

THE HAGUE CONVENTION ON THE LAW APPLICABLE TO BOOK-ENTRY SECURITIES – THE RELEVANCE FOR THE EUROPEAN SYSTEM OF CENTRAL BANKS

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ABSTRACT

Finora si è osservato un considerevole grado di incertezza giuridica a livello internazionale, in relazione alla determinazione di una precisa legislazione nazionale relativa ai titoli accreditati su un conto presso un intermediario in una dimensione internazionale, dovuta alla varietà dei possibili sistemi legislativi (legge dell'emittente, legge del luogo in cui i certificati sottostanti - certificati cartacei del tipo al portatore - possono essere fisicamente depositati o detenuti, legge di registro, legge dell'emittente CSD - Central Security Depository, legge di un altro intermediario a livello superiore o inferiore, etc.). Tale incertezza genera a sua volta rischi giuridici per l'industria dei valori mobiliari e gli investitori nella misura in cui la legge che regola i titoli smaterializzati determinerà la protezione offerta al possessore in caso di insolvenza dell'intermediario, nonché le formalità da adempiere per creare, perfezionare e attuare i contratti di garanzia finanziaria su tali titoli. L'applicazione di un'altra legge, diversa da quella attesa dalle parti, al rapporto di custodia potrebbe in realtà compromettere i diritti di proprietà dell'investitore, o invalidare le sue operazioni di garanzia finanziaria qualora i requisiti di quest'altra legge non fossero stati soddisfatti.

A livello UE, le Direttive sulla Definitività del Regolamento, la Riorganizzazione e la Liquidazione degli istituti di credito e il Collaterale hanno notevolmente elevato il livello di certezza giuridica, ma rimangono limitate alla UE, senza rivolgersi al resto del mondo e tener conto di tutti gli aspetti rilevanti per i possessori di titoli e tutti gli operatori di mercato. E' proprio questo che la Convenzione dell'Aia sta ora realizzando, determinando la legge applicabile ai titoli smaterializzati con particolare riferimento alla legge scelta per regolare l'accordo relativo al conto titoli. Lo studio commenta la Convenzione dell'Aia incentrandosi sui suoi principali risultati in vista delle suddette incertezze giuridiche. E in conclusione spiega anche perché tale Convenzione dovrebbe essere particolarmente rilevante in una prospettiva SEBC.

I INTRODUCTION

1. The need for legal certainty when dealing with securities held through intermediaries on a cross-border basis is undisputed among market players, law practitioners and public authorities. This need is at the heart of multiple law reforms introduced at national level over the last 20 years as well as at international or at European level, with the adoption by the European Union (EU) of the Settlement Finality Directive (SFD)¹, the Directive on the Reorganisation and Winding-up of Credit Institutions² (WUD) and, more recently, the Collateral Directive.³ These legal reforms were aimed at improving the substantive legal regimes of collateral transactions and of transfer of securities (and cash) in general, particularly against insolvency risk of the counterpart, the intermediary holding the securities itself, or of any third party (creditors, etc.) interested in the securities transaction.
2. It is however pointless to achieve the best possible legal protection of securities transactions in a national environment if, on the other hand, uncertainties remain about the determination of the applicable national law governing a particular securities transaction in a cross-border dimension. Of course, this question is less of an issue when for example two domestic banks exchange domestic securities on behalf of domestic clients in a domestic central securities depository (CSD), which will naturally take place under the law of the domestic jurisdiction in question. However, financial transactions nowadays are often substantially more complicated with many international aspects to consider, such as the involvement of foreign market players conducting transactions from abroad on a remote basis with a domestic player or through a domestic branch. Domestic players also deal with foreign securities, either in the domestic CSD that holds such foreign securities via a link with another CSD, or with a custodian in the jurisdiction where these securities were issued and are primarily deposited, or even directly in the local market. Additionally, they may themselves hold securities on behalf of domestic or foreign customers, and so on. Central banks that are members of the European System of Central Banks (ESCB) have since 1998 adopted rules on the eligibility of assets for monetary policy purposes and on the

1 Directive 98/26/EC of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems, OJ L 166, 11.6.1998, pp. 45 ff; on this Directive, see D. Devos, “La directive européenne 98/26/CE concernant le caractère définitif du règlement dans les systèmes de paiement et de règlement des opérations sur titres” (1999), *Euredia*, pp. 149 ff; D. Devos, “Collateral transactions in Payment and Securities Settlement Systems: The EU Framework”, *Revue (belge) de Droit bancaire et financier* (2002), pp. 10-27; and D. Devos, “The European Directive of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems”, in G. Ferrarini, K. J. Hopt and E. Wymeersch (eds), *Capital Markets in the Age of the Euro* (The Hague: Kluwer Law International, 2002), pp. 361-88.

2 Directive 2001/24/EC of 4 April 2001 on the Reorganisation and Winding-up of Credit Institutions, OJ L 125, 5.5.2001, p. 15; on this Directive, see in particular J.-P. Deguée, “La directive 2001/24/CE sur l’assainissement et la liquidation des établissements de crédit: une solution aux défaillances bancaires internationales?” (2002), *Euredia*, p. 241.

3 Directive 2002/47/EC on Financial Collateral Arrangements, OJ L 168, 27.6.2002, p. 43; on this Directive, see D. Devos, “The Directive 2002/47/EC on Financial Collateral Arrangements of June 6, 2002”, in *Mélanges en Hommage à Jean-Victor Louis* (Brussels: ULB, 2003), Vol. II, p. 259; see also S. Economou, “La proposition de directive européenne sur les contrats de garantie financière”, *Bull. Joly Bourse*, 2002, chron., 1; Clifford Chance, *Securities Newsletter* (May/June 2002); and D. Turing, “The EU Collateral Directive”, *Journal of International Banking and Financial Law* (2002), p. 187.

cross-border use of collateral (correspondent central banking model (CCBM) arrangements and the use of eligible links between eligible securities settlement systems (SSSs)). This represents a departure from long-standing monetary policy traditions, which classically limited the range of securities eligible as collateral for refinancing purposes to domestic assets.

