OFFICIAL COMMENTARY ON THE UNIDROIT CONVENTION ON SUBSTANTIVE RULES FOR INTERMEDIATED SECURITIES

PREAMBLE

THE STATES SIGNATORY TO THIS CONVENTION,

CONSCIOUS of the growth and development of global capital markets and recognising the benefits of holding securities, or interests in securities, through intermediaries in increasing the liquidity of modern securities markets,

RECOGNISING the need to protect persons that acquire or otherwise hold intermediated securities,

AWARE of the importance of reducing legal risk, systemic risk and associated costs in relation to domestic and cross-border transactions involving intermediated securities so as to facilitate the flow of capital and access to capital markets,

MINDFUL of the need to enhance the international compatibility of legal systems as well as the soundness of domestic and international rules relating to intermediated securities,

DESIRING to establish a common legal framework for the holding and disposition of intermediated securities,

BELIEVING that a functional approach in the formulation of rules to accommodate the various legal traditions involved would best serve the purposes of this Convention,

HAVING due regard for non-Convention law in matters not determined by this Convention,

EMPHASISING the importance of the integrity of a securities issue in a global environment for intermediated holding in order to ensure the exercise of investors' rights and enhance their protection,

EMPHASISING that this 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 this Convention,

RECOGNISING that this Convention does not limit or otherwise affect the powers of Contracting States to regulate, supervise or oversee the holding and disposition of

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intermediated securities or any other matters expressly covered by the Convention, except in so far as such regulation, supervision or oversight would contravene the provisions of this Convention,

MINDFUL of the importance of the role of intermediaries in the application of this Convention and the need of Contracting States to regulate, supervise or oversee their activities,

HAVE AGREED upon the following provisions:

COMMENTARY

I. INTRODUCTION

P-1 The Preamble identifies the background, purposes and approach of the Convention and related matters.

II. HISTORY

P-2 A first proposal for a Preamble was made during the third session of the CGE. See UNIDROIT 2007—Study LXXVIII—Doc. 58, Appendix 10.

P-3 This proposal formed the basis of a Preamble text submitted to the first session of the diplomatic Conference, which contained an additional consideration regarding regulation, supervision and oversight. See UNIDROIT 2008—CONF. 11—Doc. 7. At the first session, this text was adopted with hardly any changes. See UNIDROIT 2008—CONF. 11—Doc. 33, p. 2 and Doc. 48 Rev.

P-4 During the final session of the diplomatic Conference three recitals were added to the Preamble, relating to the integrity of a securities issue in a global environment, insolvency law and the need to regulate, supervise or oversee the activities of intermediaries in light of their important role in the application of the Convention.

III. ANALYSIS

P-5 The first three recitals provide the background of the Convention. As capital markets grow, holding of securities through intermediaries is commonly observed around the world and the protection of investors who acquire and hold such intermediated securities is essential for the effective operation of financing transactions in today's capital markets. However, the development of intermediated holding systems may in some circumstances produce legal risk, systemic risk and associated costs in relation to both domestic and cross-border transactions involving intermediated securities. Thus, to reduce these risks is of vital importance to facilitate the flow of capital and access to capital markets.

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The fourth and fifth recitals state the purposes of the Convention. The fourth recital identifies the need to enhance the international compatibility of legal systems as well as the soundness of domestic and international rules relating to intermediated securities. The fifth recital identifies the object of the Convention as being to establish a common legal framework for the holding and disposition of intermediated securities. **P-6**

The sixth recital states the Convention's "functional" approach. Different jurisdictions have different legal formulations, doctrines and histories in relation to intermediated securities. The Convention does not attempt to harmonise such legal doctrines or formulations. It is rather intended to harmonise the result of the rules on certain key matters while allowing Contracting States to maintain or adopt their own legal doctrines or formulations. **P-7**

The seventh recital sets out the minimalist approach of the Convention. It makes clear that rules on the matters not determined by the Convention are supplied by the non-Convention law. See the commentary on Article 2. **P-8**

The eighth recital was added at the final session of the diplomatic Conference. It emphasises the importance of the integrity of securities issues in a global environment for intermediated holding in order to ensure the exercise of investors' rights and enhance their protection. **P-9**

The ninth recital was also added at the final session of the diplomatic Conference. The Convention is generally not intended to harmonise or otherwise affect insolvency law. However, the effectiveness and priorities of rights and interests governed by the Convention must be recognised in insolvency proceedings, subject to the rules specific in insolvency proceedings. See the commentary on Articles 14 and 21. **P-10**

The tenth recital recognises that 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. However, the tenth recital at the same time notes that this applies, except in so far as such regulation, supervision or oversight would contravene the provisions of the Convention. **P-11**

The eleventh recital was added at the final session of the diplomatic Conference. It notes the importance of the role of intermediaries in the application of the Convention and the need for Contracting States to regulate, supervise or oversee their activities. During the negotiation process, and in particular following the financial crisis which occurred in 2008, participants felt that intermediaries are important players and the importance of the role of Contracting States to regulate, supervise or oversee their activities must be noted. **P-12**

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CHAPTER I—DEFINITIONS, SPHERE OF APPLICATION AND INTERPRETATION

Contents and outline

I-1 *Chapter I* contains definitions and other general provisions, including provisions relating to the scope of the Convention's application and its interpretation. The provisions in Chapter I generally apply to the Convention as a whole.

I-2 *Article 1* contains the Convention's general definitions. These definitions are essential to the application of the Convention's substantive provisions and also to the scope of its application.

I-3 *Article 2* determines the sphere of application of the Convention. It applies when the applicable conflict of laws rules point to the law of a Contracting State and when circumstances do not lead to the application of any other law.

I-4 *Article 3* makes it clear that in the case where the applicable law is not the law of the forum State, the forum State will apply the declarations made under Chapters I to VI of the Convention by the State whose law applies, and not its own declarations.

I-5 *Article 4* specifies several criteria that provide guidance for the implementation, interpretation and application of the Convention. These are the Convention's purposes, the general principles on which it is based, its international character and the need to promote uniformity and predictability in its application.

I-6 *Article 5* permits Contracting States (by declaration) to limit the scope of application of the Convention to the securities accounts maintained by "regulated" intermediaries and/or those maintained by a central bank. This offers a Contracting State the option to exclude the application of the Convention to securities accounts that are maintained by "unregulated" intermediaries.

I-7 *Article 6* excludes from the scope of the Convention several functions vis-à-vis the issuer of securities. These functions may be carried out by a CSD, central bank, transfer agent, registrar or any other person.

I-8 *Article 7* is intended to clarify the concept of an intermediary in a situation in which the task of "maintaining" a securities account is divided between two or more persons. See also Article 1(d), defining "intermediary". Article 7 ensures the proper application of the Convention to the holding patterns where a third person ("other person") is involved in the relationship between the relevant intermediary and its account holders. This is important, in particular, in the case of certain legal systems sometimes referred to as "transparent" systems.

I-9 *Article 8* generally provides that the Convention does not affect the relationship between an issuer of securities and an account holder. In general, this means that the Convention does not regulate the body of law usually called "corporate law".

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Article 1
Definitions

In this Convention:

(a) "securities" means any shares, bonds or other financial instruments or financial assets (other than cash) which are capable of being credited to a securities account and of being acquired and disposed of in accordance with the provisions of this Convention;
(b) "intermediated securities" means securities credited to a securities account or rights or interests in securities resulting from the credit of securities to a securities account;
(c) "securities account" means an account maintained by an intermediary to which securities may be credited or debited;
(d) "intermediary" means a person (including a central securities depository) 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;
(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);
(f) "account agreement" means, in relation to a securities account, the agreement between the account holder and the relevant intermediary governing the securities account;
(g) "relevant intermediary" means, in relation to a securities account, the intermediary that maintains that securities account for the account holder;
(h) "insolvency proceeding" means a collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of the debtor are subject to control or supervision by a court or other competent authority for the purpose of reorganisation or liquidation;
(i) "insolvency administrator" means a person (including a debtor in possession if applicable) authorised to administer an insolvency proceeding, including one authorised on an interim basis;
(j) securities are "of the same description" as other securities if they are issued by the same issuer and:
   (i) they are of the same class of shares or stock; or
   (ii) in the case of securities other than shares or stock, they are of the same currency and denomination and are treated as forming part of the same issue;
(k) "control agreement" means 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;

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(l) "designating entry" means 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;

(m) "non-Convention law" means the law in force in the Contracting State referred to in Article 2, other than the provisions of this Convention;

(n) "securities settlement system" means a system that:
  (i) settles, or clears and settles, securities transactions;
  (ii) is operated by a central bank or central banks or is subject to regulation, supervision or oversight by a governmental or public authority in relation to its rules; and
  (iii) has been identified as a securities settlement system in a declaration made by the Contracting State the law of which governs the system on the ground of the reduction of risk to the stability of the financial system;

(o) "securities clearing system" means a system that:
  (i) clears, but does not settle, securities transactions through a central counterparty or otherwise;
  (ii) is operated by a central bank or central banks or is subject to regulation, supervision or oversight by a governmental or public authority in relation to its rules; and
  (iii) has been identified as a securities clearing system in a declaration made by the Contracting State the law of which governs the system on the ground of the reduction of risk to the stability of the financial system;

(p) "uniform rules" means, in relation to a securities settlement system or securities clearing system, rules of that system (including system rules constituted by the non-Convention law) which are common to the participants or to a class of participants and are publicly accessible.

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COMMENTARY

I. INTRODUCTION

1-1 Article 1 contains a list of definitions that are applied throughout the Convention. The Convention also contains some definitions for specific purposes, notably in the context of Chapter III on the transfer of intermediated securities (see Article 17), upper-tier attachment (see Article 22(2)) and in the context of Chapter V on collateral transactions (see Article 31(3)).

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II. HISTORY

Over the course of the drafting of the Convention the evolution of the definitions contained in Article 1 generally followed the corresponding development of the substantive provisions of the Convention. In particular, the scope and operation of the Convention is based substantially on its principal defined terms, such as securities, intermediated securities, securities account, intermediary, account holder, and relevant intermediary. Of course, stylistic changes to the definitions were also made throughout the process, but most of those need not be mentioned here. **1-2**

During the first session of the CGE the term "securities held with an intermediary" was replaced by the term "intermediated securities". No change in the text of the definition was made. The definition of intermediated securities was changed during the third session of the CGE in order to make it clear that intermediated securities may include both the underlying securities as well as rights and interests in securities, in each case credited to a securities account. Also during the third session a corresponding change to the predecessor of Article 9(1)(d) was made to reflect the current text of that provision. See Sections 9-27 to 9-30. **1-3**

The definitions of "control agreement" and "designating entry" were included in the draft Convention at the first session of the CGE, during which the concept of acquisition by control agreement was also included for the first time. These definitions were modified and refined during subsequent sessions of the CGE and at the final session of the diplomatic Conference. See generally the History part of Article 12. **1-4**

The defined term "domestic non-Convention law" was added during the first session of the CGE as a replacement for the reference to "the applicable law" which was used in the draft submitted to that session. The term was changed to "non-Convention law" during the CGE's third session and the reference to "domestic" law in the definition was deleted as unnecessary. Several refinements and clarifying modifications to the definition were made during the fourth session of the CGE and during the first session of the diplomatic Conference. **1-5**

During the second session of the CGE the defined term "securities settlement [or clearing] system" was added to the draft text, indicating some continuing discussion as to whether both types of system should be defined. During the third session separate defined terms, "securities settlement system" and "securities clearing system" were added along with the term "uniform rules", which applies in connection with either type of system. During the diplomatic Conference, some clarifications and editorial changes were made to these definitions. **1-6**

III. ANALYSIS

1. Article 1(a)—"securities"

The definition of "securities" is very broad and includes any financial assets which are capable of being held in the intermediated holding system and governed by **1-7**

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the Convention. However, the definition of securities does not cover cash (*e.g.*, money deposited with a bank) or certain categories of financial assets, including some categories of derivatives, which do not meet the two functional criteria described below. See Section 1-10.

1-8 To qualify as "securities", financial assets must meet two functional criteria. First, they must be capable of being credited to securities accounts (Article 1(c)) maintained by an intermediary (Article 1(d)). Second, they must be capable of being acquired and disposed of in accordance with the provisions of the Convention, in particular Articles 11 and 12. Note that Article 29(1) requires Contracting States to permit the holding through intermediaries of securities permitted to be traded on an exchange or regulated market. Such securities would always meet the definition of "securities".

1-9 As far as these two functional criteria are satisfied, the definition includes bearer and registered securities. It also includes securities represented by individual certificates or a single (global) certificate, and purely dematerialised securities. The definition does not, however, affect or modify the regulatory power of a Contracting State to decide whether it permits the issuance of securities in any of these forms.

