

Title	2006 Securities Convention and Digital Developments in respect of Securities Markets: Update
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Action to be Taken	For Decision <input checked="" type="checkbox"/> For Approval <input type="checkbox"/> For Discussion <input type="checkbox"/> For Action / Completion <input type="checkbox"/> For Information <input checked="" type="checkbox"/>
Annexes	N/A
Related Documents	Prel. Doc. No 5B of January 2024 Prel. Doc. No 10A of January 2023

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2006 Securities Convention and Digital Developments in respect of Securities Markets: Update

I. Introduction

- 1 At its March 2023 meeting, the Council on General Affairs and Policy (CGAP) noted the outcomes of the 2022 HCCH Conference on Commercial, Digital and Financial Law Across Borders (CODIFI Conference), and mandated the Permanent Bureau (PB), in partnership with relevant subject-matter experts, and subject to available resources, to study the determination of jurisdiction and applicable law in the context of securities markets in light of developments in technology such as distributed ledger technology (DLT); assess the ramifications of the growing attention that financial services and securities industries have accorded to developments in technology; and identify opportunities, in the context of the digital economy, for the desirability and feasibility of future normative guidance concerning securities.¹ CGAP further mandated the PB to explore, subject to available resources, the possibility of organising an online colloquium on these topics and to develop promotional materials on the *Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary* (2006 Securities Convention).² This Prel. Doc. reports on the work carried out over the last year in fulfilment of these mandates.

II. Status of Work

- 2 The 2006 Securities Convention entered into force in 2017 for each of its three Contracting Parties.³ Although the Convention's primary private international law (PIL) rule provides clarity and practical answers for the law applicable to securities held with an intermediary, no new Contracting Parties have joined the instrument. As was reported to CGAP ahead of its meeting in March 2023, technological advancement, in particular in relation to distributed storage mechanisms (incl. distributed ledger technology (DLT)) means that the scope of securities laws in various jurisdictions is expected to expand, especially concerning legal entitlements recorded via such distributed storage mechanisms.⁴ The PB has continued to monitor the jurisdictions from its study in 2023 in order to understand approaches taken by domestic securities regulators and legislative bodies, and to monitor the challenges to the traditional means of determining applicable law and jurisdiction that arise as a result of these competing national approaches.⁵
- 3 Monitoring over the last year has shown that there are still no uniform definitions of appropriate connecting factors for DLT-based securities and securities based on other forms of distributed storage mechanisms. The PB continues to study the current and future role of the 2006 Securities Convention in the context of the continued digitisation of the global economy and the added complexity of novel use cases, keeping in mind that, for (digital) book-entry securities held through intermediaries, where no tokenisation is involved, the solutions provided in the framework of the 2006 Securities Convention continue to stand. The PB also initiated preliminary steps to organise an online colloquium on these topics. Due to the limited resources available to the PB last year however, the online colloquium has not yet been held.

¹ Conclusion & Decision (C&D) No 43 of CGAP 2023, available on the HCCH website at www.hcch.net under "Governance" then "Council on General Affairs and Policy" and "Archive 2000-2023".

² C&D No 44 of CGAP 2023, available on the HCCH website at www.hcch.net (see path indicated in note 1).

³ A status table detailing *inter alia* the dates of signature, ratification and entry into force of the Contracting Parties to the Securities Convention is available on the HCCH website at www.hcch.net under "Instruments" then "Conventions and other Instruments" then "2006 Securities Convention" then "Status table".

⁴ "2006 Securities Convention, 1985 Trusts Convention, 2015 Principles on Choice of Law: Update", Prel. Doc. No. 10A of February 2023, available on the HCCH website at www.hcch.net (see path indicated in note 1), para. 5.

⁵ The PB began the study in 2023 with 18 jurisdictions spanning every region of the world, and continues to monitor these jurisdictions while considering which other jurisdictions to add to the study in order to provide a balanced and inclusive examination. See Annex I of Prel. Doc. No 10A of February 2023, *ibid*.

