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Thévenoz, Luc

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Who Holds (Intermediated) Securities? Shareholders, Account Holders, and Nominees

Luc Thévenoz

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Who Holds (Intermediated) Securities ? Shareholders, Account Holders, and Nominees *

Luc Thévenoz **

How the 2009 *UNIDROIT Convention on Substantive Rules for Intermediated Securities* interfaces with company law was one of the difficult questions tackled during the preparation and negotiation of the Convention.¹ It remains a controversial issue, fuelling resolute opposition from certain corners. The same issues have been partially addressed by the EU Shareholder Rights Directive² and will also be considered by the future EU directive on legal certainty of securities holding and dispositions.³

The central question is whether the operation of the Convention, if not its plain letter, displaces or disturbs the direct relationship that company law generally wishes to establish and maintain between an issuer and its shareholders⁴ and which degree of transparency applies to the shareholding.

* This paper was first presented at the Colloquium on “The law of securities trading in emerging markets: lessons learned from the financial crisis and long-term trends” held at the UNIDROIT headquarters in Rome on 6-7 September 2010.

** Professor of Law and director of the Centre for Banking and Financial Law, University of Geneva (Switzerland).

¹ At its first session, the Committee of Governmental Experts set up an *ad hoc* working group to discuss the position of issuers of securities, particularly in the context of the predecessor to what is now Article 29 of the Convention. A report was presented to the Committee at its second session, see UNIDROIT 2006, Study LXXVII – Doc. 25, February 2006. See also the comments submitted by European Issuers to the first Diplomatic Conference, UNIDROIT 2008, CONF-11 – Doc. 11 (July 2008), and to the second Diplomatic Conference, UNIDROIT 2009, CONF-11/2 – Doc. 7 (6 August 2009).

² See Art. 13 of the Directive 2007/36/CE of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies.

³ See Sections 15 and 16 of the November 2010 Consultation Document of the Services of the Directorate-General Internal Market and Services, Legislation on Legal Certainty of Securities Holding and Disposition, DG Market G2 MET/OT/acg D(2010) 768890, available at <http://ec.europa.eu/internal_market/consultations/2010/securities_en.htm>, as well as Recommendations 12 and 13 of the Second Advice of the Legal Certainty Group, Solutions to Legal Barriers related to Post-Trading within the EU, August 2008.

⁴ The same question applies to the relationship between an issuer and its bondholders, which is less a matter for corporate law than for the law governing the contract represented by the

Central policy issues are connected with this question. Good corporate governance and the effective exercise of shareholders' rights is the most obvious one. Board of directors are very keen to know the structure and composition of their shareholder base, information that becomes critical in takeover situations and other proxy fights. Beyond the corporate stakeholders, governments may also have a significant interest in identifying shareholders for a number of reasons, including taxation of income and capital gains, fighting money laundering, or protecting key industries from undesired foreign influence. These are all legitimate policy issues lying well beyond the remit of the international negotiations which resulted in the adoption of the Geneva Securities Convention.

I. – A DIVERSE AND COMPLEX WORLD

In this respect as in many others, the Convention must deal with a very diverse world of national policies, legal and regulatory provisions, and clearing and settlement arrangements. A number of jurisdictions in Asia, Europe, and Latin America, including some key financial markets such as China and Brazil, have opted for some form of what is now known as "transparent systems."⁵ In these systems, which were closely examined during the Convention's preparatory work, a central securities depository (CSD) maintains an account in the name of each investor which, subject to potential additional company law requirements, allows each (domestic) shareholder of a (domestic) company to be individually identified. Banks and brokerage firms are authorised by their clients to operate their clients' account with the CSD. In those jurisdictions, there is only one intermediary within the meaning of the Convention, with other persons (in fact, financial firms) performing certain functions of an intermediary. Transparent systems, which would have been a bureaucratic nightmare 20 years ago, are now made possible by efficient and widespread information technology. It must be noted, however, that the full transparency allowed by these legal, regulatory, and technical arrangements generally stops at the relevant jurisdiction's frontiers. Cross-border holding of securities is complicated by the diversity of relevant national laws and by the limited connectivity of operators.

securities. This is a less sensitive point, except perhaps in case of the issuer's insolvency, and shall not be discussed further in this paper.

⁵ The sharing of functions of an intermediary characteristic of transparent systems is addressed by Article 7 of the Convention. Comprehensive descriptions and analysis is provided by the Report of the Transparent Systems Working Group, UNIDROIT 2007, Study LXXVIII – Doc. 88, July 2007.

