

THE HAGUE SECURITIES CONVENTION:

A MODERN AND GLOBAL CONFLICT OF LAWS REGIME FOR TRANSACTIONS INVOLVING SECURITIES HELD WITH AN INTERMEDIARY

1. The need for uniform conflict of laws rules that comport with the reality of how securities are held and transferred today (*i.e.*, by electronic book-entry debits and credits to securities accounts) has become critical. Legal uncertainty as to the law governing the perfection, priority and other effects of transfers imposes significant friction costs on even routine transactions and operates as an important constraint on desirable reductions in credit and liquidity exposures. Increased exposure to unsecured credit risk amplifies systemic risk and the potential proliferation of the number of bankruptcies. To address the current uncertainties, delegations from around the world, representing all major legal systems, both developed and developing financial markets and including experts of private international law as well as professionals from securities industry practice and representatives of numerous financial institutions, unanimously adopted, on 13 December 2002, the *Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary* (Hague Securities Convention). The Convention reflects a pragmatic approach, based on real world needs, aimed at achieving certainty and predictability as to the law governing issues that are of crucial practical importance for holding and transfer of securities held with an intermediary.

2. The Hague Securities Convention:

- provides certainty as to the law applicable to clearance, settlement and secured credit transactions that cross national borders,
- markedly improves transactional efficiencies in global securities markets,
- reduces systemic risk in cross-border transactions and intermediary holdings, and
- facilitates cross-border capital flows.

3. The Convention deals only with applicable law; it has no effect on the substantive law that will be applied once the conflict of laws determination has been made. Article 4 is the key provision of the Convention. It sets forth the primary conflict of laws rule to determine the law applicable to all the issues falling within the scope of the Convention. The rule is not based on an attempt to 'locate' a securities account, the office at which a securities account is maintained, an intermediary, the issuer, or the underlying securities.¹ Rather, the Convention's primary rule is based on the *relationship between an account holder and its intermediary*: it gives effect to the express agreement by the parties to an account agreement on the law governing all the issues falling within the scope of the Convention. This choice may be expressed in either of two ways: if the parties expressly agree on a law governing their account agreement (general governing law clause), that law also governs all the issues falling within the scope of the Convention; if, however, the account holder and its relevant intermediary expressly agree that the law of a particular State will govern all the issues falling within the scope of the Convention, that law governs all these issues (whether or not there is also a separate choice of law to govern the account agreement generally). The law chosen by the parties to the account agreement applies only if the relevant intermediary has, at the

¹ After comprehensive and inclusive discussions, fact-finding and widespread consultation, it became clear that, given the realities of the operations of intermediaries in today's globalized marketplace and current technology, there exists no criterion – acceptable on a *global* basis and applicable to *all* intermediaries – on the basis of which the location of a securities account or the office at which an intermediary maintains the account can objectively and realistically be determined with an acceptable degree of certainty.

time of the agreement on governing law, an office ('Qualifying Office') in the State whose law is selected which, alone or with another office or third party (which does not have to be in the selected State), serves certain functions relating to the maintenance of securities accounts (though not necessarily the particular account in question), or is identified, by any specific means, as maintaining securities accounts in that State (though not necessarily the particular account in question). If the applicable law is not determined under Article 4, there are certain fall-back provisions (Art. 5) in the Convention that would result, ultimately, in application of the law of the jurisdiction in which the intermediary is incorporated or otherwise organised.

4. The law determined under the Convention applies to all the issues enumerated in the exhaustive but very broad and intentionally very generally worded list in Article 2(1) (the "Article 2(1) issues"). The list in Article 2(1) includes all issues that might have practical significance. Most significant among the issues listed in Article 2(1) are the legal nature and effects against the intermediary and third parties of rights resulting from a credit of securities to a securities account, the legal nature and effects against the intermediary and third parties of a disposition of securities held with an intermediary, perfection requirements of a disposition and whether an interest extinguishes or has priority over another person's interest.

5. The Convention also deals with a number of other important considerations. These include: (i) the protection of rights on change of the applicable law (Art. 7), (ii) the role of the Convention in insolvency proceedings (Art. 8), (iii) the determination of applicable law for Multi-unit States (Art. 12), and (iv) certain transitional provisions for determining priorities between pre-Convention and post-Convention interests and for dealing with pre-Convention account agreements and securities accounts (Arts. 15 and 16).

6. It is important to note that the Convention 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. Thus, 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').

7. The G30 recommends that "the Hague Convention be ratified as quickly as possible by as many nations as possible" (Group of Thirty (G30), *Global Clearing & Settlement – A Plan of Action*, January 2003 (Recommendation 15); see also the *Final Monitoring Report of 2006*). The *ex ante* legal certainty that the Convention is designed to achieve is also very important under the revised capital adequacy framework commonly known as Basel II.

8. The Convention was signed by the USA and Switzerland on 5 July 2006.² The first States to ratify the Convention were Switzerland and Mauritius (both in 2009). A comprehensive and updated list of the Contracting States to the Convention is available on the HCCH website at < www.hcch.net >, under "Welcome" → "Conventions / All Conventions" → "36" → "Status table".

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² This joint signing gave the Convention its date (5 July 2006) although the final text of the Convention was adopted in December 2002.