The World Organisation
for Cross-border Co-operation
in Civil and Commercial Matters

HCCH
HAGUE CONFERENCE ON
PRIVATE INTERNATIONAL LAW
CONFÉRENCE DE LA HAYE
DE DROIT INTERNATIONAL PRIVÉ

L'Organisation mondiale pour
la coopération transfrontalière
en matière civile et commerciale

The Secretary General

European Commission
DG Internal Market and Services
Financial Services Policy and Financial Markets
SPA2 Pavillon
rue de Spa, 2
B-1000 BRUSSEL
Belgium

THE HAGUE, 10 June 2009

Our ref.: 45707(09)VL/SM

Dear Sir/Madam,

The Permanent Bureau of the Hague Conference on Private International Law very much welcomes the European Commission's *Consultation document of the Services of the Directorate-General Internal Market and Services* of 16 April 2009 (reference G2/PP D(2009), and is pleased to offer the following comments:

Information on the Respondent:

A) Name and address:

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The Permanent Bureau agrees to making the present letter available on the website of the Directorate-General for Internal Market and Services.

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B) Field of activity:

The Hague Conference on Private International Law is an Intergovernmental Organisation, whose origins date back to 1893, with 69 Members (status on 1 June 2009): 68 States from all continents (incl. all EU Member States) and the European Community (since April 2007). The mandate of the Hague Conference is the "progressive unification of the rules of private international law" (see Art. 1 of the Statute, available on the Hague Conference's website). To this effect, the Hague Conference has adopted 38 treaties (mostly Conventions) since 1951.

One of these Conventions is the *Hague Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary* (hereinafter: the "Securities Convention" or the "Convention"). The Hague Securities Convention is most relevant in the context of this consultation, as it establishes a uniform conflict of laws regime for a series of practically very important aspects of transactions involving securities held with an intermediary. The text of the Securities Convention was unanimously adopted, without the need for a single vote to be taken, by a Diplomatic Session held in December 2002.[1] This Diplomatic Session was attended, amongst others, by all then 15 Member States of the European Union, with the exception of Greece (although Greece did sign the Final Act of the Diplomatic Session); the Session was also attended by 19 observers, including the Council of the European Union, the European Commission, the European Parliament, the European Central Bank, the European Investment Bank, and the European Financial Market Lawyers Group.[2] In other words, all then-Member States of the EU, including its main organs and institutions, as well as important European stakeholders and interest groups participated very actively and prominently in the negotiations of the Convention and joined in the final text of the Convention.

The Convention was signed by Switzerland and the United States of America on 5 July 2006 (hence the date of the Convention), and by Mauritius on 28 April 2008. Several other States are presently actively assessing a possible ratification of the Convention.[3]

Points C) to E) of the "Information on the Respondent" Section are not applicable to the Hague Conference

Preliminary Remarks

While we fully acknowledge the importance of all the questions in the comprehensive Consultation document, we wish to comment only on Section 1.5 entitled "Identification of the applicable law". This of course is in line with the Hague Conference's mandate and field of expertise.

Furthermore, the way in which Questions 14-15bis are drafted seems to suggest that they are addressed primarily to market participants. The Hague Conference does of course not fall within this category. We therefore prefer to offer a few general comments on the conflict of laws as it arises in the context of securities held with an intermediary, and on the solution offered by the Hague Securities Convention and how the latter relates to the future legislative initiative of the EU in this field.

Comments

The current regime in the EC and the Hague Securities Convention

The Permanent Bureau very much welcomes the Commission's initiative to review the conflict of laws rules that currently address the subject matter within the EU Member States, in

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1 Technically, this was Part II of the Nineteenth Session of the Hague Conference.
2 Bulgaria and the Czech Republic, which subsequently became EU Member States, also participated in Part II of this Diplomatic Session.
3 For more information on the Hague Securities Convention, see http://hcch.e-vision.nl/index_en.php?act=conventions.text&cid=72 (with a comprehensive bibliography on the Convention). See in particular the *Explanatory Report* by Roy Goode, Hideki Kanda & Karl Kreuzer – with the assistance of Christophe Bernasconi (Permanent Bureau), The Hague 2005.