III. PIL Issues Relating to Digital and Tokenised Securities

A. Digitisation and Tokenisation of Securities

- 4 Securities markets have recently witnessed an increase in digitisation and tokenisation of financial securities and instruments, in particular those that utilise distributed storage mechanisms such as DLT or comparable technology-based protocols in their security lifecycle. This may be unsurprising given the increasing digitalisation of the global economy, advancement of technologies and DLT applications in the financial technology (fintech) industry, which have enabled new forms and methods of selling and holding securities and other securities-like instruments. The growing institutional and regulatory familiarity with DLT across various jurisdictions, together with commercial dynamics of sustained cost pressures and client service expectations⁶, have led to participants in capital markets increasingly using DLT-enabled solutions to tokenise traditional financial instruments and distribute digital securities to investors.⁷
- 5 It has been noted that a digital security is a right (a claim, a corporate right, etc.) that is entered into a registry meeting the statutory minimum requirements for securities registries.⁸ Registration in a securities registry has a legal effect that a right is transferred between parties to a transaction by way of an entry in the securities registry, as defined by the underlying system. This has several consequences that may have implications for PIL:
- a. **Control and / or possession:** As digital securities are controlled through a private key infrastructure,⁹ to effect a transaction, the holder of the private key can change the status of the distributed database. Such power conferred on the holder of the private key is comparable to the power of control or possession of a movable, physical asset.¹⁰ Therefore, similar to the possession of certificated securities, what is being transferred is the right to control entries in the securities registry.
 - b. **Tamper-proof registries that permit direct control and validation by holders of digital securities:** Digital and / or tokenised securities that are held on a DLT-enabled solution ensure that any changes are validated by participants in accordance with an agreed-upon validation mechanism and are reflected in all copies of the ledger.¹¹ This immutability ensures transparent and tamper-proof registries,¹² and the direct changes effected allow direct control and validation by holders of digital and / or tokenised securities. This also ensures identity verification¹³ and enables risk and collateral management in real time.

The impact of digitising and tokenising securities on a DLT-enabled solution thus may generate efficiency gains through the consolidation of previously separated infrastructures for the issuance, custody, trading and clearing and settlement of securities transactions on one single platform.¹⁴

⁶ World Economic Forum, "[Digital Assets, Distributed Ledger Technology and the Future of Capital Markets](#)" Insight Report, May 2021.

⁷ *Ibid.*

⁸ H. Kuhn and K. Löber, "Crypto Securities and Other Digital Assets: Aspects of Substantive and Regulatory Law". In Thomas Keijser (ed), *Transnational Securities Law*, (2nd ed.), para. 10.82.

⁹ *Ibid.*, para. 10.15.

¹⁰ *Ibid.*

¹¹ H. Kuhn and K. Löber, *supra* note 8, para. 10.07.

¹² D. Patel and E. Ganne, "[Blockchain & DLT in Trade: A Reality Check](#)", November 2019.

¹³ S. Blemus and D. Guégan, "[Initial crypto-asset offerings \(ICOs\), tokenization and corporate governance](#)", *Capital Markets Law Journal*, Vol. 15, Issue 2, April 2020.

¹⁴ H. Kuhn and K. Löber, *supra* note 8, para 10.02.

B. Determining Jurisdiction and Applicable Law in Securities Markets in light of Technological Developments relating to Distributed Storage Mechanisms

