



**The Relevant  
Conflict of Laws Analysis for  
Holding, Transferring and  
Pledging Securities Today:**

***The Hague  
Securities Convention***

Christophe Bernasconi  
*First Secretary*

## **In a nutshell, the Hague Securities Convention...**

- ✓ provides practical rules to achieve urgently needed legal certainty and predictability as to the law governing crucial aspects of the holding, transferring and pledging of securities held through intermediaries
- ✓ is a pure conflict of laws instrument ("traffic sign" – no impact on existing or future substantive law)
- ✓ offers a solution at the global level (not limited to a purely national or regional context) and for all dispositions (any transfer of title and grant of security interest)
- ✓ will reduce legal risk, systemic risk and costs of cross-border securities transactions – facilitates flow of and access to capital
- ✓ has no impact on regulatory schemes relating to the issue or trading of securities, regulatory requirements placed on intermediaries, or enforcement actions taken by regulators

## A few figures ...

➤ Estimated value of securities held with intermediaries:  
**> 50.000.000.000.000 US\$**

➤ Volume of trades and collateral transactions in OECD government and corporate securities, per day:  
**> 2 trillion US\$**

exceeds world's total GDP (> US\$ 40 trillion)  
approx. every 20 trading days

# The traditional conflict of laws rule applicable to proprietary rights...



**lex rei sitae  
(lex cartae sitae)**



Painting in the Netherlands



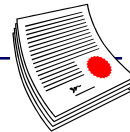
Bankruptcy Trustee



Christophe Bernasconi



Transfer to Bank Account



Security interest (Swiss Law)



Arturo Navarro



BioTeX Inc. (Delaware)



100  
Shares

Certificates in Mexico



Bankruptcy Trustee



Christophe Bernasconi



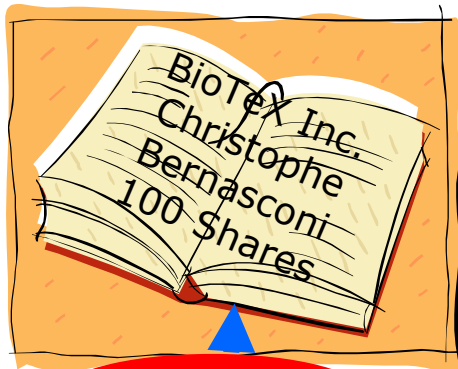
Transfer to Bank Account



Collateral Agreement  
(Swiss Law)



Arturo Navarro



BioTeX Inc. (Delaware)

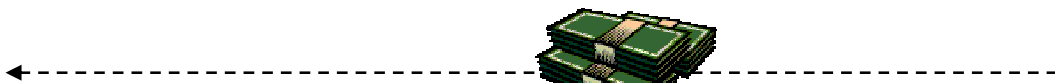
Register in **New Jersey**



Bankruptcy Trustee



Christophe Bernasconi



Transfer to Bank Account

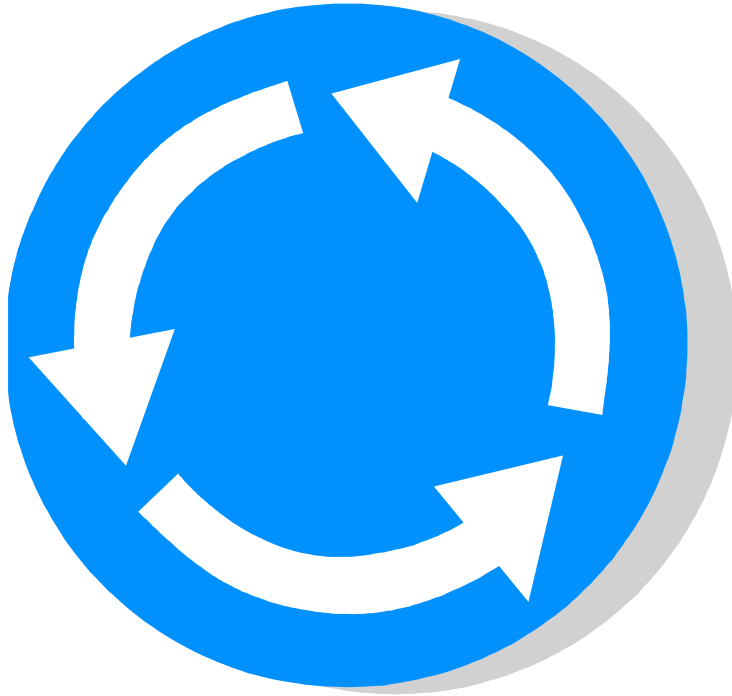


Collateral Agreement  
(Swiss Law)