1-10 Securities come in many different types, 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 transferrable units (other than shares) in collective investment schemes (unit trusts, *fonds communs de placement*, *Anlagefonds*, etc.). Derivatives transactions, such as futures contracts or swaps, are bilateral agreements imposing fixed or contingent obligations on both parties. They constitute both an asset and a liability of each of the parties, much like any ordinary contract, and as such are not within the scope of the definition. See also Unidroit 2006—Study LXXVIII—Doc. 37, p. 2; Unidroit 2006—Study LXXVIII—Doc. 45(g); and Unidroit 2008—CONF. 11—Doc. 4, Section 31. However, some derivative instruments (*e.g.*, warrants, structured products) are issued to, and traded among, an undefined number of investors ("securitised"). This is possible because they are designed in such a manner that the payout to investors could be nil, but it would never be negative so that the investor would never be required to make a subsequent payment to the issuer. Such securitised products meet the two functional criteria discussed above and fall within the scope of the definition of securities.

1-11 The Convention does not provide a "laundry list" of securities qualifying under the definition. This allows for the evolution of market practice and the creation of new types of securities capable of being held in the intermediated holding system.

1-12 The two functional criteria were developed by the CGE. The CGE also set out the requirement that securities must be "transferable" (Unidroit 2005—Study LXXVIII—Doc. 24), added the words "capable of being credited" (Unidroit 2006—Study LXXVIII—Doc. 42) and replaced the word "transferable" with the

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reference to acquisition and disposition in accordance with this Convention (UNIDROIT 2006—Study LXXVIII—Doc. 57).

1-13 At its third session, the CGE deleted the words "or any interest therein", which had been included in the original draft (UNIDROIT 2004—Study LXXVIII—Doc. 18). At the same time, the definition of "intermediated securities" was changed to its final language (UNIDROIT 2006—Study LXXVIII—Doc. 57), which includes the "rights or interests in securities resulting from the credit of securities to a securities account". These related changes reflect the fact that, under the applicable non-Convention law, a book-entry in a securities account may not represent full ownership. The fact that it is possible to acquire a limited interest in securities and that this limited interest may be credited to a securities account does not qualify the notion of securities, but the rights and interests that an account holder derives from the credit of such securities.

1-14 The definition of "securities" was not modified during the diplomatic Conference.

2. Article 1(b)—"intermediated securities"

1-15 The definitions of "intermediated securities", "securities account" and "intermediary" are central in determining the scope of the Convention's application. Thus, "intermediated securities" is a central concept for the Convention. The defined term refers to rights which arise from the credit of securities (Article 1(a)) to a securities account (Article 1(c)). In accordance with the non-Convention law (Article 1(m)), such rights may include direct ownership or joint ownership rights in the underlying securities or other forms of proprietary interests, entitlements or contractual rights arising out of the securities. However, the definition does not include contractual obligations such as those to redeliver securities pursuant to securities lending transactions or title transfer arrangements. The definition of intermediated securities in Article 1(b) is closely connected with Article 9. It is best understood in the light of its drafting history.

1-16 Article 1(f) of the initial draft of the Convention (UNIDROIT 2004—Study LXXVIII—Doc. 18) defined "securities held with an intermediary" as "the rights of an account holder resulting from a credit of securities to a securities account". Article 2 of the same draft described these rights as resulting partially from the Convention itself and partially from non-Convention law. At its first session, the CGE maintained that definition but changed the defined term to the shorter phrase of "intermediated securities". See UNIDROIT 2005—Study LXXVIII—Doc. 24. Over the next two sessions, the definition itself was modified in order properly to account for those legal systems in which account holders may have a direct ownership interest in the underlying securities, as opposed to rights other than a direct ownership interest (such as an interest in a pool of securities) or rights only against their relevant intermediary. For the "relevant intermediary", see Article 1(g).

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1-17 At its third session, the CGE significantly changed the definition to the language now contained in Article 1(b) while retaining the connection between the definition and the substantive provision, Article 9. See UNIDROIT 2006—Study LXXVIII—Doc. 57. That definition was not further modified by either the CGE or by the diplomatic Conference.

1-18 The definition is structured with an "or" in order to accommodate the functional approach. In some systems, reflected by the definition's first clause, the credit of securities to a securities account confers on an account holder direct ownership rights to those securities. In other systems, reflected by the definition's second clause, the credit of securities to a securities account confers on an account holder other rights or interests, for example rights other than a direct ownership interest (such as an interest in a pool of securities) or rights only against its relevant intermediary. In either case, the Convention itself confers on the account holder certain rights when securities are credited to a securities account, such as the right to effect a disposition of intermediated securities. See Article 9(1)(b). These Convention rights arise in addition to the rights conferred by the non-Convention law. Contracting States are not required to introduce in their legal system a new "category" of securities called "intermediated securities" as a distinct asset.

1-19 Intermediated securities exist when certificated or uncertificated securities are brought into the intermediated holding system and are credited to a securities account. They no longer exist when (if permitted under the terms of their issuance and the applicable law) securities are withdrawn from the intermediated system to be held directly by an investor. In particular, the definition of intermediated securities excludes certificated securities held physically and directly by an investor as well as securities registered directly with an issuer in the name of investors.

1-20 A credit of securities to a securities account does not necessarily produce a full interest in the underlying securities. Partial or limited interests, such as a security interest or a usufruct, may also be credited to a securities account. See Section 1-13. In such cases, the non-Convention law determines any limits to the rights conferred on the account holder. See Article 9(3).

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3. Article 1(c)—"securities account"

1-21 *"[S]ecurities account"* is defined as an account maintained by an intermediary to which securities may be credited or debited. Securities accounts are essential to the operation of the Convention because they are necessary for book-entries and for acquisitions and dispositions relying on book-entries, for example credits and debits (see Article 11) and designating entries (see Articles 1(l) and 12(3)(b)).

1-22 A securities account makes it possible to record credits and debits as well as designating entries, where allowed by the non-Convention law of a Contracting State. How book-entries and balances are recorded is typically the subject matter of domestic regulatory provisions, which are unaffected by the provisions of

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the Convention. In fact, unlike a cash or currency account recording a single monetary balance to the credit or debit of the account holder, a securities account must record as many balances as there are securities of different descriptions credited to the account. Only securities of the same description, as defined in Article 1(j), are fungible among themselves and may be aggregated and netted to produce one number representing the holding in the relevant securities.

1-23 For the purpose of the definition, it is not necessary that any securities have actually been credited to the securities account at any time. A securities account may be opened in anticipation of some future transaction.

1-24 The definition of securities accounts applies *inter alia* to accounts maintained:

- by an intermediary in the name of a natural or legal person who is not an intermediary;
- by an intermediary in the name of another intermediary;
- by a CSD in the name of an intermediary; or
- in a so-called transparent system, by a CSD in the name of a natural or legal person (which may be an intermediary holding intermediated securities for its own account).

1-25 The definition does not apply, however, to accounts maintained directly by issuers in the name of their shareholders or bondholders, or to issuer accounts (or registers) maintained by CSDs or other persons such as transfer agents on behalf of issuers.

1-26 A Contracting State may by declaration exclude certain securities accounts from the application of the Convention. See Article 5(a).

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4. Article 1(d)—"intermediary"

1-27 In some systems intermediaries are referred to as "custodians" or "account providers". The function of intermediaries is a central element of the intermediated holding system. The application of the Convention requires that at least one intermediary is involved in the holding of the securities in question.

(i) "a person (including a central securities depository)"

1-28 In practice, intermediaries are usually entities such as banks, brokers, central banks and similar persons that maintain securities accounts for their account holders. However, from a purely functional perspective, the definition does not set any limit as to who could be an intermediary. Virtually any natural or legal person is covered, including any kind of association, partnership or other person, provided that it maintains securities accounts for others in the course of its business. See also Section 1-31.

EXAMPLE 1-1: A bank acting in the capacity of agent agrees with its customer to manage the customer's investments by arranging for a securities account to be opened with a third party in the name of the customer. The agent bank itself

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maintains a parallel record of the customer's holdings. This does not make the bank itself an intermediary, since it is not the party holding the securities for the customer, nor can transfers be effected across the bank's books, which merely record what is held for the customer in the records of the third-party intermediary. The position of the bank is thus to be contrasted with that of an intermediary that maintains securities accounts across which transfers may be effected.

1-29 The term "intermediary" includes both regulated and unregulated entities. The Convention does not limit the powers of States to restrict or regulate the activity of maintaining securities accounts for others. In addition, Article 5 permits a Contracting State by declaration to limit the circle of intermediaries covered by the Convention.

1-30 While, in general, the definition relies on a functional description, CSDs are specifically mentioned, although the term is not defined. This specific mention was inserted on the occasion of the fourth session of the CGE with a view to confirming the inclusion of securities accounts held by CSDs in the scope of the Convention, notwithstanding their special role and relationship with issuers. See UNIDROIT 2007—Study LXXVIII—Doc. 95, Section 13 *et seq.* However, CSDs are intermediaries only in relation to their participants but not in relation to the issuer, because the CSD and issuer are not tied to each other by means of a securities account to which securities are credited and debited.

(ii) "in the course of a business or other regular activity"

1-31 The notion of intermediary is primarily reserved for persons that maintain securities accounts for others on a professional basis. Maintaining a securities account must take place "in the course of a business or other regular activity" of the intermediary. This requirement is a functional one. It does not matter, for example, what legal, operational or regulatory set-up the intermediary has. Moreover, nothing in the definition excludes a central bank from its scope in so far as the central bank otherwise qualifies.

(iii) "maintains securities accounts for others or both for others and for its own account"

1-32 The term "for others" refers to legally distinct natural or legal persons. In some cases securities accounts are kept by integrated parts of a legal entity for other parts of the *same* legal entity, which would *not* constitute maintaining a securities account for *others*. However, legally distinct affiliated firms can maintain securities accounts for other affiliates (such as a parent company or a subsidiary) even if the firms are fully integrated from an economic and operational point of view.

1-33 The phrase in the definition relating to "both for others and for its own account" makes clear, as a complement to Article 9(1)(a), that an intermediary can at the same time be an account holder itself without losing the status of intermediary for this reason. The definition uses the formula of "maintaining a securities account for

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its own account". However, this wording does not prescribe how such securities must be held from an operational, accounting or legal point of view. It may be that the non-Convention legal or regulatory framework sets different parameters for the treatment and evidence of securities accounts maintained for account holders and the own holdings of the intermediary.

(iv) "and is acting in that capacity"

1-34 The "acting in that capacity" formulation recognises that the same entity may act in the capacity of an intermediary and in other capacities, such as broker, agent or the recipient or provider of collateral. However, in some situations receiving or providing collateral may constitute "acting in that capacity" if that activity is closely related to an intermediary's maintaining of securities accounts.

5. Article 1(e)—"account holder"

1-35 An "account holder" is defined as 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).

1-36 Not all account holders are investors. Under current market practices, many securities accounts are maintained in the name of intermediaries. An intermediary holding securities with a higher-tier intermediary, whether it is acting on its own behalf, on behalf of its account holders, or both, is the account holder of the securities account maintained by the higher-tier intermediary.

1-37 Even the "ultimate" account holder, at the lowest tier of the holding chain, may not be an investor as understood by financial markets. In many instances, the ultimate account holder holds intermediated securities for its own account and benefit. However, even if it is not acting in the capacity of an intermediary, it is not uncommon that an ultimate account holder is serving as an agent, trustee or in another capacity on behalf and for the benefit of one or more other persons.

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1-38 For any particular securities account, only the account holder identified as such is generally relevant to the operation of the Convention. Persons on whose behalf an account holder may be acting are strangers to the securities account. The relevant intermediary is not required to concern itself with strangers, except in the circumstances described in Articles 22 and 23(2), such as a power of attorney, legal authority to act in the name of the account holder, a control agreement or a designating entry.

1-39 While the Convention consistently uses "account holder" in the singular, it does not purport to prohibit that a securities account be maintained for several persons acting jointly. Whether such joint account holders may exercise their rights individually or whether they must act jointly may be regulated by the account agreement or the rules of a securities settlement system, subject to the non-Convention law. The nature and availability of joint holdings and the rights of joint holders are governed by the non-Convention law.

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1-40 The Convention contemplates that an intermediary will maintain records to identify its account holder(s) for which it maintains a securities account. However, it does not affect in any manner the application of know-your-customer rules set out by States exercising their legislative and regulatory powers, for example for the purpose of fighting money laundering or financing terrorism. The Convention does not specify the manner in which an intermediary is to identify its account holders in practice. Moreover, it leaves any legal identification requirements to the non-Convention law (which includes, of course, applicable regulations).