At the exact opposite, the largest capital market in the world, and one of the most efficient ones, that of the United States, relies on what could be called a fully in-transparent system where almost all shares issued by U.S. companies are held by one company, Cede & Co., as nominee and registered in Cede's name.⁶ DTC, the Depository Trust Company, which is the parent company of Cede & Co., sits at the top of a pyramid of intermediaries which create securities entitlements for their account holders by crediting securities to the securities account of the same. The beneficial shareholders can only be identified by information requests sent from the top to the bottom of the pyramid through each tier of intermediaries. Votes and proxies then flow back from the beneficial shareholders to the issuer through the same channels, which are typically outsourced to specialised firms.

Somewhere in-between, a number of national or local systems of securities holding may be observed, providing varying degrees of transparency regarding the shareholding of companies and more or less direct communication channels between issuers and shareholders. Most of the States which participated in the negotiations of the Convention rightly claim that their corporate law and their securities holding systems maintain a direct legal relationship between an issuer and its shareholders, with intermediaries (within the meaning of the Convention) being mostly custodians of their account holders' securities. A closer look at some of these national arrangements has led this author to discern that the direct legal relationship enjoyed by issuers and their shareholders or bondholders most often requires a significant degree of support, processing and transmission by the various intermediaries in the holding chain. Ultimately, this is part of what they are paid for. The services provided in maintaining that connection – the handling of so-called corporate actions, which may include the transmission of documents and information, the collection of dividends and other payments, the transmission or casting of votes, the processing of numerous forms, etc. – are extensive and not necessarily highly cost-efficient.

⁶ The U.S. system has been extensively described (and criticised) by David C. DONALD, *Der Einfluss der Wertpapierabwicklung auf die Ausübung von Aktionärsrechten*, Peter Lang, Frankfurt a.M. (2008), with a condensed English version published as a working paper: "The Rise and Effects of the Indirect Holding System: How Corporate America Ceded its Shareholders to Intermediaries", *Working Paper Series No 68* (September 2007), of the Institute for Law and Finance of the Johann Wolfgang Goethe-Universität Frankfurt. For an analysis of the parallel situation in United Kingdom, see Jennifer PAYNE, "Intermediated Securities and the Right to Vote in the UK", in *Intermediated Securities: Legal Problems and Practical Issues*, L. Gulliger & J. Payne (Eds), Hart Publishing, Oxford etc. (2010), 187-218.

This paper does not purport to describe further this fascinating and highly complex diverse reality. It intends to assess if, and to what extent, the Geneva Securities Convention interferes with this diversity in respect of one issue: who is the shareholder? We shall first recall the explicit policy decisions on which the Convention is based. We will then review and discuss the main arguments raised in support of the contention that the Convention, explicitly or implicitly, meddles with the identification of the shareholders and, where it exists, with the direct relationship between issuers and shareholders. This will allow us to offer a conclusion.

II. – POLICIES OF THE CONVENTION

Article 8 in the first chapter of the Convention states the basic policy in relation to the law governing the issuer. It reads:

“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.”

The Convention does not use the traditional notions of company or corporate law. It does not either refer to investors, shareholders, or bondholders because using these words would require defining them, something which falls outside the ambit of the Convention. Consistent with its purposes,⁷ the Convention sets out rules harmonising the holding and the transfer of securities held with an intermediary. It does so by referring to account holders, to intermediaries, and to the securities that the latter credit to the securities accounts they maintain for the former. Article 8 draws the consequences from that approach.

First, the Convention does not affect the rights attached to the securities, *i.e.*, the rights that an account holder may (or may not) have against the issuer of the securities credited to its securities account.⁸ The contents of the rights

⁷ See particularly the 2nd, 3rd and 4th items of the Preamble, emphasising the protection of persons who acquire or hold intermediated securities, the reduction of legal and systemic risks in domestic and cross-border transactions, and the need to enhance the international compatibility of legal systems and the soundness of rules relating to intermediated securities.