- 6 However, the lack of certainty as to the rules determining jurisdiction and applicable law in relation to digital and / or tokenised securities held on distributed storage mechanisms (including DLT-enabled platforms) creates considerable risk. Distributed storage mechanisms such as DLT-enabled platforms make it difficult to attribute a *situs* to digital and / or tokenised securities. This in turn makes it challenging to determine the applicable law or the relevant jurisdiction on the basis of traditional connecting factors. It has however been noted that issues of localisation are not new and have indeed been addressed as regards financial instruments,¹⁵ and there have been suggestions that the conflict-of-laws analogy may be drawn between such financial instruments as certificated securities and digital and / or tokenised securities. In such an analogy, digital and / or tokenised securities can be functionally seen as a digital representation of a right, claim, or other types of financial or non-financial asset that can be controlled by the holder of the private key in a manner equivalent to direct possession of physical securities. In this case, the entity reflected in the (distributed) ledger as the holder is considered to be the legitimate creditor, and the transfer of the digital security in accordance with the rules of the underlying DLT protocol would transfer the right represented to the transferee.¹⁶
- 7 In the absence of clear connecting factors connecting a DLT-based digital and / or tokenised securities or a distributed storage mechanism to a specific jurisdiction, it has been noted that party autonomy may be a good means for ensuring legal certainty.¹⁷ Where there is a valid choice of law, granting parties the autonomy to choose the applicable law in governing their contractual relationship has proven to be an efficient approach.
- 8 In respect of the choice of law in governing proprietary rights in securities held by an (identified) intermediary, Article 4 of the 2006 Securities Convention attaches the choice of law to certain physical presence criteria that the relevant intermediary should meet at the time of the account agreement. Additionally, Article 5 of the 2006 Securities Convention provides fall-back rules to refer intermediated securities to the law under which the relevant intermediary is incorporated or otherwise organised or, failing such incorporation or organisation, to the law of its principal place of business. In the context of digital securities, the connecting factors used in the 2006 Securities Convention in determining the applicable law for digital securities held by identified intermediaries continue to remain relevant.
- 9 In practice, third party actors only participate in a digital securities transaction if they have directly or indirectly become participants in the relevant (distributed) securities system or platform¹⁸ and, in doing so, they would have to agree to the terms and conditions for participants. Such terms and conditions may include overriding mandatory provisions put in place by the regulators or legislators of the relevant jurisdiction, and may also include a choice of law provision. By accepting the terms and conditions as downloaded from the blockchain software for conducting any transactions in digital securities, the user generally also accepts the choice of law clause in the terms and conditions.¹⁹
- 10 Where digital securities are (i) recorded on permissionless distributed systems; (ii) not held by identified securities intermediaries; and (iii) have no express (or valid) choice on the applicable law,

¹⁵ M. Haentjens, T. de Graaf, and I. Kokorin, "[The Failed Hopes of Disintermediation: Cryptocustodian Insolvency, Legal Risks and How to Avoid Them](#)", (September 2020), Singapore Journal of Legal Studies 526.

¹⁶ H. Kuhn and K. Löber, *supra* note 8, para 10.205.

¹⁷ H. Kuhn and K. Löber, *supra* note 8, para 10.96.

¹⁸ H. Kuhn and K. Löber, *supra* note 8, para 10.98.

¹⁹ M. Lehmann and M. Haentjens, "The Law Governing Secured Transactions in Digital Assets", in A. Bonomi, M. Lehmann and S. Lalani (eds), *Blockchain and Private International Law*, (Brill: 2023) 456.

reference to the location of one of the parties to the transaction, if such location be known, may provide a connecting factor for such transaction.

IV. Alignment with Proposed Work on the PIL Issues Relating to Digital Tokens

11 In line with a proposal put to the PB by a Member of the HCCH and with subsequent consultations with other HCCH Members, Prel. Doc. No. 5B of January 2024 outlines a proposal for work on the PIL issues relating to digital tokens.²⁰ Prel. Doc. No. 5B excludes from the scope of its proposal work relating to “[s]ecurities, whether held directly or indirectly, noting that questions of PIL regarding securities, both held with an intermediary and those held in a disintermediated system, are being examined within the study on the 2006 Securities Convention and digital developments in respect of securities markets”.²¹ The PB is to ensure coordination and alignment between the work proposed in Prel. Doc. No. 5B and this ongoing work relating to the 2006 Securities Convention and digital developments in respect of securities markets.²²

V. Proposal for CGAP

12 In light of the above, the PB proposes the following C&D for CGAP’s consideration:

CGAP took note of the PB’s work in relation to the 2006 Securities Convention and digital developments in respect of securities markets.

CGAP mandated the PB, in partnership with relevant subject-matter experts, and subject to available resources, to continue to:

- a. study the determination of jurisdiction and applicable law in the context of securities markets in light of developments in technology such as distributed ledger technology;
- b. assess the ramifications of the growing attention that financial services and securities industries have accorded to developments in technology; and
- c. identify opportunities, in the context of the digital economy, for the desirability and feasibility of future normative guidance concerning securities.

CGAP further mandated the PB to explore, subject to available resources, the possibility of organising an online colloquium on these topics and to develop promotional materials on the 2006 Securities Convention. The PB will report to CGAP at its 2025 meeting.

²⁰ “Proposal for a Normative Project: Private International Law Issues Relating to Digital Tokens”, Prel. Doc. No 5B of January 2024, available on the HCCH website at www.hcch.net under “Governance” then “Council on General Affairs and Policy”.

²¹ *Ibid.*, para. 12.a.

²² Prel. Doc. No 5B of January 2024, *supra* note 20, para. 13.