3. In the above context, the specific need for legal certainty with respect to determining which law will govern the holding of securities has been stressed many times in the legal literature⁴, as well as in the preparatory Report prepared by the Permanent Bureau of the Hague Conference on Private International Law⁵, which seeks to justify the adoption of what has become the “Convention on the law applicable to certain rights in respect of securities held with an intermediary” (“the Hague Convention”), adopted by the Nineteenth Session of the Hague Conference on 13 December 2002. The Hague Convention is the subject of this paper. The reader is referred to the rationale explained in this preparatory report as well as in the Explanatory Report of the Hague Convention prepared by three professors of law (Roy Goode, Hideki Kanda and Karl Kreuzer) with the assistance of Christophe Bernasconi (henceforth “the Report”), which can be found on the website of the Hague Conference.⁶

2 THE ISSUES

4. In seeking to assess the important and complex issues addressed by the Hague Convention, it is necessary to revisit the overall situation as a whole, since it is probably in this field that some misunderstandings may have arisen in the past – misunderstandings which are currently influencing the debate about the need to have the Hague Convention adopted at EU level. This is why it is worth recalling some basic principles of conflict of laws in relation to securities. This paper will subsequently address the issues at stake in the context of indirect holding of securities and the correlative criteria that have to be taken into account as part of the commentary on the Hague Convention itself.

The key principles to take into account when looking at the determination of the law governing indirectly held securities are as follows:

- a) It is generally admitted that the law applicable to securities in the direct relationship between the end-investor and the issuer is the domestic law under which these securities were issued. This is the domestic company law, or *lex societatis*, of the domestic issuer for domestic issues in the form of equities

4 See “The Oxford Colloquium on Collateral and Conflict of Laws” held at St John’s College, Oxford University, in *Butterworths Journal of International Banking and Financial Law*, special supplement September 1998.

5 “The Law Applicable to Dispositions of Securities Held through Indirect Holding Systems”, preparatory report prepared by C. Bernasconi, First Secretary at the Hague Conference’s Permanent Bureau, available on the website of the Hague Conference (www.hcch.net).

6 <http://www.hcch.net>; see also the rationale indicated in the Proposal for a Council Decision concerning the signing of the Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary, presented by the EU Commission on 15 December 2003 (COM (2003), 783 final).

or bonds, which is in common law countries determined by reference to the place of incorporation of the company; and in continental law systems, by reference to the place of the main seat of the company.⁷ Alternatively, for international bonds, the applicable law is determined by reference to the *lex contractus*, the law governing the issue of such international bonds (as selected in applicable contractual issuing documentation, e.g. the prospectus, etc.).⁸

- b) It is also generally recognised that the law applicable to the listing and trading of securities listed on a particular stock exchange is indeed the law of that stock exchange⁹; the law applicable to the netting process in case of intervention by a central counterpart (clearing) is the law chosen to govern such contractual netting (generally by way of novation).¹⁰
- c) Again, it is not disputed that the law applicable to over-the-counter (OTC) securities transactions between the two relevant counterparts is the law governing the particular OTC transaction (forward sale, repo, transfer of title, loan, sale and buy-back, securities swap, etc.) as *lex contractus* (see Article 3 (1) of the Rome Convention of 19 June 1980 on the law applicable to contractual obligations in the EU).
- d) Categories a) to c) above are however restricted to the institutional and contractual aspects of the issuance and transfer of securities vis-à-vis the issuer or the counterpart. As such, they do not concern third parties with respect to either the enforceability of the possible transfer of ownership that the securities transaction may entail, or the enforceability of the collateral transaction, especially in case of insolvency or any other form of competition between creditors. Nor do they address the law governing the rights of the holder of the securities account in case of insolvency of the intermediary maintaining the account. In other words, the above categories do not address the proprietary aspects of securities holdings, which are usually governed under private international law by the so-called *lex rei sitae* rule¹¹, which refers to the law of the place where the relevant assets are located.¹²
- e) The *lex rei sitae* (or “*lex situs*”) rule is relatively easy to apply in the case of direct holdings (and related transactions) of bearer securities in paper (“physical”) form, as these are indeed governed by the law of the place where such paper certificates are physically located or held, as is the case for any

7 H. Van Houtte (ed.), *The Law of Cross-border Securities Transactions* (London: Sweet & Maxwell, 1999), No 1.07.

8 Van Houtte, op. cit., No 2.03-2.06 (by S. Weber); R. Tennekoon, *The Law and Regulation of International Finance* (London: Butterworths, 1991), p. 168.

9 Van Houtte, op. cit., 4.22–4.24; see also Article 9 of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ No L160 of 30.06.2000, pp. 1-13, which states that “the effects of insolvency proceedings on the rights and obligations of the parties to [...] a financial market, shall be governed solely by the law of the Member State applicable to that [...] market”.

10 See V. Marquette and S. Hirsh, “Clearing: Quelques considérations sur la loi applicable”, *Rev. droit bancaire et financier* (2001), pp. 237 ff, especially p. 240, No 8.

11 R. Van der Elst, “Conflit de lois”, *RPDB*, Complément, II (1966), No 70; N. Watté, “Questions de droit international privé des sûretés”, in J. Barreau (ed.), *Le Droit des sûretés* (1992), No 66, p. 325.

12 On *lex situs* in English law, see Dicey and Morris, *The Conflict of Laws*, Vol. 2 (London: Sweet & Maxwell, 2000), Chapter 22, pp. 917 ff.

other moveable asset.¹³ Under the same *lex rei sitae* rule, registered securities are governed by the law of the place where the register, which constitutes the rights of the holder, is located or maintained¹⁴, as such securities are represented by entries on the register maintained by the issuer or its agent (the so-called registrar).

- f) Difficulties started to emerge when securities became largely held through intermediaries, which felt the need to dispense with physical paper certificates or the requirement to generate entries in the issuer's register every time registered securities were transferred between their clients. Financial intermediaries in every country decided to "immobilise" their securities with a common agent (the CSD or any other central custodian) so that the only way to exchange securities was by way of book-entry transfers between themselves. This eliminated the need to physically move pieces of paper or make entries in the register (through the use, where possible, of a nominee of the CSD or of its affiliates to hold on a pooled basis registered securities on behalf of ultimate beneficial owners). In some systems, a new form of securities – so-called dematerialised securities – was created. This last type of securities is only represented by book-entries on accounts held with authorised account-keepers in the books of a CSD in direct relation to the issuer. Even just at the domestic level, this trend created a strong need for legal protection of securities *held in book-entry form*. Certain key issues distinct from the rules applied to the underlying securities as such needed to be addressed, such as: what would happen in case of insolvency of the CSD/central custodian with respect to the underlying paper certificates held in bearer form by the latter? What would happen in case of insolvency of the custodian/account-keeper? The same also applied to collateral transactions on such book-entry securities, since pledging of a securities account per se may represent a more efficient and adequate solution in view of the book-entry character of the securities immobilised in this fashion, compared with a physical delivery of securities to the pledgee or with special segregated physical storage in the hands of a common agent.
- g) The intervention of foreign market players also willing to offer to their own customers the benefits of immobilising securities issued in different domestic jurisdictions through book-entry holdings¹⁵ logically led intermediaries to centralise in their own books, again in book-entry form, all the entitlements of their clients with respect to the underlying securities already held at local level in book-entry form on behalf of their clients. By doing so, intermediaries were able to offer their customers a centralised pool of assets governed by the same rules irrespective of where the underlying certificates were ultimately held or deposited. These securities could then be transferred or pledged centrally without necessarily physically moving either the paper

¹³ Van der Elst, *op. cit.*, No 78; Dicey and Morris, *op. cit.*, No 22-040.