6. Article 1(f)—"account agreement"

1-41 An *"account agreement"* is a contract between an account holder and its relevant intermediary governing a securities account, in which their respective rights and obligations are specified.

1-42 An account agreement may be oral, in writing or in any other form. It may consist of several linked contractual documents. The Convention does not set out the formal requirements the agreement must meet in order to be effective, although it contains a number of references to the rights and obligations under the account agreement. See Articles 1(l), 9(1)(c), 15(2), 16, 18(5), 23(2)(a), 24(4) and 28. Formal requirements and any other issues, such as mandatory disclosures or prohibited terms, are subject to the provisions of the non-Convention law and, if so provided by conflict of laws rules, any other law that may otherwise govern the account agreement, such as the *lex contractus* (if different from the non-Convention law), the law governing the capacity of parties, etc.

1-43 In a so-called transparent system, where a CSD maintains accounts in the name of individual investors but securities brokers or banks are responsible for the performance of certain functions of the intermediary, the CSD maintains accounts for and in the name of individual investors who may not have a contractual relationship with the CSD. The relationship with the account holder is handled by the securities broker or bank performing certain functions of an intermediary in accordance with Article 7. While it is possible for there to be no account agreement at all, it is likely that an account agreement will be entered into by the account holder and by the broker or bank which is the party responsible for the performance of that function. Under Article 7(2)(b)(ii), the relevant Contracting State may choose to make a declaration that identifies the parties to such account agreement.

7. Article 1(g)—"relevant intermediary"

1-44 The defined term "relevant intermediary" is used throughout the Convention in respect of "an account holder", "a securities account" or "intermediated securities" to identify the intermediary maintaining a particular securities account for a particular account holder, where particular intermediated securities are credited, and to distinguish that intermediary from any other intermediary in the holding chain.

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In a transparent system, where a CSD maintains accounts in the name of individual investors but securities brokers or banks are responsible for the performance of certain functions of the intermediary, "relevant intermediary" may mean the CSD or the securities broker or bank, depending on which function is the subject matter of the relevant provision using the defined term. See Article 7(3). **1-45**

8. Article 1(h)—"insolvency proceeding"

The Convention contains a broad definition of *"insolvency proceeding"*, which covers collective proceedings, including interim proceedings, aimed at reorganisation or liquidation. In an insolvency proceeding, the assets and affairs of a debtor are subject to control or supervision by a court or other competent authority. **1-46**

9. Article 1(i)—"insolvency administrator"

An *"insolvency administrator"* is the person who is authorised to administer the insolvency proceeding, including a trustee appointed by the court or a so-called "debtor in possession", such as the manager of a company that continues to exercise its tasks as a fiduciary to the insolvent estate or another administrator. The definitions relating to insolvency are particularly relevant for Article 14, for Chapter IV on the integrity of the intermediated holding system and for Chapter V, which contains special provisions for collateral transactions. **1-47**

10. Article 1(j)—securities "of the same description"

This definition is necessary to recognise the fungibility of securities to the extent appropriate. If securities are of the same description, those securities are fungible. If securities are of the same description then rights or interests in the securities are of the same description as well, so that intermediated securities (defined in Article 1(b)) are of the same description for the purposes of the Convention. The definition of "of the same description" is relevant, for instance, under Article 24 with respect to an intermediary's duty to hold (or have available) sufficient securities. See the commentary on Article 24, especially Section 24-13. It is also relevant to Articles 11(5), 25, 26, 29(2) and 31(3)(i). **1-48**

Securities are of the same description only if they are issued by the same issuer. For shares or stock (usually called equity securities), securities are of the same description only if they are issued as the same class. Thus, common shares and preference shares are not of the same description. Voting shares and non-voting shares are not of the same description. For securities other than shares or stock (usually called debt securities), securities are of the same description if they are of the same currency, denomination, maturity and interest and are treated as forming part of the same issue. **1-49**

11. Article 1(k) and (l)—"control agreement" and "designating entry"

Control agreements and designating entries are two methods which, subject to a declaration by the relevant Contracting State, may be used by an account holder to **1-50**

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grant an interest in intermediated securities to another person (hereafter: the other person) to make that interest effective against third parties. See Article 12 and its commentary. Of course, both methods also require "an agreement with or in favour of that person" pursuant to Article 12(1)(a). Nothing in the Convention obliges a Contracting State to recognise the methods of control agreements or designating entries. This is left to the decision of each Contracting State under the declaration mechanism provided by Article 12.

1-51 Control agreement and designating entry are mere functional descriptions of methods used under national law as a necessary step to create an interest in securities. For example, national law might call the method a pledge: in order to create a valid pledge, the relevant assets of the security provider must be blocked in favour of the security taker. Under national law this may be accomplished under an agreement with the intermediary to block the assets and not to release them without consent of the security taker. This mechanism would be covered by the functional description of control agreement. If the intermediary is required, on top, to reflect the blocking by a specific electronic marker in its system, and perhaps by a specific marker on the account statement, the mechanism would correspond to the functional term of designating entry.

1-52 A control agreement is typically a three-party contract between the account holder, the relevant intermediary and the other person. Through the control agreement, the relevant intermediary allows the other person to exercise control over the intermediated securities subject to the interest granted. In certain jurisdictions, control agreements may be made bilaterally: that is, entered into by the account holder and the relevant intermediary for the benefit of the other person. In other jurisdictions, a control agreement may be executed by the account holder and the other person and, under the non-Convention law, is binding upon the relevant intermediary if it has received notice of the agreement.

1-53 A designating entry has the same effects as a control agreement. The main difference between the two is that the former, unlike the latter, is "an entry [made] in a securities account" by the relevant intermediary, so that it is not only a private matter between the account holder, the intermediary and the other person, but it is or should be visible on the books and records of the intermediary relating to the account and would be visible to any person authorised to review those books and records. Depending on the nature of an intermediary's accounting system a designating entry also might be visible on an account holder's account statement, but that is not required by the Convention. Moreover, even in a system in which designating entries so appear on an account statement, as a general matter, persons relying on the existence or absence of designating entries in the account must at all times remain aware that an account statement or print-out is merely a snapshot of the account at a given point in time and the situation of that account may change at any time thereafter. The person in whose favour a designating entry has been made, however, may take comfort from the prohibition of a debit, removal of the

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designating entry or other disposition in the absence of that person's authorisation. See Article 15(1)(a), (c) and (d).

1-54 The type of control required for control agreements and/or designating entries to make an interest effective against third parties may vary among jurisdictions based upon the declaration made by a Contracting State under Article 12(5). The key element of a control agreement, whether it be negative, positive, or both, is that the other person's consent is required or the other person is entitled to give instructions, or both. But the requirement of consent or the right to give instructions need not be presently effective or absolute. For example, the control agreement may provide that after the occurrence of an event of default (or after the other person's notification to the intermediary of such an event) the other person's consent is required or the other person is entitled to give instructions. Such a conditional control agreement is effective from the time it is entered into, however, not from the time that the triggering event occurs. The declaration made by a Contracting State under Article 12(6) or (7) may require "negative control", so that the "the relevant intermediary is not permitted to comply with any instructions given by the account holder in respect of the intermediated securities [...] without having received the consent of that other person". See Articles 1(k)(i) and 1(l)(i). Alternately, the declaration may require "positive control", so that "the relevant intermediary is obliged to comply with any instructions given by that other person in respect of the intermediated securities [...] in such circumstances and as to such matters as may be provided [...]". See Articles 1(k)(ii) and 1(l)(ii). Or, the declaration may require both positive and negative control. Whenever a Contracting State makes a declaration in respect of control agreements or designating entries, that declaration must specify the type of control required. See Article 12(3), (6) and (7).

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12. Article 1(m)—"non-Convention law"

1-55 In many instances, the Convention refers to substantive law (other than the Convention) of the Contracting State. The term "non-Convention law" is a generic term to describe these other rules of law. The language (but not the purpose) of this definition has evolved over time and a consensus on the current wording was achieved at the first session of the diplomatic Conference.

1-56 The provisions of the Convention are part of the law of any State that is a Contracting State. On many issues, the Convention refers to substantive law (other than the Convention) of the Contracting State, which may apply or be relevant to such issues. These other rules of law are referred to as the non-Convention law. In some instances, the Convention prevails over these rules (*e.g.*, Article 11(2)); in other instances, the Convention contemplates that its provisions may be supplemented by these rules (*e.g.*, Articles 13 and 28); in yet other instances, these rules may derogate from the provisions of the Convention (*e.g.*, Article 23(2)(d)). It must be emphasised, however, that certain provisions of the Convention will displace any other domestic rule to the contrary. This is so even if such Convention provisions

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do not specify that they pre-empt the non-Convention law if the context and the purpose of these provisions dictate that result. See, for example, Article 22 on the prohibition of upper-tier attachment.

1-57 In a multi-unit State whose territorial units have legislative authority on the matters dealt with in the Convention, the reference to the non-Convention law is a reference to the internal law of the relevant territorial unit. See Article 43(5).

1-58 The non-Convention law is not necessarily the substantive law of the forum State. Instead it may be the law of a State other than the forum State, which is the case where the conflict of laws rules of the forum State point to the application of the law of another State which is a Contracting State. See the commentary on Article 2.

1-59 The definition of non-Convention law does not specify that it excludes the conflict of laws rules of the relevant Contracting State. However, the context in which the term is used in the Convention mandates such exclusion.

1-60 The term "non-Convention law" should not be confused with the term "applicable law" used in some provisions of the Convention. See Articles 2, 9(1)(c), 9(2)(b), 12(8), 18(4), 19(5) and 19(6). The term "applicable law" is not defined and must be given its ordinary meaning. It is the law that is applicable by virtue of the private international law rules of the forum. The applicable law may, or may not, be the law of a Contracting State, *i.e.*, the non-Convention law.

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13. Article 1(n)—"securities settlement system"

1-61 Securities settlement systems ("SSSs") are market infrastructures permitting the efficient transfer of securities amongst intermediaries. SSSs may perform a wide range of different services and, consequently, their operational make-up is often complex. The sound and efficient functioning of many SSSs is of systemic importance for the financial system. Therefore, many national laws provide for, or allow, SSSs to operate under special legal rules, which may contain provisions differing from the generally applicable law on crucial issues such as the insolvency of a participant in that system.

1-62 The Convention takes the special role of SSSs and their rules into consideration in Articles 1(l), 9(1)(c), 15(2), 16, 18(5), 23, 24(4), 26(3), 27 and 28.

1-63 The starting point of the definition is the word "system" in the chapeau of the definition. The three sub-paragraphs describe the characteristics of an SSS, first with respect to its functions, second with respect to the necessity of some form of public control over an SSS, and third with respect to the need for identification of qualifying SSSs by declaration.

(i) System (chapeau of Article 1(n))

1-64 The word "system" is not itself defined in the Convention. It is intended to be broadly interpreted to include the different types of clearing and settlement

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arrangements existing in Contracting States. However, from the context of the Convention, it can be derived that a system in the sense of Article 1(n) has to have certain minimum characteristics.

1-65 First, a system has to connect a multitude of financial actors for purposes of securities clearing and settlement. A good characterisation of the basic idea of a system is the term "infrastructure" (or "network"). An SSS is an infrastructure that provides standardised securities clearing and/or settlement services.

1-66 The users of such infrastructure are generally called participants. Participants may be legal entities (generally, but not necessarily, financial institutions subject to public supervision or oversight) or even natural persons. In respect of the clearing and settlement of securities within a system, participants may act on their own account or, to the extent permitted by the applicable law, on behalf of others, *i.e.*, as an intermediary.

1-67 For the purposes of the Convention, the minimum number of participants in a system normally should be three or more. This is because a "system" of only two participants generally would not need the special protection that is provided to systems in order to mitigate systemic risk, *i.e.*, the risk that the inability of one participant in a system to meet its obligations will cause other participants to be unable to meet their obligations when due, with possible consequences such as significant liquidity or credit problems that may threaten the stability of, or confidence in, the financial markets. In contrast, the unwinding of transfer instructions or dispositions between two parties is a classical scenario to be resolved in the usual case by general commercial and insolvency law. The systemic risks flowing from unwinding instructions and/or dispositions occur primarily once rights and obligations of three or more parties are settled multilaterally in a standardised legal and operational environment.

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1-68 Many systems have an operator, *i.e.*, an entity responsible for its legal and operational set-up and the provision of technical and other infrastructure support. Often, CSDs, stock exchanges or central banks perform this role. There may also be other entities which have an ancillary function in the process of clearing and settlement of securities within a system, in particular, central counterparties, clearing houses and settlement agents. Finally, systems may be interconnected, for example by (cross-)participation of their operators.