⁸ Under Art. 9(1)(a), “the right to receive and exercise any rights attached to the securities, including ... voting rights” accrues to an account holder in two cases: (i) by virtue of the

attached to the securities is determined by the articles of incorporation of, and the law governing, the issuer (for shares and other equity securities) or by the terms of, and the law governing, the issue (for bonds and other debit instruments). What is the law governing an issuer or an issue is not determined by the Convention, which does not purport to set any rule of conflict of laws.⁹

Second, the Convention does not prescribe who the issuer must recognise as the holder of securities. This person may be an account holder, an intermediary, or possibly some other person. The Convention is only concerned with how the rights attached to the securities flow down through the intermediary chain to whoever is entitled to receive and exercise them.¹⁰

In two respects, however, Article 29 imposes obligations on Contracting States in respect of their laws governing the issuers (or their securities) over which they have jurisdiction.¹¹ Under Article 29(1), Contracting States must allow the issuers whose securities are traded on an exchange or regulated market to introduce their securities into the intermediated holding system and must provide for the effective exercise of the rights attached to such securities. Article 29(2) deals with the more sensitive issue of nominees. It requires that Contracting States allow cross-border shareholders to hold their securities through a nominee and exercise their voting and other rights through that nominee. Since the holding of securities through nominees should not allow investors to circumvent the conditions (e.g., disclosure, maximal holdings, etc.) applying to the exercise of their rights, the Convention “does not determine the conditions under which [a nominee] is authorised to exercise such rights.”

Convention when the account holder is the so-called ultimate account holder and (ii) if so provided by the non-Convention law.

⁹ As stated in its title, the Convention exclusively contains substantive rules of law. It does not determine which law governs whatever issue closely or loosely related with the object of its provisions. Where appropriate, it refers to the “non-Convention” law (*i.e.*, the law in force in a Contracting State which is designated by the applicable rules of conflict of laws, see Arts. 1(m) and 2), “the applicable law”, “the law [governing] the system”, “the law applicable in an insolvency proceeding”, but never attempts to determine which law that is.

¹⁰ See Arts. 9(1)(a), 10(1), 10(2)(e) & (f) and 29(2).

¹¹ Art. 30 confirms the general policy by providing that in the insolvency of an issuer the holding of securities through one or more intermediaries is not, in itself, an obstacle to a set-off between mutual claims of the issuer and the account holder.

III. – DOES THE CONVENTION INTERFERE WITH CORPORATE LAW AND CORPORATE GOVERNANCE?

In various fora, critics of the Convention strongly argue that despite its apparent neutrality, the Convention tips towards an indirect holding system where intermediaries intermeddle in the relationship between issuers and shareholders.¹² In their views, the Convention is essentially inspired by Article 8 of the Uniform Commercial Code and to the U.S. experience and is strongly biased against direct holding systems where investors have property rights over the securities themselves and enjoy a direct legal relationship with issuers while intermediaries are mere custodians of their clients' assets.

This section will review, discuss and assess the three major arguments cited in support of these criticisms.

1. The Convention fails to distinguish investors from other account holders

A large number of legal systems characterise the rights of investors in securities held through one or more intermediaries as property rights in the securities themselves, at least where securities are issued in certificated form. The investor owns her securities and thus can personally exercise against the issuer the rights attached to her securities. The laws in these jurisdictions tend to focus on three groups of parties: issuers, investors (or owners of securities, or shareholders and bondholders, etc.), and custodians. Custodians are financial intermediaries such as banks, securities brokers and the like whose function in this so-called direct holding pattern¹³ is to maintain accounts reflecting the holding of their clients and, where applicable, to keep safe the physical securities in their custody. In such legal systems, the term "account holder" tends to refer to the contractual situation resulting from the account agreement, as distinct from the property characterisation of the rights of investors over their securities.

Some commentators familiar with these systems are dismayed by the fact that the Convention only refers to issuers, account holders (not investors)¹⁴

¹² See Thiebald CREMERS, "Reflexions on 'intermediated securities' in the Geneva Securities Convention", *Euredia* (2010/1), 93-106.

¹³ Or "direct ownership" model, as described in one of my earlier articles, "Intermediated Securities, Legal Risk, and the International Harmonization of Commercial Law", 13 *Stanford Journal of Law, Business & Finance* (2008), 384, at 404.

¹⁴ Except for the use of "investors" in the 8th item of the preamble and of "shareholder" and "bondholder" in Art. 8 for the purpose of excluding their identification from the material scope of the Convention.

and intermediaries (not custodians). Proposals to distinguish the legal position of the investor (or ultimate account holder) from that of any other account holder, who is but an intermediary, were not accepted during the negotiations. This rejection may be the one most potent explanation for the perception that the Convention gives intermediaries rights that should only be enjoyed by the shareholders themselves. It may also account for the perception that the Convention favours a contractual over a property characterisation of investors' interests in securities.

