

Developments in the Legal and Regulatory Framework

Cross-Collateralization: Advances in the Context of the Hague and Unidroit Conventions

November 28, 2007

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Summary

- ✓ Motivation of the Conventions
- ✓ Overview
- ✓ Scope
- ✓ Current Status

The Harmonizing Conventions - Motivation

✓ Nowadays...

- ✓ intermediated holding system with book-entries: investor holds securities through a chain of intermediaries that are ultimately connected to the CSD
- ✓ high value of securities held with intermediaries, large volume of trades and many collateral transactions
- ✓ need of *legal certainty* and *predictability* as to the law applicable to securities

 <p>Hcch HAGUE CONFERENCE ON PRIVATE INTERNATIONAL LAW CONFÉRENCE DE LA HAYE DE DROIT INTERNATIONAL PRIVÉ</p>	 <p>UNIDROIT INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE</p>
<p>1893</p>	<p>1926</p>
<p>Law Applicable to Certain Rights in respect of Securities held with an Intermediary</p>	<p>Substantive Rules Regarding Intermediated Securities</p>
<p>Cross-border legal situation regarding securities holding, transfer, securities interest, etc.</p>	
<p>Conflict of Laws</p>	<p>Substantive Law</p>

Overview

- ✓ global intergovernmental organization
- ✓ with over 60 Member States the Conference held its first meeting in 1893 and became a permanent intergovernmental organization in 1955, upon entry into force of its Statute

Purpose:

- ✓ to work for the progressive unification of the rules of private international law
- ✓ create and assist the implementation of multilateral conventions promoting the harmonization of conflict of laws principles in diverse subject matters within private international law

Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary

- ✓ establish common provisions on the law applicable to securities held with an intermediary

Scope

- ✓ the Convention allows the parties involved to select the law that is going to apply to their account agreement
- ✓ focus is on relationship between account holder and its intermediary - not about “place” of account or intermediary
- ✓ the recognition of the “Place of the Relevant Intermediary Approach” (or PRIMA)

Determination of applicable law

Primary rule

- ✓ applicable law:
 - ✓ express agreement on law governing account agreement; or
 - ✓ express agreement on law governing specific issues subject to Qualifying Office provision
 - ✓ relevant intermediary, at the time of the agreement, must have a “Qualifying Office” in selected State

Qualifying Office

- ✓ an office of the relevant intermediary that:
 - ✓ alone or with other offices
 - ✓ effects or monitors entries to securities accounts;
 - ✓ administers payments or corporate actions; or
 - ✓ is otherwise engaged in a business or other regular activity of maintaining securities accounts; or
- ✓ is identified by an account number, bank code, or other specific means of identification as maintaining securities accounts in that State

Fall Back Rules

- ✓ if there is no express choice made, a number of fallback rules then apply to determine which law is applicable with the following priority:
 - ✓ place where the account agreement was executed
 - ✓ place of incorporation or organisation of relevant intermediary at time of agreement/opening of account
 - ✓ (main) place of business of relevant intermediary at time of agreement/opening of account

Project Development

- ✓ December 2002 - Treaty adopted by the Hague Convention on Private International Law
- ✓ July 2006 - United States and Switzerland signed the Convention
- ✓ July 2006 - release of European Commission's "legal assessment of certain aspects" of the Convention
- ✓ May 2007 - ACSDA recommended to its members to study the possibility of signing the Convention

ACSDA's Recommendation

- ✓ finalized on May 14, 2007
- ✓ *"...the Executive Committee and the Legal Committee are in agreement that this Convention will truly contribute to alleviating the legal uncertainty with regards determining the applicable law for important practical matters relating to the holding, transfer and granting of guarantees or pledges with regards securities held with an intermediary, thus helping to reduce a critical component of legal risk."*

ACSDA's Recommendation

- ✓ *"Executive Committee of the Association now specifically recommends that the member institutions of ACSDA and their respective countries direct their efforts as soon as possible toward analyzing the Hague Securities Convention and consider signing and ratifying said treaty at the nearest possible future date"*
- ✓ At this time, this recommendation is not joined by Depósito Centralizado de Valores de Colombia DECEVAL S.A.

Current Position

- ✓ it would take a minimum of three countries to ratify the treaty before it can come into force as actual law

Overview

- ✓ independent intergovernmental organization
- ✓ set up in 1926 as an auxiliary organ of the League of Nations, the Institute was, following the demise of the League, re-established in 1940 on the basis of a multilateral agreement, the UNIDROIT Statute
- ✓ Purpose:
 - ✓ to study needs and methods for modernizing, harmonizing and coordinating private and, in particular, commercial law as between States and groups of States

Substantive Rules Regarding Intermediated Securities

- ✓ many countries still relies on traditional legal concepts first developed for the traditional method of holding and disposition of securities
- ✓ cross-border holding must have internal soundness of domestic systems and compatibility between different legal frameworks

A Functional Approach

Internal Soundness (workability):

- ✓ Any system must operate properly

Compatibility (connectibility):

- ✓ Even if one system as such is "workable," two different workable systems must function properly when two systems are combined in international transactions.

Scope of the Convention

- ✓ rights from the credit of securities to a securities account
- ✓ acquisition, disposition and granting of security interests
- ✓ finality and irrevocability of book entry transfers
- ✓ good faith acquisition
- ✓ rights of the account holder
- ✓ responsibilities of the intermediary in the event of insolvency
- ✓ loss allocation
- ✓ clarification of the legal relationship between collateral taker, intermediary and account holder

Project Development

- ✓ 2002-2004 - meeting of Study Group
- ✓ Nov. 2004 - release of Preliminary Draft Convention
- ✓ 2005-2007 - meetings of Committee of Governmental Experts
- ✓ Sept. 2008 - Diplomatic Conference is expected

- ✓ Not in competition but complementary
- ✓ They share the topic (i.e. intermediated securities), but address different questions:
 - ✓ Hague: *Which law* applies (law of which State)?
 - ✓ Unidroit: What is the *content* of that law?
- ✓ A road signal (traffic sign) x the road
- ✓ Persistent legal risk may:
 - trigger systemic effects
 - affects the efficiency of the markets
 - increase transaction costs

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