1-69 To the extent that they exercise the function of operator (or otherwise perform ancillary functions), these entities are not necessarily regarded as participants in the system. However, they may, outside the scope of the function of operator (or ancillary entity), also act as participants.

1-70 Finally, a system must operate under a legal, institutional and operational framework established on an ongoing basis and covering standardised services for a multitude of participants. The establishment and operation of a system on an ongoing basis over time is an important attribute, inasmuch as in the absence of such

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continuity operations would not truly be a "system". A core part of this framework is formed by the rules of the system governing the activities of clearing and settlement, in the Convention referred to as "uniform rules". See Article 1(p).

(ii) Function of the SSS (sub-paragraph (i))

1-71 An SSS is defined by the Convention as a system that "settles, or clears and settles, securities transactions". Clearing and settlement occurs, in the course of a transaction, where an agreement about the transaction is reached (*e.g.*, a trade has been concluded on a stock exchange or a collateral transaction has been agreed) but obligations arising from this agreement are still open.

1-72 Thus, the notion of SSS refers to those market infrastructure services relating to the settlement (and possibly clearing) of securities in a system environment as described above. Whereas "settlement" of securities is a sufficient and necessary condition for the qualification of an SSS, "clearing" is only a possible ancillary function. The definition of SSS is intended to cover those market infrastructure services, where the reduction of transactions to be settled is achieved through the structure of the SSS processes itself rather than by relying on additional entities.

1-73 In the post-trade environment, as a first step, clearing may, but does not have to, intervene: *"clearing"* is to be broadly interpreted to mean the process of transmitting, reconciling and, in some systems, confirming instructions for a disposition of securities. In some systems, clearing may also include the bilateral (*i.e.*, between identical participants) or even multilateral (*i.e.*, between all participants) netting of these instructions and the establishment of final positions for settlement.

1-74 Often, but not necessarily, clearing involves a so-called central counterparty ("CCP"), which is an entity interposing itself as the buyer to every seller and as the seller to every buyer for some specific, or all kinds of, transactions. Through the involvement of CCPs, market participants only bear the standard credit risk of the CCP, and not that of individual market participants. Further, a so-called clearing house may cause the completion of the majority of the underlying transactions by discharging the obligations in respect of securities transfers and payments by means of netting, meaning the conversion of a potential multitude of claims and obligations of each participant into one net claim or obligation (as regards its cash position as well as every securities issue bought and/or sold).

1-75 Ultimately, the transactions are settled: *"settlement"* is to be understood as an act which discharges the obligations arising from the agreement of the parties and possibly established and/or confirmed during clearing. Settlement comprises those acts that ultimately entail disposition of securities on the one hand and acquisition on the other. (Note that settlement does *not* embrace the performance of an *issuer* of its obligations in respect of securities, such as an issuer's payment of principal or interest on debt securities.) In the past, when securities certificates still circulated, settlement consisted of the physical delivery into the possession of the acquirer or its representative,

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for example a bank. In the paperless world, the manifestation of settlement is the making of credits, debits and designating entries to securities accounts, resulting in title to securities or interests in securities being transferred, to fulfil the underlying obligations. The term applies regardless of whether securities are transferred dependent on a corresponding payment or (possibly) securities delivery obligation.

1-76 Thus, an SSS, for the purpose of the Convention, either fulfils both functions or only the settlement function, in which case the clearing may be performed by a separate entity, usually referred to as CCP, clearing house or clearing system. The notion of SSS may also encompass parts of the activities of a CSD, to the extent that such CSD performs settlement (and clearing) functions as defined in the Convention.

(iii) Operated by a central bank or subject to public control (sub-paragraph (ii))

1-77 An SSS forms an infrastructure network linking all participants in the system. Consequently, it is important that an SSS is designed and operated in such a way that the possibility of financial difficulties spreading from one participant to another is very small.

1-78 The effective and safe operation of a systemically important system requires its internal rules and procedures to be enforceable with a high degree of certainty. Their function, namely the settlement (and, possibly, clearing) of transactions on a multilateral basis and their processes (*e.g.*, processing of orders or batches of orders at a given time) should be immune from certain rules generally contained in insolvency law that can result in the revocation of instructions or the unwinding of a clearing or settlement process. This means that the applicable law may stipulate that the statutory and contractual rules related to the operation of the system will be enforceable even in the event of the insolvency of a system participant or the operator, whether the participant is located in the jurisdiction whose law governs the system, or that of the operator of the system, or in another jurisdiction altogether.

1-79 Against the background of the considerations mentioned in the preceding two sections, system functions should be monitored and/or controlled by competent public authorities in order to contain systemic risks and to avoid any abuse of legal privileges. Therefore, Article 1(n)(ii) requires that SSSs within the definition be regulated, supervised or overseen by a governmental or public authority. This broad formula was adopted in recognition that in a number of States there is a distinction between regulation, supervision and oversight and the different entities which might conduct them. It is meant to cover any form of continued processes of monitoring of the activity and rules of an SSS, both existing and planned, assessing them against pre-set standards, and, where necessary, inducing change.

1-80 The definition does not require that the entirety of the activities of an SSS be monitored in such manner, but that the monitoring cover at least the uniform rules (see Article 1(p)) governing its settlement (and possibly clearing) related activities and the activities performed in accordance with such rules.

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1-81 SSSs operated by central banks (either by a single central bank or jointly by more than one central bank) qualify even if they are not as such subject to monitoring by a governmental or public authority. Central banks are as a consequence of their public tasks and functions well placed to ensure the required degree of control over the settlement (and possibly clearing) related activities of SSSs operated by themselves.

(iv) Identification by declaration (sub-paragraph (iii))

1-82 The text of the Convention preserves, in the articles cited above, the specific protection afforded by the uniform rules of an SSS, even if these rules might contain provisions that deviate from provisions of the Convention. Consequently, it is necessary to notify the exemption of specified systems from the application of certain rules of the Convention to all Contracting States. This is done by declaration. For the details of the declaration mechanism, see Article 45.

1-83 The declaration must be made by the Contracting State the law of which governs the system and not, for example, the Contracting State the law of which governs the contractual relationships of the system with its participants or the Contracting State in whose jurisdiction the operator of the system is established.

1-84 The declaration mechanism is also meant to provide clarity in respect of multiple systems operated by the same entity, a situation that is not uncommon in financial markets. For example, there are cases where public authorities and/or financial market participants in a State have decided not to create the relevant technical infrastructure for the settlement of securities covered by their national law but rather to entrust (under proper authorisation and supervision or recognition) its setting-up and operation to an operator located in a different State. In such cases, while the technical infrastructure is operated by an entity situated in another State, the first State will (under its local law) put in place statutory provisions to support the validity and effectiveness of electronic transfer orders sent into the system. In such situations, it is necessary to distinguish between the law that gives validity, enforceability and binding effect to a transfer order within any given system and the law that might govern the contractual relationship between the system operator and the system participants in relation to their participation in that system, including their acceptance. These two laws may, but need not, be one and the same.

1-85 Further, the declaration must be made on the ground of the reduction of risk to the stability of the financial system. This is to make clear that not every SSS, but only systemically important ones, may benefit from the recognition of their uniform rules under the provisions of the Convention. See Article 1(p).

1-86 An SSS is systemically important if it has the potential to trigger systemic risk when it is insufficiently protected against the risks to which it is potentially exposed, such as the insolvency of a participant or disrupted functioning of the SSS. Systemic risk is the risk that there could be consequences (such as significant liquidity or credit problems) affecting other participants in the system or even other parts

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of the financial infrastructure that may ultimately threaten the stability of the financial system. An SSS must address the risk that the inability of one participant to meet its obligations will cause other participants to be unable to meet their obligations when due, with possible spillover effects such as significant liquidity or credit problems that may threaten the stability of or confidence in the financial markets.

1-87 The identifying declaration to be made under Article 1(n) should be made with the intention of increasing the effectiveness and safety of the operation of a systemically important system and qualifying the system for special treatment under the Convention. See the Articles referred to in Section 1-62, which address issues such as insolvency, revocation of instructions and unwinding of transactions.

1-88 Whether or not there are grounds for the reduction of risk to the stability of the financial system is a matter to be judged by the declaring Contracting State. See in this respect also the principles for systemically important systems as established by the Committee on Payment and Settlement Systems of the Bank for International Settlements. See, for instance, the 2001 CPSS/IOSCO Recommendations for securities settlement systems and the 2004 CPSS/IOSCO Recommendations for Central Counterparties; see Section 1-105.

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14. Article 1(o)—"securities clearing system"

1-89 Securities clearing systems ("SCSs") are market infrastructures facilitating and enhancing the efficient settlement of securities transactions amongst intermediaries. SCSs may perform a wide range of different services, and consequently their operational make-up is often complex. The sound and efficient functioning of many SCSs is of systemic importance for the financial system(s) in which they operate. Therefore, many national laws provide for or allow SCSs to operate under specific legal rules, which may contain provisions differing from the generally applicable law on crucial issues such as insolvency of a participant in that system.

1-90 The Convention takes the special role of SCSs and their rules into consideration in Article 27(a).

1-91 The starting point of the definition is the word "system" in the chapeau of the definition. The three sub-paragraphs describe the characteristics of an SCS, first with respect to its functions, second with respect to the necessity of some form of public control over an SCS, and third with respect to the need for identification of qualifying SCSs by means of declaration.

(i) System (chapeau of Article 1(o))

1-92 The commentary on Article 1(n) applies here correspondingly.

(ii) Function of the SCS (sub-paragraph (i))

1-93 An SCS is defined by the Convention as a system that "clears, but does not settle, securities transactions".

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1-94 The definition of SCS refers exclusively to those market infrastructure services performing clearing functions (and possibly other functions not covered by the Convention), but not settlement.

1-95 The commentary on Article 1(n) regarding "clearing" and "settlement" applies here correspondingly.

1-96 Often, but not necessarily, clearing involves a so-called CCP, which is an entity interposing itself as the buyer to every seller and as the seller to every buyer for some specific, or all kinds of, transactions. Through the involvement of CCPs, market participants only bear the standard credit risk of the CCP, and not that of individual market participants. Further, a so-called clearing house may cause the completion of the majority of the underlying transactions by discharging the obligations in respect of securities transfers and payments by means of netting, meaning the conversion of a potential multitude of claims and obligations of each participant into one net claim or obligation (as regards the participant's cash position as well as all securities bought and/or sold).

1-97 Thus, an SCS in the sense of the Convention may perform exclusively the clearing function, as, for example, a CCP, clearing house or clearing system. If it were also to perform the settlement function, it would be considered as an SSS in accordance with Article 1(n) of the Convention.

(iii) Operated by a central bank or subject to public control (sub-paragraph (ii))

1-98 The commentary on Article 1(n) applies here correspondingly.

(iv) Identification by declaration (sub-paragraph (iii))

1-99 The commentary on Article 1(n) applies here correspondingly.

15. Article 1(p)—"uniform rules"

1-100 The definition of "uniform rules" identifies those rules of an SSS or SCS which are recognised and deferred to by certain provisions of the Convention and is intended to distinguish them from internal or contractual rules of a system (SSS or SCS) which are not given such recognition and deference. As a general principle, the uniform rules should be clearly stated, understandable, internally coherent and unambiguous. The effective operation of a system requires its internal rules and procedures to be enforceable with a high degree of certainty.

1-101 The term "uniform rules" is intended to be widely interpreted to encompass *inter alia* all forms of statutory laws, regulation, system rules and by-laws and generally applicable, non-negotiable contractual agreements or other conditions that may provide rules concerning the clearing and settlement functions of systems.

1-102 The term "uniform rules" is used in many provisions of the Convention and it should be noted that the term is defined as being "in relation to a securities settlement system or securities clearing system". However, the contents of the uniform

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rules may not be limited to the matters strictly relating to clearing or settlement but include other matters referred to in those provisions.

1-103 The uniform rules must be common to the participants or to a class of participants. This will be the case to the extent that uniform rules may include general laws such as property and insolvency laws, and may also include laws specifically related to the operation of the system. In some jurisdictions, the general laws governing property rights and insolvency may not apply to, or may contain special provisions related to, the clearing and settlement of securities transactions. Laws applicable to securities settlement may also be augmented by regulations or other administrative acts.

1-104 Another important component of uniform rules are the rules and procedures of the various parts of the system, many of which represent contractual arrangements between the operators and the participants. These define the relationships, rights and interests of the operators, the participants and their customers and the manner in which, and time at which, rights and obligations, both in respect of contractual obligations and regarding proprietary aspects of the holding of securities, arise through the operation of the system. Here, the necessary degree of uniformity, commonality and transparency to override otherwise applicable laws and Convention rules is only achieved to the extent that non-negotiable, generally applicable rules and contractual arrangements are concerned. It excludes non-uniform bilateral agreements between the system and individual participants.