¹⁴ Van Houtte, *op. cit.*, No 1.10, p. 15; Dicey and Morris, *op. cit.*, No 22-044.

¹⁵ On the immobilisation process and the emergence of multi-tiered securities holdings, see Dicey and Morris, *op. cit.* No 22-042; R. Guynn and N. Marchand, "Transfer of Pledge of Securities Held through Depositories" in *The Law of Cross-border Securities Transactions*, *op. cit.*, p. 47; and J. Benjamin, *Interests in Securities* (Oxford: OUP, 2000), No 1.78 et seq.

certificate or the local book-entry corresponding to the holding (except for deliveries with another local recipient). This is the so-called intermediated or indirect holding system, which basically implies a chain of intermediaries (registrar, CSD, CSD participants, custodians at various levels) between the ultimate beneficiary and the issuer. It is also on this basis that links between CSDs have been established, even though some features of such links may differ from standard custody relationships and practices.

- h) The protection of investors that own foreign securities held on such an intermediated basis may vary, depending on the jurisdictions and the legal regime organised for such indirect holding systems¹⁶ (e.g. ownership or co-ownership in a pool composed of the securities of the same issue credited on the books of the intermediary, which reflects the holding of underlying securities held ultimately by the intermediary). Such an ownership right may either be regarded as directly traceable to the underlying securities – as far as the law of the intermediary is concerned – or only be enforceable against the intermediary (as evidenced by the book-entries in its records) with, however, enforceable recovery rights (including in case of insolvency of the latter). In this last regime, the intermediary must have in turn the enforceable right to obtain restitution in kind (for bearer certificates, through physical delivery; for registered securities, through the re-registration of the ultimate owner in the issuer register; or for dematerialised securities, through their transfer to another account keeper of the investor’s choice) of the underlying securities for the benefit of the account holders up to the amount recorded in their respective securities accounts.
- i) In view of the intermediated/indirect holding structure as described in points (f) to (h) above, it is crucial to make sure that when holding securities through a chain of intermediaries, the law governing the custody relationship at each level of the chain is also the only law applicable between the relevant intermediary at that level in the chain and its respective account holder (or between different account holders of the same intermediary), with respect to the holding of book-entry securities as such and to their transfer, whether outright or for collateral purposes, and not the law of the jurisdiction where the underlying securities are primarily issued and deposited (nor the law of another intermediary one level above or below the relevant level in the multi-tiered custodial chain). This risk that a foreign court could decide to apply not the law of the custodian, but instead the law of the place where the underlying securities are deposited or registered to determine under which conditions a transfer of ownership can be enforceable or a pledge be perfected (i.e. made good against third parties) is known as the “look-through” approach (so named because the Court would in this instance look through the book-

16 C. Bernasconi, R. Potok and G. Morton, “General Introduction: Legal Nature of Interests in Indirectly Held Securities and Resulting Conflict of Law Analysis”, in R. Potok, *Cross Border Collateral: Legal Risk and Conflict of Laws* (London: Butterworths, 2002), No 2.38 et seq., p. 20.

17 Bernasconi, Potok and Morton, op. cit., No 2.68 and following with reference to the US Fidelity & Guaranty Co. judicial case in footnote 80; see also R. Goode, “Security Entitlements as Collateral and the Conflict of Laws” in *The Oxford Colloquium on Collateral and Conflict of Laws* (1998), special supplement to JIBFL, 1998, p. 22.

entry intermediated holding to apply only the law of the place where the underlying securities are physically located or, alternatively, the law of the issuance).¹⁷ This approach probably constitutes one of the major legal risks in the cross-border securities business, since it could potentially jeopardise the legal certainty required for a securities account relationship with an SSS or a custodian by disregarding the law of the custodian expected to be applied by the parties, and on the basis of which they designed the account structure, its rules and protection, in favour of another law that the account holder does not know. This last solution can in practice only work properly if the end-investor has its securities account directly opened with the issuer CSD in a segregated position. It certainly will not work if the underlying securities are held on a fungible pooled basis in the name of an intermediary by means of an omnibus account representing the total amount of clients' positions, or on a nominee registration basis for registered securities in the books of the issuer or of its registrar. In such a case, which is standard practice in almost all indirect holding schemes, the law of the place of the underlying certificates will of course continue to govern the property aspects of the custody relationship between *the intermediary* (holding for the account of its clients) and its custodian at local level (the issuer CSD, another custodian, the registrar or the issuer directly). However, it will not determine the rights of the clients of such an intermediary that have no *direct* contractual or property rights on the underlying securities. The property rights and related collateral rights of clients holding through their intermediary will be determined by the law of the place where *their* assets are "located", which is the law of the jurisdiction in which *their rights in the securities* are recorded on the accounts of their intermediary, i.e. the law governing *the book-entry securities held with such an intermediary*.¹⁸