Arturo Navarro

# **The traditional conflict of laws rule applicable to proprietary rights...**



**...is not suitable for  
securities held with  
an intermediary!**





BioTeX Inc.  
(Ruritania)

Gotham Bank A/c  
| 950,000

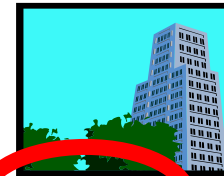


Ruritanian CSD



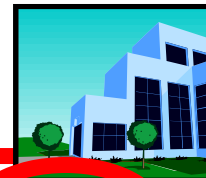
Ruritanian CSD Vault  
(Metropolis)

Mexican Bank Customers A/c  
| 45,000



Gotham Bank

ARG Investor A/c  
| 100 0



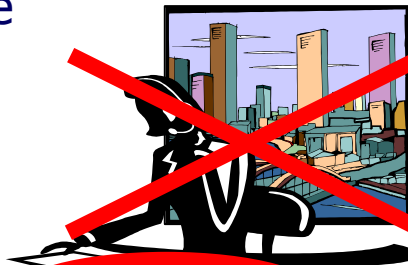
Mexican Bank

ARG Inv. Pledge  
to NY Bank A/c

100



Bankruptcy  
Trustee

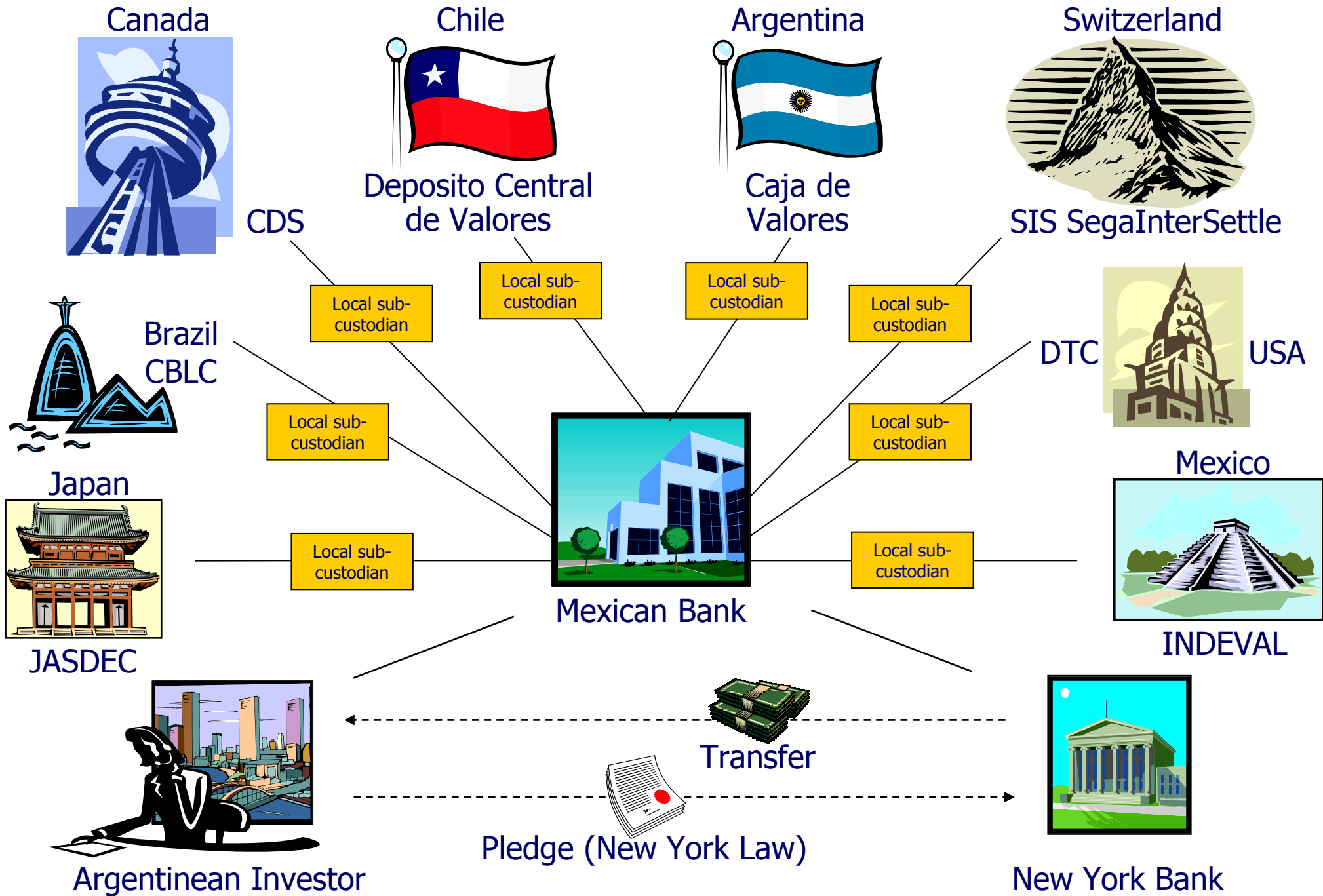


Argentinean Investor

Transfer to Bank Account

Pledge (New York Law)

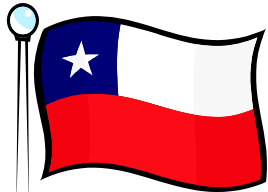
New York Bank



Canada



Chile



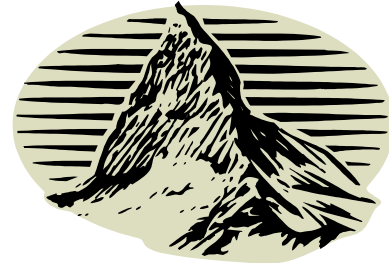
Deposito Central de Valores