1-105 The uniform rules (but only those) also have to be publicly accessible. Public accessibility ensures the necessary degree of transparency and certainty concerning the rules applicable to the holding and transfer of securities in a system, which is particularly important if such uniform rules of a system derogate from the principles of the Convention for reasons of systemic stability. System participants and their customers as well as interested third parties, should have a high degree of certainty regarding the scope and nature of rights and interests in the securities and other assets held in the system, including rights to use collateral or transfer property interests, especially in the event of the insolvency of a participant or of the operator. To ensure the ability to assess these aspects, full transparency of the applicable rules is necessary. On this issue, see also the CPSS/IOSCO recommendations for SSSs and CCPs concerning the transparency of system rules. See the 2001 CPSS/IOSCO Recommendations for securities settlement systems and the 2004 CPSS/IOSCO Recommendations for Central Counterparties.

1-106 In some jurisdictions, the uniform rules of an SSS or SCS also may include uniform rules of a CSD. CSDs play a wide variety of roles in connection with these SSSs and SCSs and the roles of CSDs vary significantly from jurisdiction to jurisdiction. For some examples of such roles, see CONF. 11—Doc. 6. References in the Convention to the uniform rules of an SSS or SCS consequently may encompass a variety of institutional arrangements for clearance and settlement that may include CSD functions of holding, dematerialising and immobilising securities and processing securities transactions by book-entry. The uniform rules of CSDs are included where

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reference is made to SSS and SCS uniform rules in the Convention, provided that a Contracting State has designated the CSD as an SSS or SCS, or has designated the SSS or SCS of which the CSD is a part in accordance with Article 1(n) or (o) of the Convention.

1-107 Finally, the Convention does not require a Contracting State to declare the actual content or scope of uniform rules and does not oblige a Contracting State to identify divergences of such uniform rules from the Convention. However, as a minimum, Contracting States should be encouraged to identify the source (*e.g.*, the system's website) where the uniform rules can be publicly accessed.

Article 2

Sphere of application

This Convention applies whenever:

(a) the applicable conflict of laws rules designate the law in force in a Contracting State as the applicable law; or

(b) the circumstances do not lead to the application of any law other than the law in force in a Contracting State.

COMMENTARY

I. INTRODUCTION

2-1 The purpose of Article 2 is to determine the sphere of application of the Convention. The fact that a State is a Contracting State does not necessarily result in the application of the Convention on an issue involving intermediated securities which may arise in that State. The Convention applies only if the conflict of laws rules of the forum State point to the law in force in a Contracting State as the applicable law or the circumstances do not lead to the application of any other law than the law in force in a Contracting State.

2-2 Article 2 must be read together with the definition of "non-Convention law" (Article 1(m)), as the non-Convention law is also a component of the body of law governing matters with respect to intermediated securities.

II. HISTORY

2-3 As is the case for the definition of non-Convention law, the formulation of Article 2 has been the subject of variations (or proposed variations) and the current text results from discussions at the diplomatic Conference. There has never been, however, any disagreement as to the sphere of application of the Convention and the evolution in the text of Article 2 resulted only from efforts better to express its goal.

2-4 After the first session of the CGE, the provision consisted of one paragraph only (Unidroit 2005—Study LXXVIII—Doc. 24, Appendix 1, Article 2). No changes

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were made during the second session of the CGE (Unidroit 2006—Study LXXVIII—Doc. 42, Appendix 1, Article 2). During the third session of the CGE, a second paragraph was added (Unidroit 2007—Study LXXVIII—Doc. 57, Appendix 1, Article 2). Some revisions were made during the fourth session of the CGE (Unidroit 2007—Study LXXVIII—Doc. 94, Appendix 1, Article 3).

2-5 During the first session of the diplomatic Conference, Article 2(b) was reformulated without changing its substance. During the final session of the Conference, no substantive changes were made.

III. ANALYSIS

1. Article 2(a): Cross-border situations

2-6 The Convention is intended to be part of the substantive law of a Contracting State. Therefore, the Convention will be applied in such a State on the matters dealt with in the Convention to the extent that the substantive law of that State is the applicable law for such matters. The purpose of Article 2(a) is to make this clear.

2-7 If litigation takes place in a court in State A, the court will look at the conflict of laws rules of State A to determine whether the issues giving rise to the dispute are to be governed by the law of State A or the law of another State, for example, State B. If the applicable law is the law of State A and State A is a Contracting State, its law including the Convention will apply to the issues, and if the applicable law is the law of State B and State B is a Contracting State, the law of State B including the Convention will apply to the issues.

2-8 The Convention is not a private international law convention and does not set out conflict of laws rules. These rules are left to the law of the forum State outside the Convention even if the forum State is a Contracting State. For the same reason, the Convention does not specify whether or not the doctrine of *renvoi* may apply. This question is a conflict of laws issue and is to be resolved under the conflict rules of the forum State.

2-9 It is worth noting that the Convention could apply in a court in a non-Contracting State. For example, if the forum State is State A (a non-Contracting State) and its conflict rules refer to the law of State B (a Contracting State) on an issue dealt with in the Convention, then the court in State A will resolve the issue by applying the relevant provisions of the law of State B which includes the Convention.

2. Article 2(b): Purely domestic situations

2-10 If the forum State is a Contracting State and its conflict of laws rules designate the law of that Contracting State as the applicable law, the Convention (as the substantive law of that State) would apply under Article 2(a). However, there is a school of thought in private international law holding that the circumstances must have a connection with more than one State (*i.e.*, an "international" element) in order to refer to conflict of laws rules. Under that approach, in a purely domestic situation,

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reference is not to be made to conflict rules and Article 2(a) would not provide guidance as to the application of the Convention: under Article 2(a), the application of the Convention is determined by conflict of laws rules and these rules would be of no assistance if an international element is a prerequisite to using them.

2-11 Article 2(b) therefore establishes that the Convention will apply in a court in a Contracting State where the situation presents no international element, even if in such a situation the law of that State does not dictate a conflict of laws analysis. Article 2(b) need not be invoked if the application of conflict rules is not conditioned on the existence of an international element in the case. In such a case, Article 2(a) will be sufficient to mandate the application of the Convention.

Article 3
Applicability of declarations

If the law of the forum State is not the applicable law, the forum State shall apply the Convention and the declarations, if any, made by the Contracting State the law of which applies, and without regard to the declarations, if any, made by the forum State.

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COMMENTARY

I. INTRODUCTION

3-1 This article aims to ensure that in the case where the applicable law is not the law of the forum State, the forum State will apply the declarations made under Chapters I to VI of the Convention by the State whose law applies, and not its own declarations.

II. HISTORY

3-2 At the third session of the CGE, an earlier version of Article 3 was inserted into the Convention as the first of the instrument's Final Clauses. See UNIDROIT 2006—Study LXXVIII—Doc. 45(b); Doc. 57, Appendix 1, Chapter VII, Article X; Doc. 58, Sections 32, 190, 194.

3-3 During the fourth session of the CGE, no changes to the text of that provision were made. See UNIDROIT 2007—Study LXXVIII—Doc. 94, Appendix 1, Chapter VII, Article X; Doc. 95, Sections 130, 220, 237. Likewise, during the first session of the diplomatic Conference, no substantive changes were made to the provision. See UNIDROIT 2008—CONF. 11—Doc. 5, Article G; Doc. 27, Article G; Doc. 30, Sections 4–6; Doc. 40, Article G.

3-4 During the final session of the diplomatic Conference, the provision was reformulated considerably in order better to express its goal, without, however, changing its substance. Moreover, during this session, it was moved to Chapter I and placed next to Article 2 on the Convention's sphere of application. See UNIDROIT

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2009—CONF. 11/2—Doc. 21, pp. 5–6, Article 46; Doc. 31, Section 11-12; Doc. 34, Article 3 (former 46); Doc. 35.

III. ANALYSIS

3-5 The principle embodied in this article is a logical consequence of the fact that the Convention does not have an "autonomous" scope of application. The scope of application of some other international conventions in the area of private law, such as the United Nations Convention on Contracts for the International Sale of Goods ("CISG"), or the Convention on International Interests in Mobile Equipment ("Cape Town Convention"), is defined by reference to objective criteria (such as the location of one or both parties to a contract) in such a way that allows for their application without recourse to conflict of laws rules. This is not the case of the Convention, which applies, as part of the substantive law of a Contracting State, only to the extent that the conflict of laws rules of the forum State would point to a Contracting State as being the State whose law should be applied to settle a particular dispute, or if the circumstances do not lead to the application of any law other than the law in force in a Contracting State. See the commentary on Article 2.

3-6 It follows from the above that the courts of the forum State must apply the Convention in the manner in which it was given effect in that foreign State, including any declarations made by that State under the Convention. This rule should be followed notwithstanding the nature and type of the declarations that the forum State itself might have made when ratifying or acceding to the Convention.

EXAMPLE 3-1: Account holder ("AH") has taken a loan from, and committed to grant a security interest to, collateral taker ("CT") in all intermediated securities that AH holds in a securities account with intermediary ("IM"). AH and CT are both located in Contracting State A. IM is a bank exclusively operating in Contracting State B and the securities account is maintained in that State. The security interest has been made effective by a control agreement between AH and CT of which a notice has been given to IM. AH is subject to an insolvency proceeding in State A. Before the bankruptcy court of State A, creditors of AH dispute the effectiveness of CT's security interest. The declaration made by State A in accordance with Article 12 specifies that interests may be granted by control agreement and the non-Convention law of State A allows a control agreement to be executed by grantor and grantee provided a notice of it is given to the relevant intermediary. The declaration made by State B under Article 12 specifies that interests may be granted by a designating entry made into the grantor's securities account with IM, but includes no reference to control agreement.

The court of State A will apply its rules of conflict of laws to determine which law governs the effectiveness against third parties of CT's security interest. If it determines that the law of State B applies, then Article 3 requires the court to apply the declaration made by State B (and the non-Convention law of that State) and find

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that CT's security interest has not been made effective against third parties in accordance with a method declared by that State. Conversely, if the court determines that the law of State A applies to this security interest, Article 3 requires the court to apply the declaration made by State A (and the non-Convention law of that State); the court will find that the security interest is effective.

3-7 While the principle reflected in Article 3 has not been expressly stated in previous uniform law conventions, it has been recognised as a guiding principle for their interpretation and application. It has also has been affirmed by courts called to apply provisions of international conventions establishing uniform rules of private law. It should be noted, however, that nothing in the Convention prevents a State, when applying, pursuant to its own conflict of laws rules, the law of a Contracting State, to have recourse to a clause of public policy (*ordre public*) of the forum, or to apply overriding mandatory provisions, to the extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable (*lois de police*). See Unidroit 2008—CONF. 11—Doc. 30 (Daily Report, 6 September) and Doc. 40, p. 6.

Article 4
Principles of interpretation

In the implementation, interpretation and application of this Convention, regard is to be had to its purposes, the general principles on which it is based, its international character and the need to promote uniformity and predictability in its application.

COMMENTARY

I. INTRODUCTION

4-1 Article 4 lists a number of factors for the implementation, interpretation and application of the Convention. The provision refers specifically to the Convention's purposes, to the general principles on which it is based, to its international character and to the need to promote uniformity and predictability in its application. Further sources to define these factors are the Preamble to the Convention as well as the documents supporting or elaborating decisions that were taken in the course of the work on the text of the Convention.

II. HISTORY

4-2 The first version of the principles of interpretation can be found in the preliminary draft Convention produced by the Study Group. See Unidroit 2004—Study LXXVIII—Doc. 18, Article 1(2) and (4). See also the explanations set out in Unidroit 2004—Study LXXVIII—Doc. 18, p. 25.

4-3 During the first session of the CGE, the rules on principles of interpretation were moved to a separate provision, consisting of two paragraphs, without substantive change. See Unidroit 2005—Study LXXVIII—Doc. 24, Appendix 1, Article 3.

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4-4 The provision was not changed during the second session of the CGE. See UNIDROIT 2006—Study LXXVIII—Doc. 42, Appendix 1, Article 3.

4-5 During the third session of the CGE, the original two paragraphs were integrated into a single, shortened paragraph. See UNIDROIT 2006—Study LXXVIII—Doc. 57, Appendix 1, Article 4; UNIDROIT 2006—Study LXXVIII—Doc. 58, Sections 30, 31, 132.

4-6 No substantive changes were made during the fourth session of the CGE (see UNIDROIT 2007—Study LXXVIII—Doc. 94, Appendix 1, Article 6) or during the diplomatic Conference.