18 The right relating to book-entry securities held indirectly with an intermediary is generally called in Anglo-Saxon terminology "interests in securities". In the US it is also known as a "securities entitlement" (Article 8 of the Uniform Commercial Code), and in some EU legal instruments as "rights in securities" (see Article 9.2 of the SFD and Article 24 of the WUD ("other rights in such instruments")). On this terminology, see J. Benjamin, *Interests in Securities* (Oxford: OUP, 2000), No 1.05 and 2.21 et seq.; J. Benjamin, "Conflicts of Law and Interests in Securities", in K. Tyson-Quah, *Cross-border Securities: Repo, Lending and Collateralisation* (London: Sweet & Maxwell, 1997), No 2.3 et seq., p. 16; J. Benjamin and M. Yates, *The Law of Global Custody*, 2nd edition (London: Butterworths, 2002), No 2.17 and 5.30-5.31; in the context of Belgian Royal Decree No 62 of 1967 relating to the book-entry circulation of securities and governing the rights of participants in the Euroclear system, see L. De Ghenghi and B. Servaes, "Collateral Held in the Euroclear System: A Legal Overview", *Journal of International Banking and Financial Law* (March 1999), pp. 85-87; B. Servaes, "Het immobiliseren van effecten: Het Belgisch juridisch kader", in *Nieuw vennootschapsfinancieel recht 1999* (Jan Ronse Instituut-KU Leuven), p. 513. This distinction between interest in securities as evidenced by book-entries in the accounts of the intermediary and underlying securities has led to the creation of ownership rights on assets (a pool of fungible book-entry securities) that are distinct from the underlying certificates. What is then transferred or pledged in the books of the relevant intermediary is not the underlying securities but the co-ownership rights of the collateral provider in the pool of book-entry fungible securities vis-à-vis the intermediary holding the securities account. Of course, "economically, and also for balance sheet, taxation and regulatory purposes, [such an] asset is indistinguishable from the underlying certificates" (Benjamin and Yates, op. cit., No 5.30), on the basis of which corporate actions will be exercised vis-à-vis the issuer (collection of interests and cash proceeds, redemption and exchange, put and call options, tax withholding and reclaiming services, voting at a general assembly, etc.), either by the intermediary on behalf of the investor, or directly by the latter, through different techniques depending on the features of the local issuer market (proxy voting, registration in the name of the end-investor for the limited purposes of voting, etc.). Similarly, when the client exercises its rights to restitution in kind for the securities (in the event of a change to or insolvency of the intermediary), the underlying securities held locally will of course be returned by way of physical delivery (shipment) for bearer paper certificates, re-registration in the issuer records of the registered securities in the name of the clients or of its new intermediary, or transfer of the dematerialised securities to a new account keeper designated by the client owing the securities.

- j) The application of the law of the book-entry securities held with such intermediaries, which has been recommended for many years now by several international financial market associations¹⁹, has already been recognised at European level by Article 9.2 of the SFD in 1998, which governs collateral transactions in the scope of designated systems.²⁰ This is also the approach chosen in Article 24 of the WUD in 2001²¹, and is furthermore also the rule defined by the Collateral Directive in 2002 (Article 9.1) regarding *book-entry securities collateral*.²²
- k) The main purpose of the Hague Convention is to confirm this solution at international level *and to make it more precise*, without however preventing investors and securities intermediaries from holding their securities directly at local level under the law of the issuer or of the issuer CSD, if they still prefer to do so.

This paper provides below a rapid survey of the key features of the Hague Convention, focusing on its main achievements in terms of scope, connecting factors, collateral requirements and impact of insolvency (as opposed to detailed comments on all the various provisions of the Convention, for which the reader is referred to the comprehensive Explanatory Report of the Convention). As part of the conclusions of this paper, this Convention is put into perspective with the aim of demonstrating why the ESCB and the European Central Bank (ECB) should, in our opinion, support this initiative.

3 THE HAGUE CONVENTION: KEY FEATURES²³

5. *Scope*- The Hague Convention is applicable to “securities held with an intermediary” (see Article 1.1), which means:
- *Securities in the broad sense* (equities, bonds, etc.) including “any interest therein”. This naturally also covers interests in securities (see footnote 18

19 See in particular R. D. Guynn, “Modernising Securities Ownership, Transfer and Pledging Laws” (1996), a booklet published by the Capital Markets Forum (Section on Business Law of the International Bar Association). See also the “2003 G-30 Recommendations on Global Clearing and Settlement (A Plan of Action)”, in particular Recommendation 15 on legal certainty over rights to securities and collateral, p. 112.

20 “Where securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Member States or the future European Central Bank as described in paragraph 1, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State”; see also C. Keller, “Die EG-Richtlinie 98/26 vom 19.5.1998 über die Wirksamkeit von Abrechnungen in Zahlungs- sowie Wertpapierliefer- und -abrechnungssystemen und ihre Umsetzung in Deutschland” in *Zeitschrift für Wirtschafts- und Bankrecht*, 26 (2000), pp. 1269 ff, which refers to the concept of *lex conto sitae* (however, we do not share the restrictive view suggested by the author for the application of Article 9.2 of the SFD; see p. 1274).

21 “The enforcement of proprietary rights in instruments, or other rights in such instruments the existence or transfer of which presupposes their recording in a register, an account or a centralised deposit system held or located in a Member State, shall be governed by the law of the Member State where the register, account or centralised deposit system in which those rights are recorded, is held or located”.

22 “Any question with respect to any of the matters specified in paragraph 2 [property and collateral rights] arising in relation to book-entry securities collateral shall be governed by the law of the country in which the relevant account is maintained”, which is “in relation to book-entry securities collateral which is subject to a financial collateral arrangement, the register or account – which may be maintained by the collateral taker – in which the entries are made by which that book-entry securities collateral is provided to the collateral taker” (Article 2.1.g).

- above), since the main objective of the Hague Convention is to protect indirect holdings of securities through intermediaries. *Cash holdings are excluded* as such from the scope of the Convention.
- *Intermediaries in the broad sense*, meaning any person whose business is to maintain securities accounts for others. This refers to banks, investment firms, other securities intermediaries entitled to maintain securities accounts under the law of the country in which they operate, central banks, CSDs, etc., but not to pure registrars or transfer agents (see Article 1.3 (a));
 - Securities must be in *book-entry form*, which means securities credited to a securities account with an intermediary. This is again a consequence of the fact that the Hague Convention is designed to address primarily indirect holdings of securities, although it can also protect direct holdings systems as such (see Article 1.4 of the Convention: CSDs are expressly regarded as intermediaries under the Convention, especially at the request of the Scandinavian countries, which wanted to benefit from the protection of the Convention with regard to their own domestic securities held in book-entry form in the domestic CSD, even though direct holding system/CSD accounts were generally regarded as obviously governed by the law of the country where the underlying domestic securities are issued and deposited with the local CSD). As an exception, a contracting state under whose law registered (or even dematerialised) securities are constituted may declare that the operator of an SSS holding such securities directly (in such a way that its securities accounts are assimilated to the issuer records and as such directly constitute the primary record of entitlement as against the issuer) should not be treated as an intermediary for the purposes of this Convention (Article 1.5). Opt-out mechanisms have been proposed by the UK and Irish delegations to avoid treating the CREST System, which is operated by CREST Co in the UK not just for UK securities, but also for Irish equities (and is designated as a separate “Irish” system for the purposes of the SFD), as an intermediary under the Convention in respect of those Irish-registered securities, as this could lead to the application of English law instead of Irish law. This would thus be contrary to what is currently applied for the settlement of Irish securities in CREST, as CREST does not have a qualifying office in Ireland which could justify under the Convention the application of Irish laws to Irish holdings entries. This opt-out mechanism could even apply to CREST in respect of UK securities that it directly holds and for which CREST books are assimilated to issuer records, even though here the reason for not applying the Convention’s protective regime might appear less immediate.