Argentina



Caja de Valores

Switzerland



SIS SegInterSettle

Brazil  
CBLC



Japan



JASDEC

Mexico

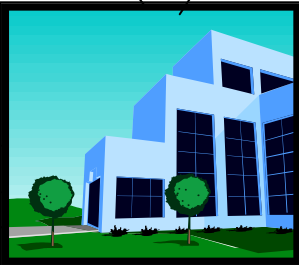


INDEVAL

USA



DTC



Mexican Bank



Transfer

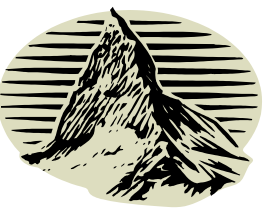


Pledge (New York Law)



New York Bank

Argentinean Investor



SIS



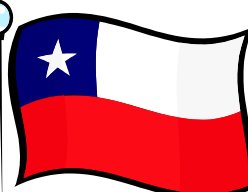
CDS



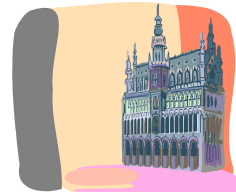
INDEVAL



JASDEC Caja de Valores



Deposito Central de Valores



Euroclear



DTC

Local sub-custodian

Local sub-custodian

Local sub-custodian

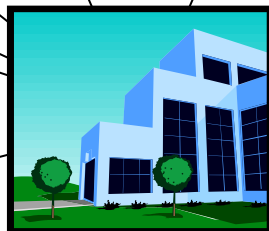
Local sub-custodian

Local sub-custodian

Local sub-custodian

Local sub-custodian

Local sub-custodian



Intermediary B



Intermediary A



Intermediary Y



Account holder 1  
(Transferor / Pledgor)



Account holder 2  
(Transferee / Pledgee)