III. ANALYSIS

4-7 Article 4 sets out principles which should be taken into account when implementing, interpreting and applying the Convention. A similar provision is found in other international instruments, such as Article 7(1) of the CISG, Article 6 of the 1988 UNIDROIT Convention on International Financial Leasing, Article 4 of the 1988 UNIDROIT Convention on International Factoring and Article 5(1) of the Cape Town Convention.

4-8 In general, the purposes and general principles on which the Convention is based include, as stated in the Preamble, the growth and development of global capital markets, the protection of persons acquiring or holding intermediated securities, the reduction of legal and systemic risk, the increase of liquidity of securities markets and internally sound and compatible legal systems for the holding and disposition of intermediated securities. Other guiding principles are the reference to the Convention's international character and the promotion of uniformity and predictability in the Convention's application.

4-9 However, it must be noted that Article 4 does not have a provision similar to Article 7(2) of the CISG, which states: "Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled *in conformity with the general principles* on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law." The lack of such a provision is intended to avoid possible confusion with respect to the relationship between the general principles and the non-Convention law, since the Convention often defers matters to the non-Convention law.

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Article 5
Central bank and regulated intermediaries

A Contracting State may declare that this Convention shall apply only to securities accounts maintained by:

(a) intermediaries falling within such categories as may be described in the declaration, which are subject to authorisation, regulation, supervision or oversight by a government or public authority in relation to the activity of maintaining securities accounts; or

(b) a central bank.

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COMMENTARY

I. INTRODUCTION

5-1 Article 5 permits Contracting States to limit the scope of application of the Convention to the securities accounts maintained by "regulated" intermediaries and/or those maintained by a central bank. The purpose of the rule is to offer the possibility to exclude the application of the Convention to the securities accounts that are maintained by "unregulated" intermediaries, if and to the extent Contracting States deem it appropriate.

II. HISTORY

5-2 Article 5 was added during the first session of the diplomatic Conference upon discussion of the point brought forward in CONF. 11—Doc. 16, Section 2.3 and Annex 2. During the final session of the diplomatic Conference, the words "that activity" in paragraph (a) were replaced by "the activity of maintaining securities accounts" for clarification purposes only.

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III. ANALYSIS

5-3 In some States only regulated intermediaries are permitted to maintain securities accounts whereas in other countries there is no such regulatory requirement.

5-4 On the one hand, there may be reasons for applying the Convention to both regulated and unregulated intermediaries. In a globalised environment of the financial market with countless cross-border links, a uniform application of the Convention rules may be called for. Unregulated intermediaries may stand in the cross-border holding chain of intermediated securities, and if in such situation the Convention does not apply to unregulated intermediaries and "something goes wrong" at that level, all lower-tier parts of the holding chain, and ultimately, investors, may suffer from lack of harmonisation of rules and legal certainty.

5-5 On the other hand, there are reasons for permitting Contracting States to limit the application of the Convention to regulated intermediaries. In many jurisdictions, intermediaries are regulated and, for instance, intermediaries which do not obtain necessary authorisation or otherwise do not comply with regulatory requirements are typically subject to fines or other sanctions. If the Convention applies to such unregulated (or illegal) intermediaries, arguably providing a coherent legal system for intermediated securities could provide an inducement for illegal, unregulated operators. This, in turn, could reduce the effectiveness of regulatory requirements. Moreover, many jurisdictions offer various safeguards for investor protection, such as compensation funds, and they apply only to regulated intermediaries. The application of the Convention to unregulated intermediaries may negatively affect the investor protection policy in that jurisdiction to the extent that some account

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holders are attracted to illegal, unregulated intermediaries. Also, the policy with respect to the insolvency law in certain jurisdictions may vary, depending on whether the law applies to regulated entities or not. Because the Convention provides some rules affecting insolvency proceedings, if it applies to unregulated intermediaries, such policies reflected in insolvency law in that jurisdiction may be affected. Finally, in the cross-border context mentioned above, lower-tier intermediaries may often be regulated and they may often be bound to hold intermediated securities exclusively through other regulated intermediaries.

5-6 The Convention is silent about, and therefore does not preclude, any power of a Contracting State to regulate intermediaries. For instance, such regulation may require intermediaries as custodians to be subject to continuous supervision by the State's relevant authority. It may also prohibit intermediaries as custodians from using foreign sub-custodians that do not operate under an equivalent regulatory scheme. Article 5 is not intended to affect the State's power to regulate intermediaries. See the tenth recital of the Preamble.

1. General mechanism

5-7 Article 5 employs a declaration mechanism by the operation of which the scope of the Convention can be narrowed. The formalities of a declaration under Article 5 follow the provisions of Article 45.

5-8 Two different scenarios can be distinguished. First, the Contracting State has made a declaration under Article 5 and the intermediary in question fulfils the specifications of the declaration, *i.e.*, it is part of the described category. In this case, the Convention applies to securities accounts maintained by the intermediary but does not apply to securities accounts maintained by intermediaries that are not part of the described category. Second, the Contracting State has not made a declaration under Article 5. In this case, the Convention applies to securities accounts maintained by any intermediary, regulated or otherwise.

EXAMPLE 5-1: In a multi-jurisdictional case involving IM, the conflict of laws rules identify the law of State A as the applicable law. State A has made a declaration under Article 5, excluding unregulated intermediaries from the scope of the Convention.

If IM is unregulated, the non-Convention law of State A applies, but the rules of the Convention do not apply to securities accounts maintained by IM. If IM is regulated, the Convention applies to such securities accounts.

2. Regulated intermediaries

5-9 The Contracting State, in its declaration under Article 5(a), must describe the category or categories of intermediaries which maintain securities accounts to which the Convention shall apply with sufficient particularity to provide adequate notice. The Contracting State thus may declare that only intermediaries which are

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regulated ("subject to authorisation, regulation, supervision or oversight by a government or public authority in relation to the activity of maintaining securities accounts") are included in the category. The Contracting State is free to determine any category of intermediaries, as long as it is a regulated category.

5-10 The requirement of being a regulated intermediary should be read against the purpose of Article 5. Therefore, Article 5 cannot be understood as permitting a general possibility of excluding all intermediaries from the scope of the Convention. Rather, the scope of application can be narrowed in order to accommodate a Contracting State's concerns regarding the modification, by the Convention, of the legal framework applicable to unregulated intermediaries. Article 5 is not intended to permit a Contracting State to exclude all or even the great majority of intermediaries from the application of the Convention rules. Such a blanket exclusion would be inconsistent with the purpose of the Convention and thus is not permitted. In this sense, Article 5 is intended to permit a Contracting State to limit the application of the Convention to regulated intermediaries where intermediaries are regulated in that State.

5-11 Article 5 targets intermediaries that are authorised, supervised or otherwise regulated by a Contracting State. Paragraph (a) expresses this understanding by reference to the three methods generally used to ensure the influence of the State, *i.e.*, by reference to being subject to "authorisation, regulation, supervision or oversight by a government or public authority". Authorisation refers to a prior permission to conduct business as an intermediary. Regulation means that there are specific rules in place governing the business of intermediaries. Supervision and oversight are both referring to the surveillance of the business of an intermediary by a governmental or public authority. In practice, intermediaries are often subject to all three requirements. However, under Article 5, a category of intermediaries can be designated if it is subject to any one of these requirements.

5-12 The regulation requirement must exist "in relation to the activity of maintaining securities accounts". It is not sufficient that an entity is authorised for other parts of its business, for example as an insurance broker or for the business of extending credit.

3. Central banks

5-13 Central banks regularly maintain securities accounts. Consequently, the default rule of the Convention is that central banks are intermediaries to the extent that they satisfy the definition of intermediary under Article 1(d). However, where a Contracting State makes a declaration limiting intermediaries to "regulated institutions" under Article 5, there may be a question of whether the central bank in that State is an intermediary. Paragraph (b) makes it clear that, where a declaration is made, there should be the possibility to include central banks in the scope of the Convention. Their status would not necessarily be adequately covered by paragraph (a), because in most countries they are not regulated entities in that sense.

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Quite to the contrary, they very often have regulatory or oversight competencies themselves. Given that they form part of the "public authorities" category, there should be the possibility to apply the Convention to them even where they are not regulated entities. This also means that under a declaration limiting intermediaries to "regulated institutions", a Contracting State may exclude its central bank from intermediaries to which the Convention applies. In summary, when a Contracting State makes a declaration in accordance with Article 5, it is advisable that the declaration explicitly mentions whether or not the Convention applies to that Contracting State's central bank.

Article 6

Excluded functions

This Convention does not apply to the functions of creation, recording or reconciliation of securities, vis-à-vis the issuer of those securities, by a person such as a central securities depository, central bank, transfer agent or registrar.

COMMENTARY

I. INTRODUCTION

6-1 Article 6 excludes from the scope of application of the Convention a number of functions vis-à-vis the issuer of securities which may be carried out by a CSD, central bank, transfer agent, registrar or any other person.

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II. HISTORY

6-2 The first version of the provision on excluded functions was inserted during the third session of the CGE upon a proposal by a number of States and observers. See UNIDROIT 2007—Study LXXVIII—Doc. 57, Appendix 1, Article 3, and UNIDROIT 2007—Study LXXVIII—Doc. 58, Sections 155 and 175 and Appendix 7.

6-3 During the fourth session of the CGE, no changes were made. See UNIDROIT 2007—Study LXXVIII—Doc. 94, Appendix 1, Article 4.

6-4 During the first session of the diplomatic Conference the provision was refined by explicitly mentioning the exclusion of functions and by mentioning additional examples of entities carrying out the functions concerned. See UNIDROIT 2008—CONF. 11—Doc. 26.

6-5 During the final session of the diplomatic Conference, the provision was renumbered, but no substantive changes were made.

III. ANALYSIS

6-6 Coupled with Article 1(d) (the definition of "intermediary") and 1(e) (the definition of "account holder"), Article 6 is intended to delineate the scope of

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application of the Convention by excluding certain functions specified in the article. Those functions are not characteristic of the activities of an intermediary as defined in Article 1(d), which typically include maintaining securities accounts, making credits, debits or designating entries to securities accounts, entering into control agreements and enabling account holders to receive and exercise their rights.

6-7 Article 6 reflects the Convention's functional approach and looks at the functions, rather than the entities, which are excluded from the scope of application of the Convention. Specifically, Article 6 excludes the functions of creation, recording or reconciliation of securities, vis-à-vis the issuer of those securities by anyone, including (but not limited to) a CSD, central bank, transfer agent or registrar. In practice, those persons may perform different functions in different jurisdictions, and they may act as intermediaries and/or account holders if they fall within the definitions under Article 1(d) and/or Article 1(e), even though at the same time they perform the excluded functions specified in Article 6.

6-8 The functions of a registrar typically include maintenance of the securities register and the handling of corporate actions on behalf of the issuer. The registrar is thus essentially a record keeper for the issuer and its functions are excluded from the scope of the Convention under Article 6. The function of registrar is usually combined with that of transfer agent, whose role is to handle transfers on behalf of the issuer, by recording the name of the transferee on the register of the issuer in place of the name of the transferor. This function is also excluded from the scope of the Convention under Article 6.

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6-9 The functions of creation, recording or reconciliation of securities in Article 6 are those vis-à-vis the issuer of the securities. In contrast, reconciliation in the securities accounts maintained by a CSD or other person is the function performed by such CSD or person as an intermediary, to which function the Convention applies.

6-10 Certain provisions of the Convention apply to the register of the issuer of the securities. See Articles 24(1) and 24(2)(a)(b). This does not mean that the Convention applies to the *functions* of creation, recording or reconciliation of securities within the meaning of Article 6. This application to the register of the issuer is simply the result of the necessary application of the functions of an intermediary. In other words, for an intermediary in the highest tier of the holding chain (typically a CSD, but not necessarily in certain jurisdictions) to comply with the obligations under Article 24(1), one must look at the register of the issuer in order to know how many securities such intermediary holds or has available for its account holders. See also Article 24(a)(b).

6-11 Similarly, Article 6 excludes the functions of creation and issuance of securities from the scope of the Convention. However, under Article 29(1), every Contracting State must recognise an intermediated holding system for securities that are traded on an exchange or regulated market. See the commentary on Article 29(1).

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Finally, Article 6 allows a person to act in the capacity of an intermediary with respect to one securities account and not with respect to another securities account. The Convention applies to an entity with respect to its functions of an intermediary but does not apply to the same entity with respect to its other functions excluded by Article 6. **6-12**

Article 7

Performance of functions of intermediaries by other persons

1. A Contracting State may declare that under its non-Convention law a person other than the relevant intermediary is responsible for the performance of a function or functions (but not all functions) of the relevant intermediary under this Convention, either generally or in relation to intermediated securities, or securities accounts, of any category or description.

