations derived thereof against the intermediary who provides the account, on the one hand and those against third parties who have an interest in the intermediary, on the other hand, are to be reconciled. The rights of the account holder must be protected in case of insolvency or similar situation regarding the patrimony of the intermediary and it must be made clear that the securities accounts belonging to account holders do not form part of the property of the intermediary available for its creditors. However the convention must stick to this clear and well defined purpose and refrain from interfering with corporate law regarding securities and the relationship between shareholders and issuers, including the rights granted to shareholders by and to be exercised against issuers. This is all the more so, as the *acquis communautaire* now includes the Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (14.7.2007), hereinafter the "Shareholder Rights Directive". It is of the utmost importance that the Convention respects the integrity and sovereignty of such EU legal framework.

Considering the foregoing, EuropeanIssuers wishes to comment hereinafter on those provisions in the draft Convention that threaten to interfere with company law matters, in particular with the issuer – shareholder relation. Our focus is on matters of specific interest to the relationship between shareholders/investors and issuers, since we believe that this

relationship should remain unaffected by the Convention. In addition, we will comment on issues that are fundamental for the stability of the intermediated securities system.

II. COMMENTS

Article 1 [Definitions]

(c) "securities account"

Draft Convention text

"(c) "securities account" means an account maintained by an intermediary to which securities may be credited or debited;"

Comments and proposal

In our view, the word "maintain" does not sufficiently reflect the difference with the word "hold" that is reserved for the account holder. We favor the use of the word "provide" instead of "maintain" because it expresses better that the intermediary or better the account provider "hosts the account" or in other words "puts this account at the disposal of a holder".

The logical (and simple) definition of "intermediated securities" should be:

<p><i>"(c) "securities account" means an account provided by an account provider to which securities may be credited or debited;"</i></p>

(d) "intermediary"

Draft Convention text

"(d) "intermediary" means a person who in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity and includes a central securities depository if and to the extent that it acts in that capacity;"

Comments and proposal

Since the draft Unidroit convention has a functional approach, it seems that the word "account provider" is more appropriate than "Intermediary". The example provided in the definition of intermediary illustrates this. According to the draft Unidroit Convention, a central securities depository, hereinafter a "CSD", is an intermediary, but is governed by the draft Unidroit convention only to the extent that it "maintains securities accounts", which is not clearly provided for in the current definition of intermediary ("to the extent that it acts in that capacity"). Does "that capacity" refer to being a CSD, an intermediary or to "maintaining securities accounts"? Using the word "account provider" instead of "intermediary" is also in coherence with the definition of "account holder".

The definition of “intermediary” should therefore read:

“(c) “Account provider” means a person, including a central securities depository or an issuer, who in the course of a business or other regular activity provides securities accounts for others or both for others and for its own account and is acting in that capacity;”

(e) “account holder”

Draft Convention text

“(e) “account holder” means a person in whose name an intermediary maintains a securities account, whether that person is acting for its own account or for others (including in the capacity of intermediary);”

Comments and proposal

1. For the sake of coherence with the previous definitions and to avoid misinterpretations to which the notion “in whose name” could give rise, this definition should be revised as mentioned hereafter.

2. The first version of the draft Convention contained explanatory notes that excluded issuers from the list of persons authorised to participate to the dematerialised or central deposit system. The present version doesn’t include these notes any longer, but doesn’t make it clear either whether the previous exclusion of issuers is maintained, which should not be the case. In some EU countries, the legal system grants issuers access to the system not only in their capacity of issuers but also as actual intermediary participants (irrespective of whether they are financial intermediaries). We find it necessary that the final version of the Convention acknowledges the possibility for the issuers to gain direct access to the central deposit system. Otherwise, issuing companies could not continue to maintain accounts of their own employees or shareholders thus enabling them to deposit the issuer’s financial instruments without bearing the related costs charged by financial intermediaries.

The definition of “account holder” is large enough to encompass the issuer. In addition, to avoid any misunderstanding as to his direct access right to the central securities depository, it should be explicitly stated, e.g. in explanatory notes, that issuers are not excluded from the right to hold securities accounts with a CSD in the capacity of participants. See also the definition on CSDs.