23 See on the final text, R. Potok and C. Bernasconi, “PRIMA Convention Brings Certainty to Cross-border Deals”, IFLR (January 2003), p. 11; M. Germain and C. Kessedjian, “La loi applicable à certains droits sur des titres détenus auprès d’un intermédiaire: Le projet de convention de La Haye de décembre 2002”, *Rev. crit. DIP* (2004), pp. 49 ff; K. Alexander, “The Development of a Uniform Choice of Law Rule for the Taking of Collateral Interests in Securities”, *JIBFL* (2002), p. 436 and *JIBFL* (2003), p. 56; H de Vauplane and P. Bloch, “Loi applicable et critères de localisation des titres multi-intermédiés dans la Convention de la Haye”, *Mélanges AEDBF-France*, IV, p. 469, to be published.

6. The Convention is aimed at determining the applicable law that should govern the following *aspects* relating to book-entry securities²⁴, as defined under Article 2.1:
- the legal *nature of the rights* of the account holder resulting from the book-entry holding (ownership, contractual claims²⁵, etc.) and the effect of such rights as against the intermediary and third parties;
 - *In case of a “disposition” of securities*, meaning any transfer of book-entry securities whether outright (a sale) or for securities purposes (transfer of title, repo) as well as any granting of security interest (a pledge) on such book-entry securities, including a lien by operation of law in favour of the relevant intermediary to secure any claim in connection with the maintenance of the securities account (see Article 1.2):
 - the *perfection requirements or steps* to make a disposition (as defined above) effective against third parties;
 - *priorities between conflicting interests* (e.g. good faith protection in case of multiple dispositions, but not the ranking between creditors’ claims in case of insolvency, which is not affected by the rules of the Convention pursuant to Article 8.2 (a); see below Section 12);
 - *the duties of an intermediary to third parties* in competition with the account holder or with other persons in relation to the book-entry securities (attachment proceedings, etc.);
 - *the realisation requirements* to enforce the rights of the collateral taker on the book-entry securities (sale of pledged assets, etc.);
 - *the extent to which a disposition of securities may include an entitlement to cash proceeds relating to such securities* (even though cash accounts as such are not covered by the Convention).
7. The Convention shall not apply (see Article 2.3) to determine either the law governing the pure contractual aspects of the custody relationship between the intermediary and the account holder (duties of the intermediary, definition of contractual services, liability, statute of limitation, etc.), or between the parties to a disposition (contractual aspects of a pledge or of a repo transaction, e.g. netting, currency, interests for late payment, etc.), which continue to be governed by the *lex contractus* nor the law governing the rights and duties of an issuer of securities (or of its registrar or transfer agent) – see above, Section 4 a.
8. *Determination of the applicable law.* The main rule of the Hague Convention is laid down in Article 4.1:
- I. The law applicable to “*proprietary*” aspects (classified as “Article 2.1 issues”; see above Section 6 and also footnote 25) of book-entry securities is the *law expressly agreed between the relevant intermediary and the*

24 This applies when an international situation involving a possible choice between the laws of at least two different States is involved (see Article 3).

25 The fact that the law as determined in accordance with the Convention would qualify the rights of the account holder on book-entry securities as mere contractual claims, and not rights of ownership, does not prevent the application of the Convention to what still constitutes “securities held with an intermediary” under the meaning of the Convention: see Article 2.2 and the Explanatory Report, No 2-30 to 2-35. For the sake of simplification, in the rest of this study the expression “proprietary (or “property”) aspects” is used to illustrate those issues specified in Article 2.1.

- account holder to govern the account agreement*; in this case, the *lex contractus* will govern the entirety of the custody relationship, both pure contractual aspects and proprietary aspects linked to a securities account;
- II. The relevant intermediary and the account holder may however agree expressly in the account agreement that the *proprietary aspects of the holding and disposition of securities in book-entry form* (“Article 2.1 issues”) will be governed by a different law than the law governing the account agreement; in that case, the contractual aspects of the custody relationship will be governed by the *lex contractus*, while the property aspects will be governed by another law specifically selected for that purpose by the intermediary and its client;
 - III. The Convention does not permit property aspects to be split between multiple laws in the same securities account: only one law must apply to the entirety of the issues mentioned under Article 2.1;
 - IV. The choice of applicable law to property aspects under points I and II is however only admitted under the Convention provided that the relevant intermediary has at the time of the account agreement *an office in the state whose law is chosen*, and that it is either:
 - a) *engaged in a business of maintaining securities accounts* by effecting or monitoring securities entries, or by administering payments or corporate actions in relation to book-entry securities, or is otherwise considered as engaged in such a business (see Article 4.1 (a iii); see below, point VI), or
 - b) alternatively, *is identified by a specific means of identification as maintaining securities account in that state* (through a bank code, account number, etc.) (see Articles 4.1 (a and b)).
 - V. The office in question under point IV must be a non-temporary place of business of the intermediary itself (see Article 1.1 (j)): *a branch* obviously qualifies in principle but *not a subsidiary*, as a subsidiary is a distinct legal person, *nor a representative office*, which has no power to enter into account agreements (see Article 4.2 (d)), but does not necessarily have to be the entity with which the relevant securities account is in fact maintained. For the purposes of the securities account business criteria defined under point IV (a) above, the assessment can also take into account not only the office in the state whose law is applicable *but also other offices* (e.g. branches) of the relevant intermediary *as well as the business of “other persons acting for the relevant intermediary”* (for example, service providers to which securities account activities may have been outsourced) which, as far as the latter are concerned, may or may not be acting in that state.
 - VI. *Are not considered per se as evidence of a securities accounts business in the state whose law is declared applicable* (meaning that the following elements are not sufficient to demonstrate per se a business of maintaining securities account under the catch-all “otherwise” residual provision of Article 4.1 (a iii); however, they may well further confirm the “securities account business” test if taken together with *other* elements under Article 4.1 (a): see Explanatory report, No 4-32 and 4-40):
 - the location in that state of *information technology* (computer processing) which supports bookkeeping for securities accounts;

- the location of *call centres* for communication with account holders;
or
- the location of mailing, filing or archiving centres.

