



Securities Industry Association

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Dr. Christophe Bernasconi, LL.M.
First Secretary of the Permanent Bureau of
the Hague Conference on Private International Law
Scheveningseweg 6
2517 KT
The Hague, Netherlands

Re: Comments on Proposed Convention on Law Applicable to Dispositions
of Securities Held Through Indirect Holdings.

Dear Dr. Bernasconi:

The Operations Committee (“the Committee”) of the Securities Industry Association (“SIA”)¹, would like to comment briefly on the ongoing work of the Hague Conference on Private International Law (“Hague Conference”) to develop a multinational convention on law applicable to proprietary rights in indirectly-held securities (“the Convention”). Public trust and confidence in the capital markets, as well as market efficiency, are enhanced when national laws are harmonized to ensure legal certainty and predictability, so that parties’ expectations as to the applicable law

¹ The Securities Industry Association brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 80 million investors directly and indirectly through corporate, thrift, and pension plans, and generates more than \$300 billion of revenues yearly in the U.S. economy. U.S. securities firms employ more than 600,000 individuals. (More information about SIA is available on its home page: <http://www.sia.com>.)

governing their securities transactions are not frustrated. The Committee believes that the work on the Convention by the delegates to the Hague Conference will substantially advance these policy goals regarding transactions where securities are held as collateral.

The Committee is keenly interested in ensuring that laws are harmonized in a way that does not drive market participants to create unnecessary operational costs or inefficiencies. In the past, a wide range of uncertain or inconsistent choice-of-law doctrines among many nations has created substantial legal, compliance and operational costs while providing little certainty. The Convention should cut through this confusion by creating a single test (albeit, if necessary the test may consist of a cascade of subtests) that will identify the law that governs the rights of parties with an interest in securities that are held by an intermediary and used as collateral. By doing this, parties dealing with countries that follow the Convention should be able to know which law governs these rights, a very helpful development in the increasingly common situation where any two or more of the following, *inter alia*, may otherwise point in contradictory directions for determining which jurisdiction's choice of law rules apply: the domicile or place of incorporation of the pledgor, pledgee, issuer, intermediary, depository, transfer agent, or the parent of any of the preceding, or any choice-of-law provision in the pledge agreement.

The Committee also applauds the delegates to the Hague Conference for settling on the place of the relevant intermediary ("PRIMA") as the applicable test for determining the applicable law. We think that this is a practical and wise approach. By focusing on the laws of the nation or state of the relevant intermediary, the Convention promotes legal certainty and the reasonable expectations of the parties.

While the Convention seems likely to offer a much improved approach to choice of law issues for securities pledges than now exists, it is critical that the delegates strive to make the Convention as effective as possible in dispelling operational inefficiency or legal uncertainty. The Convention, in the event of its adoption by the jurisdictions governing most or all of the world's leading financial centers, is likely to govern this topic for many decades to come. It is important to strike exactly the right balance now. It may be many years before there will be opportunities to fine-tune the Convention, or to address unanticipated problems that may arise.

The most difficult task confronting the delegates is how to determine the "place" of the relevant intermediary, and we will confine the remainder of our comments to that issue. The considerable changes in approach to this issue reflected in various drafts of the Convention reflect the difficulties of formulating the optimal approach. Most variations of the PRIMA approach under consideration are a significant improvement over current legal uncertainty in this area. However, some variations reflect greater sensitivity than others to practical realities faced by intermediaries. We want to highlight

those realities, and urge the delegates to shape the final Convention to reflect them. We have three principal concerns:

First, the determination of the “place” of the intermediary should provide financial market participants with maximum *ex ante* certainty as to what rules apply. Any approach that invites courts to weigh a range of factors, rather than apply a black-line test, will result in unnecessary legal uncertainty, cost and delay. For example, lenders, intermediaries and customers will be forced to conduct expansive but inconclusive due diligence efforts to try to assess in advance of a transaction what conclusion a court would be likely to reach concerning the law to apply, and might feel compelled to perfect their securities interests in a number of jurisdictions to minimize their legal uncertainty.

Various drafts of the Convention have contained provisions that in some circumstances invite courts to engage in a weighing of factors.² We strongly urge the delegates to avoid such an approach, even under limited circumstances. The drafts have also contained some provisions emphasizing the “place of business,” “chief executive office” or location of “central administration” of the intermediary.³ While we are not as troubled by this approach as by a balancing of factors approach, we note that this approach may also prove less than ideal in the highly mobile, electronically based business conditions that are likely to obtain in coming decades.⁴

² See, e.g., proposed subsections 4(5) and 4(6) of the November 2001 draft, under which Option B provides a “fallback” test based on “the place of the office or branch of the relevant intermediary with which the securities account is most closely connected.” It then enumerates several factors that the adjudicator is not to consider in making this determination, implying that any factor not listed is fair game. This is even more troubling than an approach that enumerates multiple factors to consider, because it gives the parties no notice of the matters that will be relevant to the determination.