The definition of “account holder” should read:

“(e) “account holder” means a person who holds a securities account with an account provider, whether that person is acting for its own account or for others (including in the capacity of intermediary);”

New (e bis) “ultimate account holder”

Comments and proposal

As we will explain hereinafter (see Art. 7), it is necessary to distinguish between an account holder in general and an account holder that is not acting for anybody else, but strictly acts in its own name and for its own account.

The new definition should read:

“ultimate account holder” means an account holder who is acting for its own account;”

(g) “relevant intermediary”

Draft Convention text

“(g) “relevant intermediary” means, with respect to a securities account, the intermediary that maintains the securities account for the account holder;”

Comments and proposal

For the sake of coherence the word “maintains” should be replaced by “provided” and “intermediary” replaced by “account provider”.

The new definition should read:

“(g) “relevant account provider” means, with respect to a securities account, the account provider that provides the securities account for the account holder;”

New (Article) “central securities depository”

Comments and proposal

A Convention on intermediated securities must necessarily mention the CSD as it plays a key role as securities accounts provider in the securities holding system. The CSD represents the highest tier of holding on which the whole intermediated holding system relies. The CSD is the keystone of this system: it ensures the legal and accounting integrity, by making sure that no securities are artificially created or circulated in the holding system. The CSD’s primary role is to ensure that the aggregate number of securities in circulation for a given issuer as recorded in its participants’ books balances out the aggregate number of securities issued by that issuer and recorded in the CSD’s books. This verification function that is usually termed first level concordance is of the utmost importance for issuers in a securities dematerialized environment. The present version of the draft Convention provides for the exclusion of the CSD’s activities vis-à-vis the issuer in its Art. 3.

Considering the above and the fact that the CSD is now explicitly mentioned in the draft Convention, there is a need for a definition of the CSD that should read:

“(new littera) “central securities depository” means an entity that provides the highest tier of securities account holding by providing

- i) securities issuance accounts for issuers that are specifically dedicated to a given securities issuance and that represent the entirety of the financial instruments making up such issuance, and*
- ii) securities accounts for account providers acting as participants to the securities holding with the depository.*

Article 3 [Sphere of application]

Draft Convention text

"This Convention applies where:

- (a) the conflict of laws rules of the forum state designate the law in force in a Contracting State as the applicable law; or
- (b) the circumstances do not involve a choice in favour of any law other than the law of a Contracting state."

Comments and proposal

The scope is still only described with respect to the situation of conflicting laws and the applicable law in such case, namely the Convention. However it does not describe the scope any further as to its *ratione materiae*. The Convention's purpose is to address the relationship between the accountholder and the account provider and related areas, but not the relationship between the (ultimate) accountholder and the issuer. This should be explicitly stated.

Article 3 should therefore be completed as follows:

- "1. "This Convention applies where:*
- (a) the conflict of laws rules of the forum state designate the law in force in a Contracting State as the applicable law; or*
 - (b) the circumstances do not involve a choice in favour of any law other than the law of a Contracting state.*
- 2. This Convention does not govern corporate law matters, including the relationship between issuers and their shareholders, and does not affect in any way the domestic corporate law concerning the establishment, alteration or disposal in whatever form of the position as a shareholder of an issuer or of any shareholder rights against the latter contained in or evidenced by intermediated securities."*

Article 4 [Central Securities Depositories]

Draft Convention text

"This Convention does not apply to the activity of creation, recording or reconciliation of securities conducted by central securities depositories or other persons vis-à-vis the issuer of those securities."

Comments and proposal

It is not desirable nor practically possible to allow that this provision limits the exclusion of the CSD's activities from the scope of the Convention to the activities carried out "vis-à-vis the issuer of those securities". For the sake of concordance and the integrity of the system the exclusion must be absolute. In addition, a CSD does not create securities as such, it creates them under the form of a book entry, the actual creation is done by the issuing company.

Article 4 should therefore be shortened to:

"This Convention does not apply to the activity of book entry creation, recording or reconciliation of securities conducted by central securities depositories or other persons."

Article 7 [Intermediated securities]

Draft Convention text

"1. – The credit of securities to a securities account confers on the account holder:

- (a) the right to receive and exercise the rights attached to the securities, including in particular dividends, other distributions and voting rights
 - (i) where the account holder is not an intermediary or is an intermediary acting for its account; and,
 - (ii) in any other case, if provided by the non-Convention law;
- (b) ...
- (c) ...
- (d) ...