The deliberate choice to use the terms "account holder" and "intermediary" – rather than "investor" and "custodian" – as building blocks for the Convention was motivated by a deliberate and early policy choice that the Convention would not require Contracting States to modify their own analysis of the rights of investors in securities and against issuers. Such national choices have very deep roots in the legal history and the notion of property of each jurisdiction. From the very beginning, the experts and later on the negotiators of the instrument recognised that a Convention that would impose one model over all others would be bound to fail. It was therefore decided not to interfere with the legal characterisation of the interests that investors, their intermediaries, their collateral lenders, and possibly other related parties may have over the securities. This is, in essence, the functional approach adopted by the Convention.¹⁵

Implementing that policy requires that the Convention does not purport to identify who the investor is. For example, is the shareholder the ultimate account holder, *i.e.*, the account holder at the very bottom of the chain? Or is it someone for whom that account holder is acting as fiduciary or agent or in some other capacity? Which of the shareholder's rights are acquired, or may be exercised, by a collateral lender? Is that collateral lender the shareholder if it takes the securities by way of a repo or some other full-title transaction? What is the position of an intermediary that not only acts as a book-keeper of securities accounts and as a custodian of securities but also acts as a collateral lender? These are all questions that the Convention could not possibly address if it intended to remain consistent with its basic policy choice not to meddle with the characterisation of the rights that investors and other parties may enjoy over the securities. The best manner of implementing that policy was to focus on the rights of account holders at each tier in the holding chain. This

¹⁵ On the functional approach, see particularly the remarks of Charles W. MOONEY and Hideki KANDA, "Core Issues under the UNIDROIT (Geneva) Convention on Intermediated Securities: Views from the United States and Japan", in: *Intermediated Securities: Legal Problems and Practical Issues*, *supra* note 6, 74-76.

choice does not imply that the rights of the last account holder at the bottom of the chain are identical with the rights of any other account holder higher up in that chain. To understand this, one needs to look at Article 9 while keeping Article 8(2) (“this Convention does not determine whom the issuer is required to recognise as the shareholder ...”) in mind.

Article 9 distinguishes between the “rights attached to the securities”,¹⁶ the rights to dispose of the securities in accordance with the Convention and to cause them to be held otherwise than through an intermediary,¹⁷ and other rights that may be conferred by the non-Convention law.¹⁸ These distinctions prevent the Convention from interfering with national legal characterisation of investors’ rights in the securities and against the issuers.

Under Article 8(1), the rights attached to the securities are those that remain unaffected by the Convention.¹⁹ Article 9 only deals with their exercise. Article 9(1)(a)(i) positively requires that the ultimate account holder²⁰ “receive and exercise any rights attached to the securities, including dividends, other distributions and voting rights.”²¹ While consistent with Article 8(2), the Convention refuses to identify the shareholder, the Convention recognises and requires that the rights attached to the securities must flow all the way down through the intermediary chain. This flow-down is supported by specific obligations of all intermediaries in the chain (see Article 10).

There may, however, be two situations where an account holder other than the ultimate account holder (*i.e.*, an intermediary not acting for its own account) may also receive and exercise the rights attached to the securities. Both are determined by the non-Convention law reserved in Article 9(1)(a)(ii).

The first of these situations occurs in indirect holding systems²² where intermediaries are not mere custodians but hold legal title or some other property interest in the securities in respect of which they grant a distinct interest to their account holders in respect of the same. In this first case, which

¹⁶ Sub-paragraphs 1(a), 2(a) and 2(b).

¹⁷ Sub-paragraphs 1(b), 1(c), 2(a) and 2(c).

¹⁸ Sub-paragraph 1(d).

¹⁹ Except for Art. 29(2), see Section II.4 *infra*.

²⁰ That is, “the account holder [that] is not an intermediary or is an intermediary acting for its own account”, see Art. 9(1)(a)(i).

²¹ Whether this ultimate account holder does it for its own account or for someone else falls outside the scope of the Convention.

²² Or systems with a “multi-tiered entitlement”, as I called them in the article quoted *supra* note 13, at 406.

is a matter for the non-Convention law governing the relevant intermediary, the intermediary is nonetheless under a duty to pass down the rights that it has received in respect of its account holders' securities.²³

The second case may apply wherever an intermediary is acting as collateral lender and has obtained a security interest from its account holder. In such case, the intermediary may be entitled to use and exercise the rights attached to the securities if and to the extent provided by the non-Convention law and by the collateral agreement.