2. A declaration under this Article shall:

(a) specify, if applicable, the relevant category or description of intermediated securities or securities accounts;

(b) identify, by name or description:

(i) the relevant intermediary;

(ii) the parties to the account agreement; and

(iii) the person or persons other than the relevant intermediary who is or are responsible as described in paragraph 1; and

(c) specify, in relation to each such person:

(i) the functions for which such person is so responsible;

(ii) the provisions of this Convention that apply to such person, including whether Article 9, Article 10, Article 15 or Article 23 applies to such person; and

(iii) if applicable, the relevant category or description of intermediated securities or securities accounts.

3. Unless otherwise provided in this Convention, if a declaration under this Article applies, references in any provision in this Convention to an intermediary or the relevant intermediary are to the person or persons responsible for performing the function to which that provision applies.

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COMMENTARY

I. INTRODUCTION

The purpose of Article 7 is to clarify the identification and role of an intermediary in a situation where the task of "maintaining" a securities account is split between two, or even more, persons. See also the definition of "intermediary" in Article 1(d). Article 7 is necessary in order to ensure the proper application of the Convention to the holding patterns where a third person ("other person") is involved in the relationship between the relevant intermediary and its account holders, in particular in the scenario of a so-called "transparent" holding pattern. **7-1**

EXAMPLE 7-1: In State A, all government bonds are held with the Central Bank. Investors in government bonds open a securities account with the Central Bank

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with the assistance of a commercial bank which acts for the account of the Central Bank in this context. All instructions are given to the commercial bank which, through a technical interface and under specific arrangements with the Central Bank, causes government bonds to be credited and debited to the securities account.

7-2 Article 7 provides for a rule about responsibility, not liability. It deals with the allocation of functions among two or more persons and the duty to perform those functions, not with potential damages and other forms of liability that result from the exercise or non-exercise of these functions. Liability is addressed by Article 28(3) and (4).

7-3 In the situation described in Example 7-1, there is a need for clarification as to how and to whom the provisions of the Convention apply. Therefore, Article 7 is intended to identify:

- the person who is the relevant intermediary for the account holder;
- the functions which are performed by the *other person*; and
- the provisions of the Convention which apply to that *other person* instead of the relevant intermediary.

7-4 The rule of Article 7(1) makes clear that holding patterns involving persons other than the relevant intermediary and the account holder do actually exist and are covered by the scope of the Convention. Article 7(2) sets out a declaration mechanism that aims at specifically identifying and mapping holding patterns with shared functions where they exist in Contracting States. Article 7(3) provides that where a declaration under paragraph 2 is made, references in the provisions of the Convention to an intermediary or relevant intermediary are to the person who performs the function in question.

II. HISTORY

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7-5 A provision addressing a split of the performance of intermediary duties was included in the draft Convention on the occasion of the fourth session of the CGE. Although this provision was inserted at a relatively late stage of the work, extensive preparatory work had been undertaken earlier, in particular in light of the issues raised in relation to so-called transparent systems.

7-6 The issue was first discussed in the context of the prohibition of upper-tier attachment. See Unidroit 2005—Study LXXVIII—Doc. 23 rev., Section 96; and Unidroit 2006—Study LXXVIII—Doc. 43, Sections 29–32 and 161–165 and Appendices 9 and 16.

7-7 The issue was next discussed during inter-sessional work between the second and the third sessions of the CGE (see Unidroit 2006—Study LXXVIII—Doc. 44, and the follow-up document Unidroit 2007—Study LXXVIII—Doc. 44 Add.) and between the third and fourth sessions of the CGE (see Unidroit 2007—Study

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LXXVIII—Docs. 60–67, 70, 71, 77, 78, 81, 85, 88, 91). This resulted in the addition of a provision to the draft Convention during the fourth session of the CGE. See UNIDROIT 2007—Study LXXVIII—Doc. 94, Article 5; and UNIDROIT 2007—Study LXXVIII—Doc. 95, Sections 6–70.

7-8 During the diplomatic Conference, some clarifications and editorial changes, but no substantive changes, were made to the provision.

III. ANALYSIS

1. Paragraph 1: Recognition and specification of the sharing of functions by declaration

7-9 Article 7(1) has three purposes: (a) it generally recognises the existence of holding patterns involving shared functions of an intermediary, (b) it specifies that the other person may be responsible for the performance of some, but not all, functions and (c) it provides that a declaration may be made in this regard.

(i) General recognition of shared functions

7-10 The Convention generally contemplates that for any account holder there is one (and only one) relevant intermediary which maintains a securities account for that account holder. This understanding is the kernel of the practice of modern securities holding and mirrored in the logic underlying all provisions of the Convention. Article 7(1) recognises, however, that this two-party relationship can be extended, under certain circumstances, to a three- (or more) party relationship. It ensures, in this context, that the borderlines between the functions are not blurred in legal terms.

7-11 Whenever the functions of an intermediary are shared between two or more entities, the question arises which entity is the intermediary and which entity is the other person that shares some of its functions. Generally, as in Example 7-1, a CSD may be considered to be the relevant intermediary, while its participants or other lower-tier entities with which investors directly interact are the other persons. In some systems, however, the designations may be different, and such a system operates equally in keeping with the conception of Article 7.

EXAMPLE 7-2: State A maintains a transparent system in which, however, the CSD participants rather than the CSD itself are considered to be the relevant intermediaries for lower-tier account holders. The participants maintain the accounts, and have direct relationships with the account holders and legal responsibility to them, including receiving instructions from them. However, credits, debits and designating entries to the lower-tier accounts, though performed by the participants, are recorded in the CSD's computer systems (including in sub-accounts that fully identify the lower-tier account holders), and the intermediated securities are registered in the issuers' books in the name of the CSD as a fiduciary.

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In this example, a declaration under Article 7 can specify the participants as the relevant intermediaries with respect to the lower-tier account holders, and the CSD as "other person", rather than vice versa. Assuming that the declaration is complete in other respects as discussed below, nothing about it would be inconsistent with the Convention or prevent it from applying properly.

(ii) Quality of involvement of the other person

7-12 Article 7(1) addresses the nature of the involvement of a person other than the relevant intermediary in a number of ways.

(a) "other than the relevant intermediary"

7-13 Typically, the *other person* is a privately or publicly owned entity which provides services in the financial market. However, it is conceptually irrelevant whether the person is a natural or a legal person. In addition, it is irrelevant whether the person exclusively performs intermediary functions or whether the person offers other services as well. It must be distinct from the relevant intermediary ("other than"). Consequently, subsidiaries or affiliate companies of the relevant intermediary can be such other person as far as they are legally distinct persons, because the economic or organisational relationship between the relevant intermediary and the other person is irrelevant.

7-14 Once a declaration has been made which identifies the relevant intermediary and the other person or persons (Article 7(2)), the declaration is final and binding as to their identity and there is no need for further analysis.

(b) "responsible for the performance of a function or functions of the relevant intermediary under this Convention"

7-15 The "function or functions" of the relevant intermediary referred to in paragraph 1 should be interpreted broadly and may include any function that may occur in the context of maintaining securities accounts for account holders in the course of a business or other regular activity. See the definitions of "intermediary" and "relevant intermediary" in Article 1(d) and (g). For example, the phrase includes sending account statements, opening an account between the relevant intermediary and its account holder, receiving instructions, providing for IT services, paying out dividends or interest with respect to the securities, transferring communications from the issuer, etc. Note that the Convention does not require a person or persons named in the declaration to have exclusive responsibility for the functions identified in the declaration. Thus, for instance, some functions of the relevant intermediary can be performed by a person other than the intermediary and other functions can be performed by a different person. Also, it is possible that sharing of functions between the relevant intermediary and other person differs between holding of securities in one market (*e.g.*, domestic securities) and that in another market (*e.g.*, foreign securities).

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7-16 It is not possible for the relevant intermediary to have *all* its functions performed by another person or persons. If that were the case it would not be an intermediary at all, and the other person or one of the other persons would be the relevant intermediary.

7-17 However, the circle of persons contributing to the work of the relevant intermediary may be relatively large in some cases. It is clear that not all persons contributing to maintaining the securities account one way or the other can be considered other persons, in the sense of Article 7(1), to which certain provisions of the Convention would apply instead of to the relevant intermediary. In particular, there are two groups of ancillary contributors which are not covered:

- Persons to whom part of the activity is "outsourced": every intermediary would probably leave a considerable part of its activity belonging to the maintenance of securities accounts to service providers, for example the provision of IT infrastructure or the handling of electronic correspondence. The assistance of persons belonging to this category would normally not be apparent to the account holder and such assistance is not relevant to the Convention.
- Persons who act as legal representatives for the relevant intermediary in the sense that any of their actions take immediate legal effect between the relevant intermediary and the account holder. Such persons are often visible but it is clear that they would not have a legal role in the bilateral relationship between the account holder and its relevant intermediary. They are not relevant to the Convention.

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7-18 Outsourcing of certain functions or the use of legal representatives are not relevant to the Convention and do not modify the responsibilities of intermediaries to their account holders. Article 7 is only concerned with function-sharing, where one (or more) other person is "responsible" vis-à-vis the account holder for the performance of a function or functions. Responsible means legally responsible, *i.e.*, the person must have its own, independent role regarding the fulfilment of the function, including an element of legal accountability towards the account holder.

EXAMPLE 7-3: In a Contracting State, the local CSD X is the relevant intermediary. The provision and maintenance of the entire IT infrastructure, including the settlement platform, is entrusted to Company Y, a 100 per cent subsidiary of CSD X, on the basis of a service contract. Company Y does not have any direct relationship with account holders. The relationship with the account holders is entrusted to a category of specialised private financial institutions ("account operators"), which under the law of the Contracting State cannot maintain securities accounts for account holders themselves. They enter into service contracts with account holders and can open and manage their accounts directly in the systems of CSD X, via a special technical interface. The Contracting State is considering the content of its declaration under Article 7.

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In this example, Company Y is not legally responsible vis-à-vis the account holders of CSD X for the performance of a function and, therefore, cannot be specified as other person in the declaration. The account operators, however, can be specified as other persons in the declaration, because these operators enter into an independent legal relationship with, and are legally responsible to, the account holders.

(c) "under its non-Convention law"

7-19 The sharing of functions must be prescribed by the rules of the non-Convention law. The purpose of this criterion is to exclude sharing of functions on a purely contractual basis between the intermediary and the "other person", or sharing on a pure *de facto* basis. Such sharing is outsourcing and not dealt with in Article 7. In addition, only where the sharing of functions has its basis in the non-Convention law can foreign market participants rely on the content of the declaration reflecting properly the actual domestic legal situation.

(iii) Reference to declaration

7-20 A declaration under Article 7 has a constitutive effect, *i.e.*, unless a declaration is made, the provisions of the Convention apply exclusively to the relevant intermediary. Where a declaration is made, the application of the rules of the Convention follows the specifications of that declaration. See the comments on paragraph 2 for further details.

7-21 A declaration which does not conform with the conditions set out in paragraph 1 (see Example 7-3) cannot be made, and thus, if made, would be ineffective. Giving effect to a nonconforming declaration would have a disruptive effect and increase legal uncertainty about the application of a number of provisions of the Convention in respect of the relevant intermediary.

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2. Paragraph 2: Specifications contained in the declaration

7-22 Article 7(2) provides details about the content of the declaration mentioned at the end of paragraph 1: the declaration can be either general or in respect of intermediated securities, or securities accounts, of any category or description.

7-23 Sub-paragraph 2(a) makes it clear that, where applicable, the declaration shall specify the categories (*e.g.*, shares, bonds, etc.) or description (*e.g.*, registered or bearer shares, dematerialised or certificated, etc.) of the intermediated securities. The sub-paragraph refers also to the categories of securities accounts that may be specified, which could, for example, either relate to the tier on which the accounts are located in the holding system, in particular those at a CSD, or accounts maintained for foreign account holders, or any other description.

7-24 According to sub-paragraph 2(b), the declaration shall identify the relevant intermediary in respect of the accounts as specified under sub-paragraph 2(a), the parties to the account agreement on which the account is based and the third person

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performing functions as described in Article 7(1). A declaration has a constitutive effect in this regard, *i.e.*, the roles of intermediary and other person as attributed by the declaration cannot be contested.

7-25 Sub-paragraph 2(c) is the core part of Article 7(2). It determines the application of the provisions of the Convention to the relevant intermediary and the other person performing intermediary functions.

7-26 According to Article 7(2)(c)(i), the declaration shall specify the function or functions for which the other person shall be responsible. It is understood that "function" is used here only as shorthand for the term used in Article 7(1), "function or functions […] of the relevant intermediary under this Convention". The declaration must set out exclusively the functions of that other person. It is not necessary for the declaration to spell out any or all of the functions of the relevant intermediary itself. Under this mechanism uncertainties are avoided: if one or more functions are performed by the other person, it means that all other possible functions under the Convention are within the responsibility of the relevant intermediary.