9. *The current debate on the Hague Convention.* The main criterion of Article 4.1 for the determination of the law governing property aspects of book-entry securities is currently at the centre of intense discussions at EU level, where some voices have been raised urging Member States not to sign the Hague Convention, at least not without a comprehensive prior impact analysis. This is the view expressed by the European Banking Federation (EBF) in two letters dated 29 June and 18 November 2004 that were circulated to Permanent Representatives of Member States to the EU and to other banking federations. The main argument underlying the EBF's opposition is that the Hague Convention, by departing from a pure *lex rei sitae* approach (the "application of the law of the place where the securities account is maintained") to favour the law chosen by the parties to the account agreement, would introduce legal risks and politically adverse effects. Supporters of this approach argue that the authors of the Hague Convention did not consider the full implications of moving from *lex rei sitae* to *lex contractus*, and that this would therefore justify a prior impact analysis at EU level on numerous aspects such as the implications for all parties in the securities chain, as well as for securities systems and regulators, on the potential effect on tax regimes, money laundering and fraud prevention, and on various other economic aspects, such as costs, tariffs and risks. This is also now the advice expressed by the European Central Bank in its recent Opinion of 17 March 2005²⁶ in relation to the possible signing of the Hague Convention by the European Union ("the ECB Opinion").

In the light of the above, it must be emphasised that during the negotiations of the Hague Convention between 2000 and end-2002, there was actually right from the outset a clear debate between the European approach, focusing on the place where the account is maintained (as mentioned in some EU Directives), and the US position (derived from Article 8 of the Uniform Commercial Code), which refers to the law governing the account agreement. In the end, the latter was ultimately adopted in the final text of the Hague Convention. However, this choice was finally supported by all representatives including the EU Member States²⁷ after thorough discussions that took place during the whole negotiation process. The debate also benefited greatly from the intensive involvement of the securities industry (including the EBF) as well as from the participation of authorities, regulators, central banks, academics and law practitioners. In the period between June and October 2002, the criterion of the law of the account agreement to govern property aspects of book-entry securities was presented by the Hague Permanent

²⁶ ECB Opinion CON/2005/7 of 17 March 2005 at the request of the Council of the European Union on a proposal for a Council decision concerning the signing of the Hague Convention on the Law applicable to certain rights in respect of securities held with an intermediary (OJ C 81, 2.4.2005, p. 10).

²⁷ A formal COREPER meeting was even held on 10 December 2002, three days before the final text was signed by delegates, to confirm the common position of EU Member States and the Commission in order to proceed on the basis of the draft text on the table at the time, which already contained the debated article (No 4).

Bureau as a possible option (“Option A+”) during regional workshops conducted with banking representatives around the world, particularly in Europe (France, Germany and the UK). The topic therefore came as no surprise at the end of the Convention negotiations, as it had been assessed *ex ante* by all interested financial sectors, and was finally adopted by the Hague Convention as the main rule.

This paper submits²⁸ that the Hague Convention represents a unique opportunity to achieve in the near future the highest possible degree of legal certainty on a worldwide basis for all intermediaries active in the securities industry. This is because the Hague Convention:

- a) *Ensures the prevailing application of the law governing securities accounts* as agreed between an account holder and its intermediary *over other possible conflicting laws* such as the law(s) of the place(s) where the underlying physical certificates may be located abroad, or the law(s) of the foreign CSD(s) that primarily hold(s) the securities, or the law of the local custodian(s) that hold(s) the securities on behalf of the relevant intermediary, or the law of the place where IT processing takes place, and so on (see above, Section 4). As a result, the holding, transferring and pledging of several securities primarily issued and deposited in various issuers’ jurisdictions may be centralised in one single account under one governing law with one intermediary in a legally robust fashion (see also below, point d).
- b) *Complements the existing EU legal framework*, since the EU solution was either limited to *collateral* transactions in connection with payment and settlement systems designated as such by Member States (Article 9.2 of the 1998 SFD), or applicable to financial intermediaries, but only for collateral transactions (Article 9 of the 2002 Collateral Directive), or to a certain extent applicable to securities holdings as such, although only in case of insolvency of a credit institution (Article 24 of the 2001 WUD).
- c) Provides a *harmonised conflict of law regime* which, in contrast to the above EU current regime, is:
 - *general* (covering all aspects of book-entry securities: holding, outright transfer, collateral),
 - *universal* (aiming at covering not only the EU but also the US, Japan, Canada, Switzerland, China, emerging markets, etc.),
 - *truly uniform* (since the EU solution could not be exported outside the EU’s boundaries, as demonstrated by the preparatory work of the Hague Convention),
 - *of benefit to all securities intermediaries* (and not just system operators as in the SFD or just financial institutions as in the Collateral Directive), and
 - *workable* for all intermediaries in view of the legal and practical difficulties to determine (even within the EU) what a securities account

²⁸ See the letter of the author dated 29 November 2004 to the EBF; see also the letter dated 26 November 2004 from the Permanent Bureau of the Hague Conference to Mr Schaub, Director General of the European Commission (see Hague Conference website: <http://www.hcch.net>); see also the ISDA letter to the European Commission, DG Internal Market, dated 26 July 2004.

really is²⁹, and more fundamentally, where such an account may *in fact* be “located”, especially for multi-branches custodians operating on a cross-border basis through a large network that is decentralised or in which services relating to securities accounts are outsourced (steps such as opening a custody relationship, sending statements of account, IT processing, accounts monitoring, operating call centres, processing corporate actions instructions, etc., may indeed nowadays be each located in a different jurisdiction).

- d) *Offers the ideal solution for intermediated indirect holding systems.* This is indeed the specific aim of the Hague Convention: a key objective of an intermediary and its customers in using such a scheme is to have one law governing the entirety of the various securities holdings recorded on the securities account, irrespective of where the underlying papers may be located, while still preserving latitude, for those intermediaries and clients willing to do so, to continue to hold their securities directly with the issuer CSD(s) or via a local branch of the intermediary under local “issuer law”(s) through separate deposits.