.....

2. – Unless otherwise provided in this Convention,

- (a) the rights referred to in paragraph 1 are effective against third parties;
- (b) the rights referred to in paragraph 1(a) may be exercised against the relevant intermediary or the issuer of the securities, or both, in accordance with this Convention, the terms of the securities and the law under which the securities are constituted;
- (c) the rights referred to in paragraph 1(b) and 1(c) may be exercised only against the relevant intermediary.

3. - Where an account holder has acquired a security interest, or a limited interest other than a security interest, by credit of securities to its securities account under Article 9(4), the non-Convention law determines any limits on the rights described in paragraph 1 of this Article."

Comments and proposal

Article 7 refers to the rights attached to the shares, resulting from a credit to a securities account. As indicated above, the scope of the Convention should not cover the relationship between the account holder and the issuer. What is the *ratio legis* for having a provision that

describes the rights of a shareholder in a convention that is meant to protect the rights of a holder of a securities account against (a possible insolvency of) the account provider? If this provision serves to bring the book entry system to the same level as non intermediated shareholding, it should simply state that a holder of a securities account who is an ultimate account holder - thus excluding any intermediary that is not acting for its own account, enjoys the rights of a shareholder with respect to the securities credited to that account. It should limit itself to merely but clearly state that, without describing what these rights are. Indeed, the convention is not the adequate legal framework to address shareholder rights, which are a matter of corporate law. In addition, once again the Convention should not disregard possible domestic corporate systems as for instance registered shareholding.

As a consequence, Article 7 should be much shortened and simplified, so as to read as follows:

“1. - The credit of securities to a securities account confers on the ultimate account holder the rights enjoyed by a shareholder according to domestic corporate or other domestic non-Convention law, without prejudice to any explicit additional requirements laid down by domestic corporate or other domestic non-Convention law.

2. - Unless otherwise provided in this Convention, the rights referred to in paragraph 1 are effective against third parties.

3. - Where an account holder has acquired a security interest, or a limited interest other than a security interest, by credit of securities to its securities account under Article 9(4), the non-Convention law determines any limits on the rights described in paragraph 1 of this Article.

Article 8 [Measures to enable account holders to receive and exercise rights]

Draft Convention text

“1. - An intermediary must take appropriate measures to enable its account holders to receive and exercise the rights specified in Article 7(1), but this obligation does not require the relevant intermediary to take any action that is not within its power or to establish a securities account with another intermediary.

2. - This Chapter does not affect any right of the account holder against the issuer of the securities.”

Comments and proposal

In its current version the obligation laid down in §1 has nearly lost all interest. Moreover as a consequence of the proposed modifications indicated above, §1 should be adapted and §2 deleted altogether. The duty to take “appropriate measures to enable” an account holder “to exercise the rights specified in Article 7(1)” could imply in certain (especially non-EU) jurisdictions the exercise of voting rights by a person acting in his own name but on behalf of another person (including a nominee). However, in many EU countries provisions on corporate actions and general corporate governance principles require the identification of the shareholder, whilst the intermediary is usually considered as mere depository of the financial instruments concerned. In order to avoid problems stemming from different rules and for the sake of ensuring transparency, the Convention should safeguard the right for the

issuer to require from the intermediary the disclosure of the identity of the ultimate accountholder.

The Article should therefore read as follows:

*“Article 8 [Measures to enable account holders to receive and exercise rights]
1. A relevant account provider, when acting for others, must take all appropriate measures that are reasonably within its power to
i) enable its account holders to exercise the rights specified in Article 7(1)
ii) when so requested by or on behalf of the issuer of a security credited to a securities account provided by the account provider, disclose the identity of the ultimate accountholder with respect to that security.”*

New Article [x]

Comments and proposal

As we explained above, the CSD plays a primary role where the integrity of the intermediated holding system is concerned. Chapter IV must therefore include a provision that acknowledges this role and ensures its correlation with the obligations for intermediaries.

A new Article [x] should be added that reads:

“The Central Securities Depository ensures that the aggregate number and amount of securities in circulation for a given issuer as recorded in its participants’ books balances out the aggregate number and amount of securities issued by that issuer under the securities issuance account with that Central Securities Depository. To that end, the Central Securities Depository ensures that any debit or credit on a given participant’s securities account is balanced out by one or more entries in opposite direction on one or more participants’ securities accounts.”