## **Main provisions of the Hague Securities Convention**

## Scope of the applicable law - Art 2(1)

- Nature of rights resulting from credit of securities to account (proprietary, contractual, or other)
- Nature and effects of disposition
- Perfection
- Priorities
- Duties of intermediary where third party asserts competing interest in securities
- Realization
- Entitlement to dividends, etc.
- List is exhaustive – the “Art 2(1) issues”

## Issues *not* falling within Art 2(1)...

- ... are issues *not* governed by the Convention law – Art 2(1) would have been enough, but Art 2(3) explicitly confirms that the following issues are not within the Convention's scope:
  - Purely contractual or other purely personal rights between acc holder and its intermediary inter se (Art 2(3)(a), e.g. content and frequency of acc statements, intermediary's standard of care in maintaining sec acc., deadlines in giving instructions, etc.)
  - Number and type of securities to be disposed of, price of securities (Art 2(3)(b))
  - Rights and duties of issuer of securities, issuer's registrar or transfer agent (Art 2(3)(c))

## Issues *not* falling within Art 2(1) (cont.)

- Regulatory measures are not on the Art 2(1) list (private law Conv) – thus, regulatory schemes relating to the issue or trading of sec., regulatory requirements on intermediaries, or enforcement actions taken by regulators remain untouched by Conv (whether or not Art 2(3) confirms this)
  - Conv has no impact on existing or future regulatory regime controlling private conduct, whether towards the goal of preventing money laundering or preventing tax evasion, or assuring safe and sound business practices or minimising systemic risk
  - Expressly confirmed by Explanatory Report
  - Would have been the same had the Conv put forth a traditional *lex rei sitae* rule

## The primary rule for determining the applicable law – Art 4

- Early consensus on “no look-through” (PRIMA)
  - BUT: How to put “anti-look-through” into operation?
  - Agreement between parties to a/c agreement (not to disposition!) vs lex rei sitae (i.e. search for actual location of the securities account)
  - Final solution reached by consensus: **choice of law** (agreement on law governing a/c agreement) **+ proviso** (i.e. rel interm must have an office engaged in the business of maintaining securities accounts in the selected State – Qualifying Office requirement)
  - Focus is on relationship between account holder and its intermediary – not about “place” of account or intermediary
- *Convention goes beyond PRIMA*



# The primary rule for determining the applicable law – Art 4 (cont.)

Applicable law:

- express agreement on law governing account agreement; or
- express agreement on law governing all Article 2(1) issues

subject to Qualifying Office proviso:

- Relevant intermediary, at the time of the agreement, must have a “Qualifying Office” in selected State

## **Art 4 does not disempower supervisory authorities**

- Convention is not a grant of power to parties to a/c agreement (not a 'right' to choose any law) – it simply provides for a consequence to behaviour that they may or may not engage in
  - 'If parties have chosen law XY to govern their a/c agreement, then that law shall also govern all the Art 2(1) issues'

## Art 4 does not disempower supervisory authorities (cont.)

- Thus, choice subject to regulatory regime that may apply
  - Supervisory authorities are, in the exercise of their authority, free to prohibit intermediaries from choosing any governing law ('no choice at all'), or choosing a particular governing law ('cannot be X, Y or Z'), or choosing a governing law other than the law specified by the authority ('it must be X')
  - Regulators and securities system operators are free to impose any of such actions as a condition to participation in a system or to classification of obligations as acceptable for meeting credit standards (e.g. "eligible bank loans" in the Single List of Collateral in the Eurosystem Collateral Framework), or as a qualification for "designation" or in any other context (e.g. supervisory authorities may require that the Member State's law chosen to govern a system (under Art 9(2) of SFD) must also be chosen as the relevant law for purposes of the HSC

# The Qualifying Office requirement

An office of the relevant intermediary that:

- alone or with other offices of the rel interm or of any other person acting for the rel interm,
  - effects or monitors entries to sec a/c;
  - administers payments or corporate actions; or
  - is otherwise engaged in a business or other regular activity of maintaining sec a/c; or
- is identified by an account number, bank code, or other specific means of identification as maintaining sec a/c in that State