In sum, the claim that the Convention fails to recognise that the rights attached to the securities should be enjoyed and exercised by the shareholders and bondholders is unfounded. The Convention explicitly abstains from identifying shareholders and bondholders. Within its proper scope – the intermediated holding system – it only provides for those rights to flow down to the ultimate account holder. Whether the latter must further transmit those rights and whether intermediaries in the holding chain or collateral takers may receive these rights and possibly transmit them is not settled by the Convention. Contracting States must regulate these issues, as they do already.

2. The Convention promotes a contractual rather than a property approach

Some criticise the Convention for failing to sufficiently recognise, or promote, legal systems that protect investors by granting them proprietary rights over the securities themselves. They contend that the Convention thus favours a contractual over a proprietary approach to intermediated securities. They point to the two alternative, non-exclusive parts of the definition of "intermediated securities" in Article 1(b). The first part of the definition – "securities credited to a securities account" – fits well with the notion that intermediated securities are nothing other than securities in the custody of an intermediary and that crediting these securities to a securities account does not alter the nature of the rights of the investor over these securities. The second part of the definition – "rights or interests in securities resulting from the credit of securities to a securities account" – reflects indirect holding systems whereby the intermediation of securities transforms the position of investors by conferring on them new and different rights in respect of the securities.

²³ See particularly Art. 10(2)(f).

This argument is hardly persuasive. The two branches of the definition of intermediated securities (and the combination it allows) really confirm that the Convention is inclusive rather than exclusive and carefully avoids imposing any proprietary or contractual characterisation of the legal position of investors in respect of securities held through intermediaries. This is confirmed by Article 9(1) which acknowledges that legal systems may provide different account holders (e.g., ultimate account holder *viz.* intermediaries acting as such) with different legal rights in respect of the securities. This is why Article 9 distinguishes the rights attached to the securities, discussed above, the right of an account holder to dispose in one way or another of the securities credited to her account, and any and all further rights, “including rights and interests in securities, as may be conferred by the non-Convention law.” Sub-paragraph 1(d) provides the channel through which the Convention recognises that Contracting States generally provide more rights than the ones listed in sub-paragraphs 1(a) to (c).

Recognising the diversity of rights conferred to all or some account holders by Contracting States above and over Convention rights does not diminish the legal position of investors but rather confirms and maintains the nature and extent of their interests under the various legal systems. It also means that the bundle of rights comprising intermediated securities does vary from one jurisdiction to the other. This diversity is not created by the Convention, but recognised and upheld by it to the full extent compatible with its provisions.

In the undertones of some critics, one may perceive regrets that the negotiators and the drafters of the Convention did not impose a choice in favour of the type of legal approach that they deem more protective of investor rights. If such regret exists, it only testifies to the consistent implementation of the basic policy choice that increasing legal certainty in this highly complex area of the law does not and should not require Contracting States to modify their legal characterisation of investor rights over the securities and against the issuers.

3. The integrity of the issue is sacrificed to liquidity and settlement efficiency

A third argument draws on the delicate balance that policy makers need to reach between the integrity of the issue on the one hand and the liquidity and efficiency of the settlement system on the other hand. The integrity of a securities issue, whose importance is emphasised in the 8th item of the

preamble, means that at any given time the issuer should not be required to satisfy more claims than the total number of rights it actually issued in the first place. This principle includes that no more votes should be cast than the total number of voting rights pertaining to the securities actually issued.

The liquidity and efficiency of the settlement system is generally enhanced by securities lending facilities allowing market participants to cover their short positions quickly and cheaply. The financial crisis which started in 2007 and resulted, among other casualties, in the bankruptcy of Lehman Brothers on 15 September 2008, has illustrated the systemic importance of, as well as the risks entailed in, securities lending. To some, the Convention excessively promotes liquidity and efficiency at the risk of threatening the integrity of securities issues.