In this respect, the criticism expressed in the EBF’s letters, or now in the new ECB Opinion to the EU Council of 17 March 2005, does not seem convincing, and should in no way justify the withdrawal of the support granted so far by the EU to the Convention. To illustrate this³⁰, this paper discusses below the implications of the three main objections raised in the letters and in the ECB Opinion:

- *“The Hague convention would lead to “delocate” EU assets in favour of USA by having the major US banks imposing New-York laws to EU custodians”* (EBF letter of 18 November 2004). This argument is hard to understand. To take a practical case, assume a French bank has been requested by a US bank to open an account recording French domestic securities under New York (NY) law. There are only two possibilities: either the French bank does not have a qualifying office (as defined by the Hague Convention) in New York – in which case NY laws cannot be selected under Hague rules, or there is such an office, in which case – assuming the French bank finally agrees to open an account under NY law (or, to follow the logic of the critics, is forced to for reasons of competition) – the French dematerialised securities will be then held under the US regime, specifically Article 8 of the Uniform Commercial Code³¹ (meaning under a securities entitlement representing co-ownership

29 It is submitted that the debate on the “subjective criterion: law of the agreement” vs. “objective criterion: location of the account” is in reality theoretical, since an “account” (including a securities account) is essentially an agreement between the account holder and the intermediary to record in book-entry form assets (generally in fungible form) held by the latter in the name of or on behalf of the former, and for this purpose to submit the entitlement to such assets to a specific law that will govern the correlative rights of the account holder. *In fact, in our opinion, a securities account is nothing more than an account agreement* which will in fact create, subject to the conditions organised by the law governing the account agreement (which also may impose specific duties on the intermediary in terms of accounting treatment, etc.), the rights and obligations of the parties relating to the securities deposited with the intermediary.

30 This paper is not the place to comment on and answer every question or criticism raised in the above-mentioned letters or Opinion; however, a specific discussion of such other arguments could take place in the near future as part of the recent EU Council decision (June 2005) to launch a limited impact study on the Hague Securities Convention.

31 By contrast, the actual underlying French dematerialised securities would of course continue to be held by the French bank with Euroclear France as the CSD (or through another direct affiliate of Euroclear France) under the French law regime.

rights in the pool of similar securities held by the US branch of the French bank). The latter situation is what US banks can already require and obtain from the NY branch of a French bank if they are more interested in indirect holdings under US law than in direct holdings under French law. In any case, this does not lead to any “relocation” of assets.

- *“The Hague Convention may have tangential impacts on EU securities settlement systems which will apply different laws to the securities held in their systems”*. Again, it is difficult to understand how an EU SSS could ever agree to maintain securities accounts governed by different laws (whether EU ones or not) without totally jeopardising the fungibility of the securities held, transferred and pledged in the system (as is also recognised in the above-mentioned ECB Opinion: see paragraph 12). This would moreover directly impact the reliability of the protection granted jointly to its participants in case of insolvency of the operator, as well as the application of the SFD as such (which requires one EU law to apply to the settlement and custody rules of such a system). There are moreover additional constraints defined in the various regulatory standards that apply to such a system in terms of legal soundness (i.e. the 2001 CPSS-IOSCO recommendations on securities systems; the 2004 ESCB-CESR Standards; and the 1998 EMI/ESCB standards for the use of securities systems for ESCB collateral transactions). The ECB Opinion states however that “there could be no guarantee that” in fact an SSS would only select one law (see paragraphs 11 and 12). In our view, the guarantee is precisely the adverse consequences described above that would derive from the application of multiple laws to securities holdings. In addition, EU regulators may impose on SSSs specific limitations under the above-mentioned regulatory standards to avoid such “abuse” (if at all conceivable) as implicitly suggested in the ECB Opinion (see paragraph 10).
- *“The Hague Convention is not transparent since third parties cannot know by which law the account agreement – and as a result the securities recorded on such an account – is governed”* (see paragraph 14 of the ECB Opinion). The transparency of securities holdings and pledging mechanisms is currently an issue with regard to cross-border electronic securities; however, this difficulty already exists for securities accounts held with any multi-branch intermediary that operates on a cross-border basis, since third parties are not better equipped to know where the account of their debtor is actually located or maintained or by which law the recorded securities may be governed, especially as long as there are still some uncertainties about applicable law (for example, third parties today do not necessarily know whether their debtors are even in a custody relationship with a particular intermediary, which often obliges them to initiate attachment proceedings against multiple intermediaries simultaneously). From the above perspective, the transparency of collateral arrangements has not increased at the EU level with the elimination of any publicity requirements for the constitution and perfection of collateral in the Collateral Directive. However, public authorities and banks supported this simplification.

All in all, the new criterion introduced by Article 4.1 of the Hague Convention to determine the law applicable to book-entry securities seems reasonable, and avoids any future discussions or “second-guessing” by competent Courts on the

reality of the “location of a securities account”, since the Courts will simply have to apply the law of the account agreement (or any other law chosen to govern proprietary aspects if this differs), provided that the relevant intermediary has an office in the jurisdiction whose law has been selected.

10. *Fall-back rules*, assuming there is no law chosen to govern the account agreement or specifically the property aspects of it, are organised in a “cascade” system by Article 5 of the Hague Convention in favour of the application of the law of the particular office through which the account agreement was entered into (Article 5.1), or – failing this – by reference to the law of the jurisdiction under whose law the relevant intermediary is incorporated or otherwise organised (Article 5.2), or, in turn, by reference to the law of the country where the intermediary has its principal place of business at the time the account agreement is entered into (Article 5.3).
11. Another helpful achievement of the Hague Convention is the stipulation in Article 6 of factors that are considered explicitly as *irrelevant* for the purposes of determining the law applicable to book-entry securities (the so-called black list of excluded connecting factors). These are:
 - The place where the issuer is incorporated or organised, etc.;
 - The location of underlying certificates (no “look-through approach”;
see above Section 4 (i));
 - The location of the issuer’s register;
 - The location of any intermediary other than the ‘relevant’ one.
12. In contrast to the EU legislative framework (the SFD, WUD and Collateral Directive)³², the Hague Convention does not protect parties to the account agreement, nor any interested third parties, against any negative implications of applicable insolvency law on their respective rights as determined by the Convention law. Foreign insolvency law which is applicable to the insolvency of, say, the account holder or of its counterpart, as collateral provider, may still prevent the non-insolvent counterpart from directly enforcing its rights or from being preferred over other classes of creditors (ranking of claims). Such insolvency law could also eventually lead to the avoidance of previous securities transactions made to defraud general creditors or during a certain “suspect” period before insolvency (“voidable preferences”) (see Article 8.2). As a norm of private international law, the Hague Convention is confined to the level of determining the applicable substantive law in an international context without regulating either this substantive law³³ or the impact of applicable insolvency law. However, Article 8.1 of the Convention explicitly confirms the sole applicability of the “Convention law” (the law determined under

³² On this EU regime, see D. Devos, “Collateral Transactions in Payment and Securities Settlement Systems: The EU Framework”, *op. cit.*

³³ The harmonisation of substantive securities laws will be the subject matter of the UNIDROIT draft Convention, which was circulated in December 2004 to UNIDROIT Member States for negotiations in May 2005 and, at EU level, of the work of the newly established working party of the Commission in charge of the Legal Certainty Project (see the Communication of the European Commission on Clearing and Settlement of April 2004).

the rules of the Convention) to govern the proprietary aspects of book-entry securities for any event that occurred before the opening of that insolvency to the exclusion of any diverging solution, in terms of any conflict of law rule, which would derive from the applicable insolvency law.