# The fall-back rules for determining the applicable law – Art 5 (cascade)

## *First* fall-back:

- written account agreement
- “expressly and unambiguously” states that account agreement entered into through particular office of intermediary (*e.g.*, “through office in Mexico City”)
- subject to Qualifying Office requirement

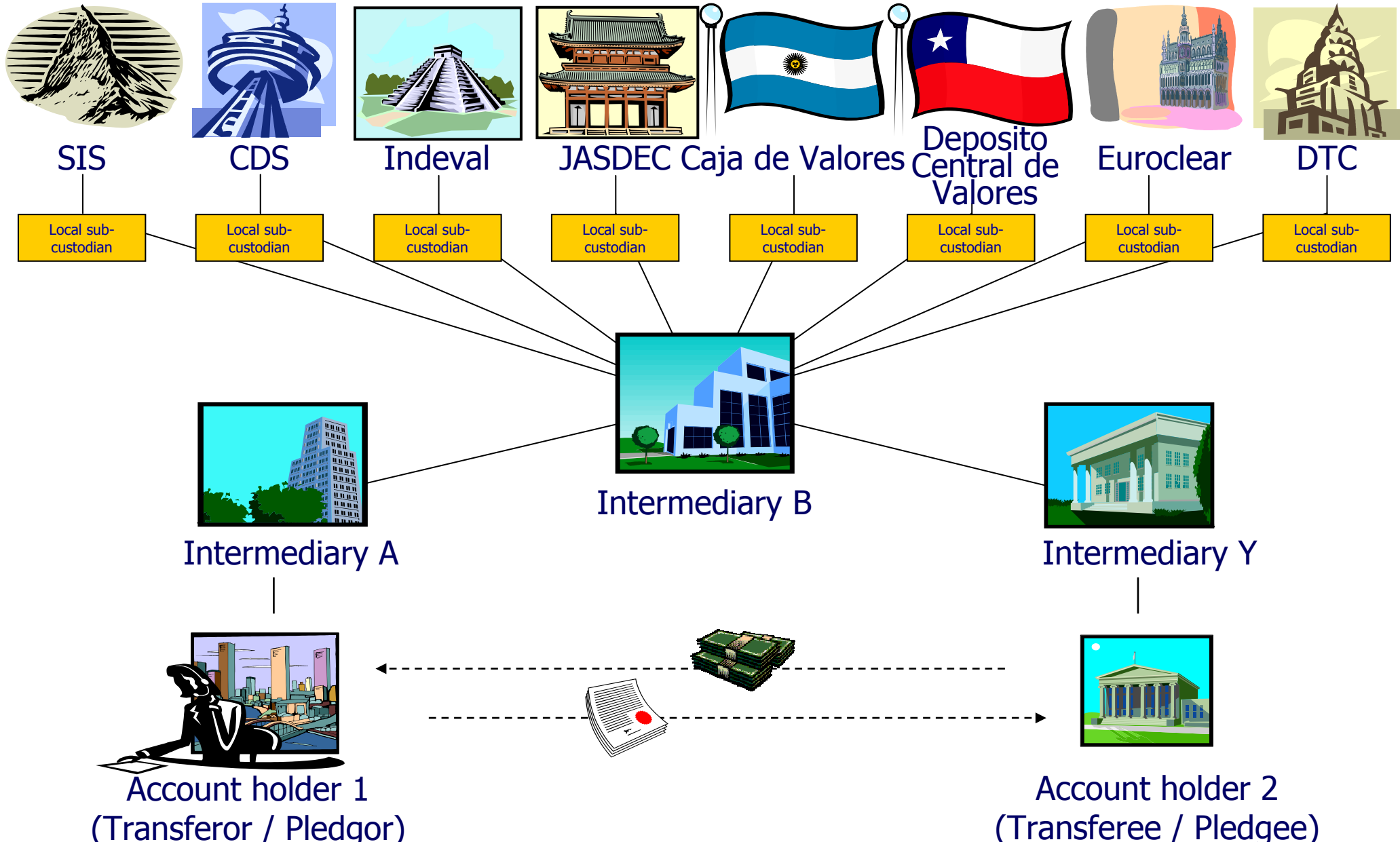
## *Second* fall-back:

- place of incorporation or organisation of relevant intermediary at time of agreement/opening of account

## *Final* fall-back:

- (principal) place of business of relevant intermediary at time of agreement/opening of account

# Arts 4 and 5 apply independently with respect to each securities account



# Some basic principles – Arts 3, 9 and 10

## Article 3 Internationality

- Convention applies in all cases involving a choice between the laws of different States

## Article 9 General applicability of the Convention

- Convention applies whether or not the applicable law is that of a Contracting State

## Article 10 Exclusion of choice of law rules (renvoi)

- “law” means the law in force in a State other than its choice of law rules

# Insolvency – Art 8

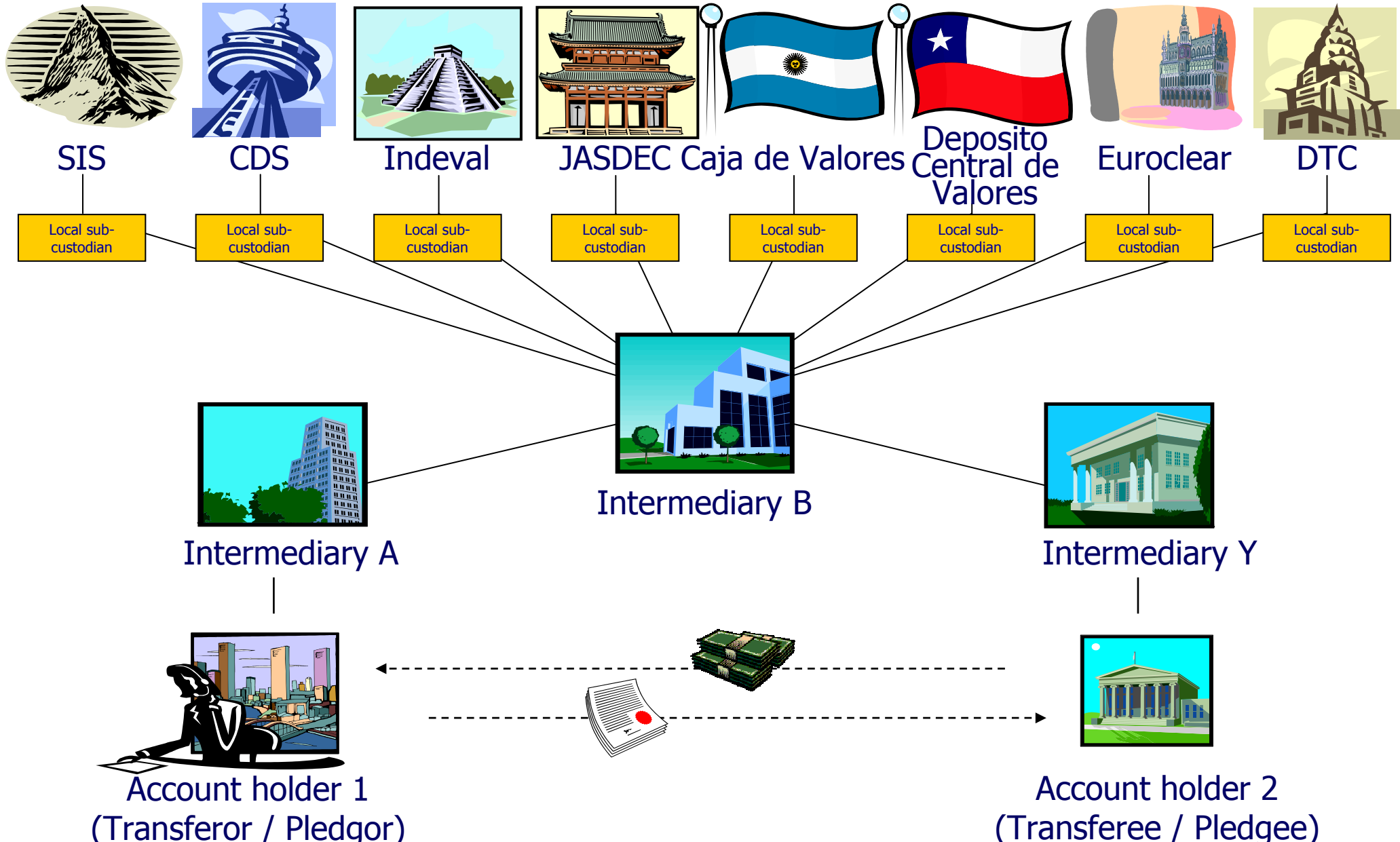
- Recognition of pre-insolvency rights (e.g. pledge perfected under applicable law must be recognised as perfected in insolvency proceedings) ...
- ... but insolvency rules continue to apply (e.g. pledge perfected during “suspect period” may be invalidated as “preference” or “fraudulent conveyance”)