particular Article 9(1) of the Financial Collateral Directive, Article 9(2) of the Settlement Finality Directive, and Article 24 of the Winding-Up Directive. The Permanent Bureau respectfully submits that these provisions are not satisfactory. The Commission's Consultation document rightly identifies the three main difficulties that arise in relation to these provisions. First, although the provisions address the same basic issue, their connecting factors vary slightly.[4] Secondly, with respect to both their personal and substantive scope of application, these Directives are not identical and are each limited.[5] Thirdly, and most importantly, it is far from clear that any of the variations of the "place where the account / register / centralized deposit system is held / located / maintained" formulation is workable when difficult, complex facts are presented. In particular, it is very unlikely that it would be applied uniformly and predictably. Depending on the facts of a case, the connecting factors used in the Directives may easily be abused as an invitation to litigation in which courts would be required to make fact-intensive inquiries. Not surprisingly, therefore, the First Giovannini Report had already stressed that for securities held with an intermediary "the location of an account (and thus the deemed location of a security) may not be obvious."[6] In light of the lack of certainty and predictability provided by this approach, and the resulting risks and burdens for a potential collateral taker, the negotiators of the Hague Securities Convention (incl. all then-Member States of the EU) unanimously decided to move beyond the initial formulation of the PRIMA concept.[7] The Convention thus abandons the effort to attribute a "location" to an intermediary, a securities account or an office at which a securities account is maintained, and replaces it with an approach giving effect to an express agreement on governing law between an account holder and its intermediary, including in this approach a "Qualifying Office requirement" (see Art. 4(1) *in fine* and Art. 4(2)). In doing so, the Convention adhered to the agreed rejection of rules based on *lex rei sitae* or any 'look-through' approach, and it retained the key element of the relevant intermediary by focusing on the relationship between an account holder and the relevant intermediary with respect to a particular securities account.

As regards the deficiencies of the current conflict of laws regime provided by the three Directives mentioned above, one may add that these Directives have not been uniformly implemented in all EU Member States. Moreover, several EU Member States have not uniformly exercised their powers to develop national conflict of laws rules covering matters outside the limited scope of the Directives.

Despite the swift endorsement of the Hague Securities Convention by key industry groups, which promptly urged its immediate and universal ratification,[8] and the Commission's initial proposal for a Council Decision concerning the signing of the Convention,[9] so far the EU Member States have not been able to agree on a joint signing and ratification of the Convention as some of them voiced concerns, in particular, that the Convention regime would interfere with regulatory measures,

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4 Art. 9(2) of the Finality Directive points to the law of the Member State in which is located the "register, account or centralized deposit system" on which the right of specified collateral takers is "legally recorded". Art. 9(1) of the Collateral Directive points to "the law of the country [which need not be an EU Member State] in which the relevant account is maintained". Art. 24 of the Winding-up Directive refers to "the law of the Member State where the register, account, or centralised deposit system […] is held or located."

5 In particular, neither Directive specifically covers unencumbered book entry securities.

6 The Giovannini Group, *Cross-Border Clearing and Settlement Arrangements in the European Union*, Brussels, November 2001, p. 58, footnote 40; in the text accompanying footnote 40, the First Giovannini Report stressed that this location-approach "is based on a multiple legal fiction" and that "the solution has the effect not only of deeming a security to have a particular location in one jurisdiction, but (of necessity) also of 'dislocating' it from another" and that this may lead to disadvantages for the owner of the securities. See also the *Communication from the Commission to the Council and the European Parliament – Clearing and Settlement in the European Union – The way forward*, April 2004 (COM/2004/0312 final, p. 24).

7 For more details on this crucial aspect of the Hague Securities Convention, see the Explanatory Report, *op. cit.* (note 3), paras Int-33 to Int-48, and 4-1 *et seq*.

8 See in particular Group of Thirty (G30), *Global Clearing and Settlement – A plan of action, January 2003* (see http://www.group30.org/recommendations.php). Recommendation 15 of this Report addresses the need to advance legal certainty "over rights to securities, cash, or collateral"; the commentary on this Recommendation stresses that "[o]ne 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 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."

9 16292/03 JUSTCIV 273, dated 15 December 2003; we understand that this proposal has now been withdrawn. See also the Commission Staff Working Document, *Legal assessment of certain aspects of the Hague Securities Convention*, SEC(2006)910, 03.07.2006, in which it is stated that "the Commission services remain convinced that adoption of the Convention would be in the best interest of the Community" (see the Executive Summary).

disempower supervisory authorities and impact negatively on the business of some European market participants.[10]

The way forward

As the Second Giovannini Report stresses, it is "clearly in the interest of all that inconsistencies between the collateral directive (which is part of EU law) and the Hague Convention (which as yet is not) be resolved."[11] The Permanent Bureau fully shares this assessment, and respectfully submits that the inconsistencies be solved in favour of the global standard set by the Hague Convention. The primary rationale underlying this reasoning is that the marketplace for securities held with intermediaries and for secured credit supported by such securities is global, not regional. The relationships between financial institutions and central securities depositaries in Europe, on the one hand, and their counterparts elsewhere in the world are vital to the success of each.[12] The global need for smooth and reliable cross-border flows of capital is clear. If the current global financial crisis has exposed one characteristic of the financial markets in unprecedented form, it is their interconnectivity. This argues against the possibility of singling out and isolating "purely" European transactions and applying a special conflict of laws regime to them.

Against this background, the Permanent Bureau continues to believe that there is an important need for the global, pragmatic and easily applicable conflict of laws regime embodied in the Hague Securities Convention, and that the European Union and its Member States have a strong interest in the success of the Convention in achieving its global goal. The Permanent Bureau thus continues to urge accession to the Convention by the European Community and the ratification of the Convention by the EU Member States.