Article 21 [Holding or availability of sufficient securities]

Draft Convention text – paragraph 1

“1. - An intermediary must, for each description of securities, hold or have available for the benefit of its account holders other than itself securities and intermediated securities of an aggregate number or amount equal to the aggregate number or amount of securities of that description credited to securities accounts which it maintains for such account holders.”

Comments and proposal

The notions “availability” and “have available” have been added since the previous version of the draft Convention. We are concerned that this notion is too vague and could lead to various interpretations by intermediaries as to what “having available” would exactly mean. Availability could even depend on contractual arrangements with third parties, the compliance of which could not be assured at all times. In our view such notion doesn’t afford

enough certainty as regards the integrity of the securities holding. The use of this notion must be avoided.

This is the right place to ensure correlation between the obligations of the CSD and those of the intermediaries in view of ensuring the integrity of the intermediated holding system. Moreover, the intermediary only has such obligations when he is not acting for his own account, in other words when he is not an actual shareholder himself.

The title of Art. 21 should therefore read:

“Article 21 Holding of sufficient securities”

Art. 21, § 1, should therefore read:

“1. - An account provider, when not acting for his own account, must, for each description of securities, hold securities and intermediated securities of an aggregate number or amount equal to the aggregate number or amount of securities of that description credited to securities accounts which it provides for such account holders.”

Draft Convention text – paragraph 2

“2. An intermediary may comply with paragraph 1:

- (a) by procuring that securities are held on the register of the issuer in the name, or for the account, of its account holders;
- (b) by holding securities as the registered holder on the register of the issuer;
- (c) by possession of certificates or other documents of title;
- (d) by holding intermediated securities with another intermediary; or
- (e) by any other appropriate method.”

Comments and proposal

As we already observed with regard to the notion of “having available” above, we have to oppose also to the use of the description in “(e) by any other appropriate method.” There is no indication whatsoever as to what would be appropriate thus leaving the door open for the widest interpretations. As these Articles concern the very fundamentals of the integrity of the securities holding and therefore even the stability of the system, littera (e) is not acceptable and should be deleted.

Art. 21, § 2, should therefore read:

“2. - An account provider may comply with paragraph 1:
(a) by procuring that securities are held on the register of the issuer in the name, or for the account, of its account holders;
(b) by holding securities as the registered holder on the register of the issuer;
(c) by possession of certificates or other documents of title;
(d) by holding intermediated securities with another account provider.”

Article 26 [Position of issuers of securities]

Draft Convention text

“1. - The law of a Contracting State shall permit the holding through intermediaries of securities that are permitted to be traded on an exchange or regulated market, and the effective exercise in accordance with Article 7 of the rights attached to such securities which are so held, but need not require that all such securities be issued on terms that permit them to be held through intermediaries.

2. - In particular, the law of a Contracting State shall recognise the holding of securities by a person acting in its own name on behalf of another person or other persons and shall permit such a person to exercise voting or other rights in different ways in respect of different parts of a holding of securities of the same description; but this Convention does not determine the conditions under which such a person is authorized to exercise such rights.

3. – This Convention does not determine whom an issuer is required to recognise as the holder of securities.”

Comments and proposal

This provision does not deal at all with the relation between the account holder and the account provider. It deals exclusively with the manner in which securities can be held which is a matter of pure corporate law and ought therefore not to be addressed in this Convention, as it is not the appropriate legal framework.

This is especially the case for paragraph 2 that contains a rule regarding the exercise of the voting rights which is far beyond the scope of the Convention: it allows for the exercise of voting rights by a person acting in its own name on behalf of another person. These matters belong to the scope of the Shareholder Rights Directive and of the domestic corporate law. This provision imposes on contracting states the recognition of this specific type of holding which is too much of interference in national law.

Paragraph 3 creates the false impression that the issuer- shareholder relation would remain unaffected whereas the present version of the draft Convention doesn't seem to leave anything in that relation unaffected. Moreover the subject of paragraph 3 is already dealt with elsewhere and the wording of this paragraph is too vague anyway as the notion “*the holder of securities*” does not have a clear meaning.

We therefore strongly advocate the entire deletion of Article 26 or at least paragraphs 2 and 3.