# Interpreting pre-Conv agreements – Art 16

- Convention applies to pre-Convention account agreements
- Distinction between account agreements which *expressly refer* to the Convention and those which do *not expressly refer* to the Convention
- Declaration possibility (“Gap Period”)

# Who benefits from the Convention?



# Assessment of Convention

- Result of highly focused, inclusive, representative and transparent process – unanimous adoption, not a single vote taken
- Provides a clear, straightforward, pragmatic and easily applicable solution to technically complex issue
- Convention regime is general (holding, outright transfer, collateral) and universal, thus truly uniform
- Crucial to determine capital requirements for credit risk and operational risk under Basel II
- Convention thus brings great benefits to market participants and financial system as a whole: reduces costs, legal and systemic risk – facilitates capital flows, incl. access to capital

# Group of Thirty – G30\*

“One area of recommendation for which united support can be offered is choice of laws. National authorities should be encouraged by all interested parties to sign and ratify the just-adopted Hague Convention as soon as is reasonably possible. It is of course critical to its effectiveness that the Hague Convention be ratified as quickly as possible in as many nations as possible.”

\**Paul A. Volcker, Former Chairman, Board of Governors of the Federal Reserve System*

*Mr Guillermo Ortiz Martinez  
Governor, Banco de México*

*Domingo Cavallo  
Former Minister of Economy, Argentina*

*Andrew D. Crockett, President, JP Morgan Chase Int,  
Former General Manager, BIS*

*Arminio Fraga Neto  
Former Governor, Banco do Brasil*

...

*Global Clearing and Settlement  
– A Plan of action  
January 2003  
(Recommendation 15)*

## Group of Thirty – G30 (cont.)

“The Hague Convention, once ratified by all relevant nations, will ensure that there will be a clear and certain answer to the question — in an international setting — as to which law governs...”

On status of implementation in EU: “... the choice-of-law rules in the Hague Convention are broader in scope and so remain an important goal.”

*Global Clearing and Settlement  
Final Monitoring Report  
2006*

# Latest developments

- Joint signing of Convention by USA and Switzerland on 5 July 2006 (date of the Convention)
- On same day, release of EC Commission's "[I]legal assessment of certain aspects" of the Convention
  - Commission concludes in particular that "adoption of the Convention would be in the best interest of the Community" and recommends that Convention "be signed after or with at least two of its main trading partners, the USA included."
  - Internal Market and Services Commissioner McCreevy: "In today's global financial markets we can no longer afford uncertainty about which law is applicable to indirectly held securities. The 'location of the account formula' has worked fine in Europe's transition to a fully integrated single securities market, but now that European citizens are able to reap the benefits of participation in global financial markets, we need legal rules that are sustainable world-wide. Therefore, we need to change. The USA and Switzerland are about to sign the Convention and the EU should not lag behind."
  - Commission had already suggested signing in December 2003
- Board of Indeval (CSD Mexico) formally recommends signing of the Convention (21 Sept 2006)
- Securities Commission of Brazil also recommends signing
- Towards an ACSDA resolution?



## The Hague Securities Convention:

*The way forward,  
bridging the gap!*

### Questions?

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First Secretary  
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