With a view to facilitating such a development within the European Union, the Permanent Bureau suggests that the ratifications of, and the accession to, the Convention be accompanied by the adoption of a regulatory framework which would effectively:

(i) require that the law applicable under Article 4(1) of the Hague Convention be *the law of an EU Member State*;

(ii) require that *the Member State's law chosen to govern a system* under Article 9(2) of the current Finality Directive also be agreed to as the governing law for purposes of the Hague Securities Convention; and

(iii) provide that a settlement system would only benefit from the protection of the Finality Directive if *all* the participants to the system agree, in their relation with the system, that the *same law* is to govern the Article 2(1) issues defining the scope of the Securities Convention.

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[10] On the evolution of the discussion within the EU Member States and European institutions, see the *Second Advice of the Leal Certainty Group*, Solutions to Legal Barriers related to Post-Trading within the EU, August 2008, p. 20-22. The concerns expressed by some EU Member States and the European Central Bank have been addressed in several articles listed in the Bibliography on the Securities Convention, which is available on the Hague Conference website (see above, footnote 3).

[11] The Giovannini Group, *Second Report on EU Clearing and Settlement Arrangements*, Brussels, April 2003, p. 13. In this regard, it should be recalled that when the European Parliament and Council adopted the Collateral Directive in 2002, they were aware that the Hague Conference deliberations were continuing and that the ultimate formulation of the Convention's primary rule, even if related to the relevant intermediary, might differ from the draft then under discussion. Earlier in the development of the Collateral Directive, there had been proposed a specific definition of the State "in which the relevant account is maintained" formulation. This proposed definition was omitted so as not to pre-empt the work at the Hague Conference. Thus, the Collateral Directive was not intended as a declaration of final adoption by the EU of the PRIMA rule as it then was under discussion at The Hague, but rather intended as an interim rule pending agreement at The Hague on a more refined rule at the end of deliberations. Furthermore, it is clear that when the EU Member States signed the Final Act of the Diplomatic Conference in December 2002, they were well aware (as were the Council and the Commission) of the prospective need to modify EU legislation to align it with the Convention. This was indeed expressly confirmed in the Commission's Communication to the Council and the European Parliament of April 2004, mentioned above in footnote 6. See also the Commission Staff Working Document, *op. cit.* (note 9), p. 9.

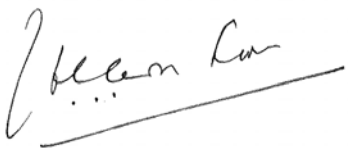
[12] The First Giovannini Report (*op. cit.*, footnote 6) had already stressed that "almost all transactions involve some cross-border element" (p. 57). See also the Commission Staff Working Document, *op. cit.* (note 9), p. 5.

All these requirements would be perfectly compatible with the Hague Securities Convention. The Hague Securities Convention is an instrument dealing with private law issues only, with a limited, well defined scope of application (see Art. 2 of the Convention). Regulatory measures are not among the Article 2(1) issues – thus, as is expressly confirmed by the Explanatory Report (see Int-59), "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." The Convention, therefore, has no impact on existing or future regulatory regimes controlling the conduct of intermediaries, whether those regimes are directed towards the goals of preventing money laundering or preventing tax evasion or assuring safe and sound business practices or minimising systemic risk. The Convention merely provides for a specified, and limited, consequence to behaviour that the parties to an account agreement may or may not engage in; the Convention does not, however, grant an absolute, unrestricted freedom ("right") to these parties to choose *any* law they wish (even if the Qualifying Office requirement is fulfilled) if, *for reasons imposed by competent regulatory or other supervisory authorities*, the law in question may not be chosen by the parties who are subject to this regulatory regime. These views are found not only in the Explanatory Report but also in several published articles which also offer more extended comments on this point.[13] Also, it is important to stress that this analysis and conclusion, based on the limited scope of the issues governed by the law determined pursuant to Article 4 of the Convention, would have been exactly the same had it put forth a *lex rei sitae* rule (*i.e.*, a conflict of laws rule based on the location of the security in question, the relevant securities account or the relevant intermediary). What would clearly be incompatible with the Convention is changing the conflict of laws regime from the agreed law to some other connecting factor.

The Permanent Bureau stands ready to further assist the Commission, and indeed all European institutions, EU Member States and stakeholders, in their assessment of the Hague Securities Convention and its implementation as suggested above. The Permanent Bureau also continues to be available to explore with the Commission, and indeed all European institutions, EU Member States and stakeholders, in cooperation with all other Members of the Hague Conference and all the States that already have or will be expressing an interest in the Securities Convention, any further action that might lead to a swift and effective implementation of the Convention across the globe.

We remain at the Commission's disposal for any further information.

Yours sincerely,



Hans van Loon

Cc. Commissioner McCreevy

[13] See, for example, Degué/Devos, *La loi applicable aux titres intermédiés: l'apport de la Convention de La Haye de décembre 2002*, Revue de Droit Commercial Belge 2006/1, p. 5 *et seq.*, in particular para. 38, and other articles listed in the Bibliography on the Securities Convention, which is available on the Hague Conference website (see above, footnote 3).