This argument suggests that striking the right balance should be a matter for uniform rules forming part of this Convention. However desirable such a result might appear, it is most unlikely that it could be achieved at this time and it certainly could not be pursued in a forum such as UNIDROIT, the Institute for the International Unification of Private Law. The conflict between the integrity of an issue and the potential shortfalls that may result from late deliveries, securities lending and borrowing, lack of segregation between clients' and house securities, etc. is the result of an extremely dense and market-specific web of regulations and practices. Securities regulators and central banks in most jurisdictions have been extensively involved in designing, reviewing and authorising these rules. Such rules have been the subject-matter of an extensive international dialogue among regulators in a number of fora, including the Committee on Payment and Settlement Systems (CPSS) and the International Organisation of Securities Commission (IOSCO).

The Geneva Securities Convention does not and should not infringe on these regulatory concerns and policies. The 10th and 11th items of the preamble confirm 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 and recall the importance of the need for Contracting States to regulate, supervise or oversee the activities of intermediaries.

The provisions of the Convention are consistent with this self-limitation. For example, Article 24(1) requires that an intermediary hold a total number of securities and intermediated securities of each description at least equal to the total number of securities of each description credited to the securities

accounts it maintains for its account holders. Article 24(3) supplements this duty in the following terms:²⁴

“If at any time the requirements of paragraph 1 are not complied with, the intermediary must within the time permitted by the non-Convention law take such action as is necessary to ensure compliance with those requirements.”

This paragraph illustrates the ambition and the limits of the harmonisation achieved by the Convention. It begins with an unqualified duty of an intermediary with insufficient holding to take action to restore compliance with the “full-cover” requirement of Article 24(1). In respect of the time within which action must be taken and compliance restored, the Convention defers to the non-Convention law, in other words to the legal and regulatory provisions of the relevant Contracting State. As noted above, some might deplore that a uniform international timeframe could not be agreed on this critical issue. But the technicalities of the rules and practices involved and the diversity of the markets addressed by this rule would make such a universal solution quite impossible to find and anyway would require the expertise of many more institutions and individuals than could ever be present in the design of this Convention.

Commentators who criticise the Convention for failing to impose an international standard in this and other related respects are misguided. In the current international financial governance, it is currently the sole responsibility of each individual State – whether or not that State decides to adopt the Convention. International forums such as IOSCO, CPPS, the Basel Committee, or the Stability Board could be tasked with the search for an international standard. Faulting UNIDROIT for failing to regulate such issues disregards UNIDROIT’s specific mission and expertise.

4. Nominees potentially disrupt corporate governance

The last argument takes us back to the general issue addressed in this paper. While the Convention generally abstains from affecting the rights of account holders against issuers of securities, Article 29(2) makes an exception to this rule:

“... the law of a Contracting State shall recognise the holding of such securities by a person acting in its own name on behalf of another person or other persons and shall

²⁴ Arts. 24(4) and 28 further refer to the non-Convention law, uniform rules of a securities settlement system and account agreements in relation to the methods and manners in which an intermediary must comply with its Convention duty to hold sufficient securities.

permit such a person to exercise voting or other rights in different ways in relation to different parts of a holding of securities of the same description; but this Convention does not determine the conditions under which such a person is authorised to exercise such rights.”

In some jurisdictions, the intermediated holding system is structured and regulated so that at any time the issuer or the central securities depository identifies each investor. Such systems work seamlessly within the relevant jurisdiction but not necessarily in cross-border situations. Let us assume that Irene, an investor resident in State A, holds shares issued by Acme SA in State B. Acme shares are fully dematerialised and the issue is registered with the central securities depository (CSD) in State B, whose laws and regulations require that the CSD identifies all investors holding such shares.

Like Irene, most investors are keen to hold an internationally diversified portfolio but they do not want to open securities accounts with as many intermediaries as there are countries represented in their portfolio. We may assume that Irene has purchased Acme shares through A-Bank, an intermediary located in her country of residence, and she now holds these shares with that intermediary. Her securities account with A-Bank is most likely governed by the laws and regulations of State A. In most cases, A-Bank is not a member of the CSD in State B. It may hold Acme shares through an account it has with B-Bank, an intermediary located in State B. It is quite possible also that A-Bank does not maintain its own network of “sub-custodians” but outsources this activity with a global custodian or an international central securities depository.

Because intermediaries organise and operate the securities accounts they maintain for their customers in accordance with the laws and regulations where the account is maintained, Irene’s securities account with A-Bank falls outside the scope of the laws, regulations, and operational arrangements of State B. In most such cross-border situations, the CSD in State B will not be able to identify the shareholder. Some bridge is needed between the intermediary in State A and the intermediated holding system in State B in order to allow the cross-border holding of securities issued in State B. In many cases, this bridge will include a legal entity serving as the holder of record of securities on behalf of investors. Such entity is generally referred to as a nominee; it is typically regulated and may be supervised in the State in which it is incorporated.