13. The Convention also contains some provisions that aim at organising a transitory regime for pre-Convention account agreements or interests, or in case the law governing the account agreement changes. These rules may be summarised as follows:
 - For account agreements entered into before the entry into force of the Hague Convention (see Article 16), the Courts may treat either the pre-Convention account agreements that would have the effect through any express terms (agreed law to govern the account agreement) that a specific law governs *some* of the property aspects (“issues specified in Article 2.1”), or those pre-Convention agreements that refer instead to a jurisdiction in which “the account is maintained”, as validly governing *all proprietary aspects of the recorded book-entry securities under the Convention regime* (Article 4.1). In both of the above scenarios, this is provided that the relevant intermediary had at the time of the pre-Convention account agreement in question an office that qualified under Article 4.1, second sentence (see above).
 - In case of conflicts between pre and post-Convention interests in book-entry securities, it is the Convention law that will determine how the conflict must be settled (see Article 15; for more details, see the Explanatory Report, No 15-1).
 - In case the law governing the account agreement changes (or the proprietary aspects of it), according to the traditional solution, the new law will as a rule immediately govern the proprietary aspects of the account agreement, except for some events that remain governed by the old law (see Article 7) and on which parties were legitimately entitled to rely on (e.g. existence of an interest, priority between interests arisen, the perfection of a disposition, made before the new law; the protection of “pre-change” rights in case of attachment of securities; or of an insolvency event occurring after the change in law).

4 CONCLUSIONS

14. Until now, the variety of possible governing laws has led to considerable legal uncertainty at international level regarding the determination of the precise national law governing securities credited to an account with an intermediary in a cross-border context. This legal uncertainty generates in turn legal risks for both the securities industry and investors to the extent that the law governing book-entry securities determines the protection offered to the holder in case of insolvency of the intermediary, as well as the formalities to be complied with to create, perfect and enforce collateral arrangements on such securities.

At the EU level, some Directives have been enacted since 1998 (e.g. the SFD, WUD and Collateral Directive) which contain provisions in the field of private international law. However, these new rules, even though they have substantially increased the level of legal certainty at the EU level, remain limited to the EU and do not address the rest of the world, or all aspects of the securities holdings or even all market players. These shortcomings are precisely what the Hague Convention seeks to address. It is therefore not correct, in our view, to state that “the existing Community regime is sufficiently satisfactory and does not require an urgent or compelling signature of the Convention” (see paragraphs 15 and 20 of the ECB Opinion).

In view of the above, and in spite of the criticism that the Hague Convention may attract (as is generally the case with any new legislation, whether at national or at EU level), this paper strongly maintains that this Convention should be supported by the ESCB and adopted by the EU Member States as quickly as possible. Any major delay in the adoption process at the EU level would simply put into question the existence of the Convention itself by sending a message to the rest of the world that the EU is now doubting its previous engagement. This is also an issue of credibility, and would in turn discourage other countries from pursuing the adoption process any further, leaving EU intermediaries without any uniform global solution for the law applicable to EU securities holdings, and maintaining the existing legal uncertainties on this crucial issue concerning transactions with the rest of the world. In this respect, the author certainly cannot support the view (see the ECB Opinion, paragraph 15) that a conflict of law rule, such as the Hague Convention, cannot be adopted before substantive laws have been harmonised, as promoted on a worldwide basis by the UNIDROIT draft Convention, or at least at Community level through the proposals that will emerge from the work of the newly established Legal Certainty Group. Such harmonisation is indeed still uncertain and, in any event, a matter of considerable work for many years to come. In the meantime, there is an urgent need to achieve harmonisation on this very basic first step in order to achieve legal certainty and predictability for the securities business, which is the determination of the applicable law to book-entry securities. If this key issue is left uncertain, and if the parties to an account relationship can not even rely on the law they agreed upon (whatever its weaknesses or strengths), but are still exposed to the risk that another unexpected law might be applicable, then the *harmonisation* of substantive laws (which is not a synonym for full equivalence) is simply pointless.

As a collateral taker, the ESCB has a major interest in legal certainty with regard to securities holdings and related collateral transactions, even though the current features of its monetary policy transactions may be less demanding in that most that are conducted by individual central banks are still domestic asset-based. With respect to the ESCB cross-border use of collateral, another central bank is used by the home national central bank

(NCB) as an intermediary directly holding local securities under local law on behalf of the home central bank (the CCBM). The use by NCBs of eligible links between eligible SSSs for monetary policy purposes is limited (so far) to EU assets held with EU SSSs under the protection of the SFD and Collateral Directive.

However, for those central banks that use collateral schemes whereby they reflect (in their own books, under their own collateral technique, and governed by their own law) the corresponding interest in securities held on their behalf in the “issuer SSS” either by the local NCB acting as the CCB, or by their home “investor SSS” via links, the Hague Convention might further enhance legal protection by confirming the application of the law governing the account in the home NCB’s books.

Some SSSs in the EU may also have a less clear regime for the holding (through links) of foreign securities in their own books under their own law than for their domestic securities, in which case they are indeed indirectly holding book-entry securities in a similar way to a custodian. Here again, they may benefit from the legal certainty provided by the Hague Convention, whether or not they hold EU or non-EU foreign securities.

Finally, the ESCB, given that it is composed of central banks which oversee EU systems and are concerned by systemic risk implications in a global worldwide market economy, should also support any major initiative which may reduce legal risks for its own financial intermediaries at the EU as well as the international level when dealing with other non-EU intermediaries.

This is what the Hague Convention offers: a unique opportunity to adopt at international level a uniform global rule for the determination of the law governing book-entry securities accounts. This is in reality the first key step in achieving legal certainty for securities holdings, before any further harmonisation of substantive legislation.