7-27 According to Article 7(2)(c)(ii), the declaration shall also specify the provisions of the Convention that apply to the other person instead of the relevant intermediary. This element of the declaration must be perfectly congruent with the specification of the function under sub-paragraph 2(c)(i). Otherwise, the declaration would be internally inconsistent and impossible to apply.

EXAMPLE 7-4: Contracting State A declares that the State's CSD is the relevant intermediary and that brokerage firms act as "account agents" and perform certain functions of the relevant intermediary. Among these functions described in the declaration is the receiving of instructions from the account holders. However, the declaration does not specify that Article 23 of the Convention applies to brokerage firms acting as account agents. The declaration is inconsistent and cannot be applied properly.

7-28 Under the second part of sub-paragraph 2(c)(ii), the declaration shall specify the provisions of the Convention that apply to the other person, "including whether Article 9, Article 10, Article 15 or Article 23 applies to such person". The declaration may specify articles other than the ones explicitly cited. The word "including" makes this clear.

7-29 The text under Article 7(2)(c)(iii) prescribes that, if the declaration does not apply in a general manner (see also Article 7(1)), it must specify, with respect to each person, the relevant category or description of securities or securities accounts.

3. Paragraph 3: Consequences for the application of the Convention

7-30 Article 7(3) sets out the consequences for the application of the Convention where the responsibility for the performance of functions is shared between the relevant intermediary and each other person. According to this paragraph, references in any provision of the Convention to an intermediary or the relevant intermediary are to

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the person responsible for performing the function to which that provision applies. Consequently, the rights and obligations set out in some provisions will apply to the other person, while those set out in the remaining provisions apply to the relevant intermediary. In particular, where applicable under the declaration provided for by Article 7(1):

- Article 9(1)(b) and (1)(c): the account holder has the right to instruct the other person instead of the relevant intermediary.
- Article 9(2)(b) and (3)(c): the account holder can exercise rights flowing from securities against the other person, or, under certain conditions, against the issuer.
- Article 10(1): the other person must take appropriate measures to enable the account holder to receive and exercise the rights flowing from the securities.
- Article 15: the requirement of authorisation applies to the other person.
- Article 23(1): the other person is the addressee of the rules on receiving and honouring instructions.

Article 8

Relationship with issuers

1. **Subject to Article 29(2), this Convention does not affect any right of the account holder against the issuer of the securities.**
2. **This Convention does not determine whom the issuer is required to recognise as the shareholder, bondholder or other person entitled to receive and exercise the rights attached to the securities or to recognise for any other purpose.**

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COMMENTARY

I. INTRODUCTION

8-1 Article 8 addresses an important aspect of the scope of the subject matter covered by the Convention. In general, the Convention does not cover the area of what is regulated by the body of law usually (but not necessarily) called "corporate law". That area includes the rights of the account holder against the issuer of the securities.

8-2 It is not easy to draw a line in precise language between what is covered and what is not covered by the Convention. In particular, it is obvious that using the notion "corporate law" would not work, because the coverage of corporate law varies from jurisdiction to jurisdiction. The Convention follows the functional approach. It delineates the coverage of the subject matter not by using the notion "corporate law" but by directly spelling out (in functional terms) what is not covered by the Convention.

II. HISTORY

8-3 The basic idea of excluding so-called corporate law matters from the Convention was supported by the Study Group and has not been problematic at any time thereafter. However, the question of how to incorporate this exclusion in the text was much debated and subject to significant discussion during the negotiation process.

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8-4 During the first session of the diplomatic Conference, upon various observations and proposals, Articles 8(2) and 26(3) in the version of Unidroit 2008—CONF. 11—Doc. 3 were combined into one article, to current Article 8. The history of current Article 8(1) and (2) should therefore be seen in light of the different provisions of which they originally formed part (respectively Articles 10 and 29 in the current numbering).

8-5 The first version of Article 8(1) was written during the first session of the CGE. See Unidroit 2006—Study LXXVIII—Doc. 24, Appendix 1, Article 4(5) (Version A), second sentence. During the second session of the CGE, it became part of a separate provision on measures to enable account holders to receive and exercise rights, which subject matter is covered by Article 10 of the current text. See Unidroit 2006—Study LXXVIII—Doc. 42, Appendix 1, Article 10(2). During the third session of the CGE, Article 10(2) was renumbered to Article 6(2), but no substantive change was made. See Unidroit 2006—Study LXXVIII—Doc. 57, Appendix 1, Article 6(2). During the fourth session of the CGE, the provision was renumbered to Article 8(2). See Unidroit 2007—Study LXXVIII—Doc. 94, Appendix 1, Article 8(2). As noted above, during the first session of the diplomatic Conference, current Article 8(1) was taken out of the provision relating to measures to enable account holders to receive and exercise rights, and moved to a separate provision relating to the relationship with issuers. During the final session of the diplomatic Conference, no change was made to Article 8(1).

8-6 The history of Article 8(2) should be seen in light of the history of Article 29. A preliminary version of Article 8(2) appeared in the text of the preliminary draft Convention by the Study Group (see Unidroit 2004—Study LXXVIII—Doc. 18, Article 17(3)) and in the text resulting from the first session of the CGE (see Unidroit 2005—Study LXXVIII—Doc. 24, Appendix 1, Article 19(3)), but was deleted during the second session of the CGE (see Unidroit 2006—Study LXXVIII—Doc. 42, Appendix 1, Article 13). A first version of the provision that ultimately became Article 8(2) was drafted during the third session of the CGE (see Unidroit 2006—Study LXXVIII—Doc. 57, Appendix 1, Article 24(3)) and remained unchanged during the fourth session of the CGE (see Unidroit 2007—Study LXXVIII—Doc. 94, Appendix 1, Article 26(3)). During the first session of the diplomatic Conference, the provision was refined and inserted into a new provision relating to the relationship with issuers as Article 8(2). During the final session, some further refinements were made, but the substance of Article 8(2) was not changed.

III. ANALYSIS

1. Exclusion of so-called corporate law issues from the Convention

8-7 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 so-called nominee

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holding structures and the splitting of voting and other rights related to the securities held in the intermediated holding system. See the commentary on Article 29(2).

8-8 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: (a) as the shareholder, bondholder or other person entitled to the rights attached to the securities, which are specifically spelled out in Article 9(1)(a); or (b) for any other purposes. Note that Article 8(1) is subject to Article 29(2) but Article 29(2) cannot override Article 8(2). See the commentary on Article 29, especially Section 29-25 and Example 29-5.

8-9 The word "account holder" is defined in Article 1(e).

8-10 The word "issuer" of the securities is not defined anywhere in the Convention. For traditional investment securities such as shares and bonds, defining the issuer is usually not difficult, but for structured financial products such as asset-backed securities, it is not always easy to determine who is the issuer.

8-11 Similarly, "shareholder", "bondholder" or "other person" (see Article 8(2)) is not defined in the Convention. From the standpoint of the Convention, it is not helpful to define these terms generally.

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2. Relationship between Articles 8 and 9(1)

8-12 When securities are credited to the securities account, the account holder is given the rights enumerated in Article 9(1)(a). While Article 8(1) uses the phrase "does not affect any right", it is not an exception to Article 9(1)(a). In other words, Article 8(1) is not intended to deny or otherwise limit the right resulting from the credit under Article 9(1)(a). Article 8(1) applies to the matters with respect to the relationship between the account holder and the issuer which are beyond what is spelled out in Article 9(1)(a).

8-13 The relationship between Articles 8(2) and 9(1)(a) is similar. Article 8(2) is not an exception to Article 9(1)(a). It does not address what the account holder is entitled to receive but only whom the issuer is required to recognise.

8-14 Typically, corporate law in most jurisdictions provides various procedural requirements for shareholders to exercise voting rights or receive dividends. For instance, corporate law may state that dividends are payable only upon a valid decision of the board of directors or the shareholders meeting. In such cases, unless the declaration is made, shareholders cannot request the issuer to pay dividends. Similarly, corporate law may state that where the shareholder exercises its voting right by proxy, a valid proxy card must be prepared, signed and submitted to the issuer within a certain number of days before the shareholders meeting. In these situations, corporate law rules apply.

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8-15 Also, corporate law in most jurisdictions provides substantive rules for dividends and voting. For instance, corporate law typically provides that dividends can be paid out of retained profits, but that if such profits do not exist, dividends cannot be paid. Similarly, under corporate law, the issuer does not have to permit shareholders of non-voting shares to vote. In these situations, corporate law rules apply.

EXAMPLE 8-1: Shares of Issuer were credited to the securities account of account holder AH maintained by its intermediary. Under the Convention, Issuer cannot assert that AH does not have the rights attached to the securities. See Article 9(1)(a). However, if under the applicable law, the issuer is obliged to recognise as shareholders only persons whose names appear on the shareholder register, then such law applies. Unless and until the name of AH appears on the shareholder register, Issuer is not obliged to treat AH as a shareholder, which means that AH cannot exercise the Article 9(1)(a) rights against Issuer. This result is obtained by Article 8(2).

EXAMPLE 8-2: In the setting of Example 8-1, what if a dispute arises as to whether the Article 9(1)(a) rights ("the shareholder rights") belong to AH or another person P? As far as the dispute between AH and P is concerned, the Convention (and not the applicable law or the non-Convention law) determines who owns the shareholder rights. Thus, if the acquisition of the intermediated securities by AH is "effective" and otherwise not affected under the rules of the Convention, AH has the shareholder rights. Neither Issuer nor any other person can deny this. However, this does not mean that AH can exercise the shareholder rights against Issuer. For instance, suppose that P is a registered holder on the register of Issuer but the shares are not credited to the securities account of P. Issuer does not have to send dividends or permit voting at a shareholders meeting to AH, if the applicable law provides that only persons whose names appear on the shareholder register of the issuer are entitled to receive dividends or to vote.

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EXAMPLE 8-3: Bondholder owes debts to Issuer, but Bondholder is not a registered bondholder on the register of Issuer. Bondholder attempts to assert set-off against Issuer of its obligations against its bondholder rights. Whether this is possible would depend on whether Bondholder could assert its bondholder rights against Issuer, and whether other conditions for set-off were satisfied. These questions are not answered by the Convention, and would be answered by the applicable law. See also Article 30.

3. Relationship between Articles 8(1) and 10(1)

8-16 Article 10(1) provides for an intermediary's obligation to take appropriate measures to enable its account holders to receive and exercise their rights specified under Article 9(1). In this context, Article 8(1) means that the obligations of an intermediary under Article 10(1) do not affect any right of the account holder against the issuer. For instance, the account holder itself can initiate legal proceedings against the issuer if the issuer fails to make dividend payments, but this is so only if it is permitted under the applicable law.

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8-17 Note also that Article 8(1) does not delineate an intermediary's obligations. For instance, whether an intermediary is obliged to take measures in order for the names of its account holders to be recorded on the register of the issuer is determined under Article 28(1).

CHAPTER II—RIGHTS OF THE ACCOUNT HOLDER

CONTENTS AND OUTLINE

II-1 *Chapter II* contains two provisions that address the rights of an account holder (Article 9) and the corresponding duties of an intermediary (Article 10).

II-2 *Article 9* describes and characterises the rights conferred on the account holder by the credit of securities to a securities account.

II-3 *Article 10* provides for the most basic obligations that an intermediary owes to its account holders. Article 10(1) sets out a general rule and requires an intermediary to take the appropriate measures so that its account holders enjoy the rights provided in Article 9(1). Article 10(2) lists the core obligations of an intermediary. Article 10(3) sets some limits on these and other obligations of an intermediary.

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Article 9

Intermediated securities

1. The credit of securities to a securities account confers on the account holder:
(a) the right to receive and exercise any rights attached to the securities, including dividends, other distributions and voting rights:
(i) if the account holder is not an intermediary or is an intermediary acting for its own account; and
(ii) in any other case, if so provided by the non-Convention law;
(b) the right to effect a disposition under Article 11 or grant an interest under Article 12;
(c) the right, by instructions to the relevant intermediary, to cause the securities to be held otherwise than through a securities account, to the extent permitted by the applicable law, the terms of the securities and, to the extent permitted by the non-Convention law, the account agreement or the uniform rules of a securities settlement system;
(d) unless otherwise provided in this Convention, such other rights, including rights and interests in securities, as may be conferred by the non-Convention law.

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 applicable law;
(c) the rights referred to in paragraph 1(b) and 1(c) may be exercised only against the relevant intermediary.

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