The interposition of nominees is a fact of the worldwide holding system. All jurisdictions that have not restricted their companies’ shareholding to resident investors have had to find some way to allow foreign investors to use

foreign intermediaries, including nominees. Some jurisdictions have been quite restrictive for legitimate policy reasons. For example, the corporate law of a jurisdiction may require (or may allow the issuer to require) that only registered shareholders may cast a vote. Some jurisdictions may set a cap to foreign ownership of shares in certain sensitive industries. Some issuers may set a ceiling on the maximum percentage of votes one shareholder may exercise or they may subject the transfer of shares to a possible veto by the board of directors. All such policies are well entrenched in national legislation. They may be controversial but they are not within the scope of the Convention which should not displace or interfere with them.

Article 29(2) strikes a balance between the facilitation of cross-border securities holding and the legitimate desire of Contracting States not to alter such policies.

On the one hand, it requires Contracting States to “recognise the holding of ... securities by a person acting in its own name on behalf of another person or other persons.” This is a clear reference to nominees in all respects but for the name. Such recognition explicitly permits nominees to cast the votes attached to the securities they hold in different ways in respect of different investors. Not allowing split voting by nominees would mean either that the affected investors cannot exercise their voting rights or that these rights must necessarily be exercised in the same manner for all investors holding through the same nominee, thereby distorting shareholders’ votes and disrupting proper corporate governance.

On the other hand, the Convention does not affect the conditions under which a nominee is authorised to exercise voting and other rights on behalf of investors. The applicable law may require that nominees disclose the identity and the holding of each investor. It may also require that nominees only exercise voting rights for which they have received explicit instructions from investors.²⁵

It is worth noting that Article 29(2) does not purport to derogate from Article 8(2). In the case of nominees as in all other cases, the Convention does not determine whether the issuer is required to recognise the nominee or the investors behind the nominee as shareholders.²⁶ The Convention is only concerned that investors must be allowed to hold securities through nominees

²⁵ Art. 29(2) of the Convention defers to the applicable laws to a larger extent than Art. 13 of the EU Shareholder Rights Directive (*supra* note 2), which restricts the disclosure and formal requirements that Member States may impose on the exercise of voting rights through nominees.

²⁶ This is a further difference with the Shareholder Rights Directive, whose Art. 13(1) only applies to “a natural or a legal person who is recognised as a shareholder by the applicable law.”

and that they may effectively exercise the rights attached to such securities subject to any condition determined by the applicable law.

IV. – CONCLUSION

Even before immobilisation and dematerialisation of securities began and the intermediated holding system was created, there was never a complete congruence between the possession of securities certificates and the recognition as shareholder or bondholder by the issuer. Whether because of incomplete formalities, loss, theft, forgery or other mishaps, discrepancies between those two capacities are a traditional concern of the law of negotiable securities, *Wertpapiere* or *valeurs mobilières*. The holding of securities through intermediaries has changed the fact settings but not altogether erased such discrepancies which are likely to stay because property law and company law remain two distinct set of rules interacting with each other.

It never was the purpose of the Geneva Securities Convention to improve corporate governance, enhance shareholder rights or increase the transparency of shareholdings. The Convention was not designed to avoid empty voting or facilitate electronic participation in shareholder meetings. Its object is to increase the legal certainty of the rights of investors and collateral lenders in securities held with intermediaries by increasing the legal soundness of national legal systems, improving their compatibility in cross-border holdings and, to a limited extent, in containing systemic risks.

In line with its object, the Convention refrains from interfering with the rules determining who the shareholder or bondholder is. It operates with account holders and intermediaries and does not determine whether an account holder, including the ultimate account holder at the bottom of the intermediary chain, should be recognised as shareholder or bondholder or more narrowly should be entitled to use and exercise the rights attached to securities. The only, narrow exception to that principle is the recognition of nominees as conduits for the cross-border holding of intermediated securities. Nevertheless, the exercise through nominees of voting and other rights attached to these securities remains subject to conditions set out by national law to further good corporate governance and other public policies.

The Convention should not be blamed for not doing what it was never intended to do. Its benefits for investors and secured lenders, for policymakers and lawmakers, are different, but very real.

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