³ See, e.g, proposed subsection 4(5) of the November 2001 draft, under Option A.

⁴ The problem is well-illustrated by a recent case in the United States, *In re Nemko, Inc.*, 209 B.R. 590, 1997 Bankr. LEXIS 832 (Bankr. Ct. EDNY 1997). In that case, the determination as to whether a bank’s security interest had lapsed turned entirely on whether, under the choice-of-law provision of the Uniform Commercial Code that is universally applied within the United States, the debtor’s “chief executive office” was in New Jersey or New York. Applying a wide range of factors, the court concluded that, while the debtor’s chief executive office was in New Jersey at the time the bank perfected its security interest in New Jersey, that office had incrementally changed location, so that it was effectively relocated to New York by the time a competing security interest was perfected in New York by another creditor. Since the first debtor did not perfect its claim in New York, the court held that it lost priority for its claim. *Id.* at 599. This case, a litigator’s dream but a compliance or credit officer’s nightmare, could be a harbinger of declining utility for a “chief executive office” or similar test if the trend toward geographically fluid multinational electronic commerce continues. See also *Mellon Bank v. Metro Communications, Inc.*, 945 F.2d 635 (9th Cir. 1991); *In re Golf Course Builders Leasing, Inc.*, 768

Second, accounts are often maintained in a geographically dispersed fashion. The Convention should reflect this, rather than rely on the fiction that an account can be found in one specific location. In the 21st century, it seems reasonable to assume that a test based on divining the specific location where an account is “maintained” will prove less workable or realistic than it might have in the past. A test based on more determinate factors than where the account is maintained would be preferable. Ideally, such an approach would give effect to any governing law agreement between the intermediary and its client. Absent such an agreement among the intermediary and its client, the Convention could follow the approach offered in Working Group Document 13 at the January 2001 deliberations at The Hague, and supported by the delegations from Belgium, Canada, Latvia, Luxembourg, Spain and the United States. That proposal suggested a fall-back test based on where the relevant securities intermediary is legally formed or established. An approach such as this, which offers a clear *ex ante* answer not dependent on exhaustive due diligence or the uncertainties of litigation, is in our view the best way to address this issue.

Third, any approach that requires changes to current procedures will be unnecessarily costly and inefficient. Any requirement requiring specific actions by the relevant intermediary in order to be effective raises two problems:

(a). It is impractical for intermediaries to amend existing contracts. Contracts cannot be revised unilaterally, and the time, cost and pragmatic barriers to revising them may be more than the intermediary is willing or able to bear. For example, many major global banks have tens of thousands of such agreements with their customers and other counterparties. In addition to needing to arrange for counterparties to each agreement to execute an amendment, in some jurisdictions the bank might also have to obtain regulatory approval, or seek to have applicable laws or regulations revised or interpreted.

(b). There would also be hazards of failure to garner the benefits of the Convention for those who hold through intermediaries that fail to take the necessary steps, whether they be amendments to agreements or the supply of certifications.

We are hopeful that the delegates will seek to move away from any approach that requires changes to existing agreements between intermediaries and customers. The delegates should continue to strive to avoid requiring intermediaries to take such actions in order for pledges made through them to fall under the provisions of the Convention.

F.2d 1167 (10th Cir. 1985) (both cases applying the following two-part test to determine chief executive office: (1) Where does the debtor manage the main part of its business operations, and (2) where would creditors reasonably expect to search for credit information?).



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Thank you for providing the Committee with the opportunity to comment on the Hague Convention's excellent work on the proposed Convention. We hope that the comments offered above will help the delegates to develop an approach that will promote worldwide efficient and fair commercial practice regarding liens on securities. If we can be of further assistance, please do not hesitate to contact George R. Kramer or Mariya Rosberg of the SIA staff at gkramer@sia.com, 011-202-296-9410, or mrosberg@sia.com, 011-212-608-1500 respectively.

Sincerely,

C. Michael Viviano
Chairman, SIA Operations Committee

Cc: U.S. Delegates to the Hague Convention

Ms. Joyce Hansen, Deputy General Counsel and Senior Vice President, Federal Reserve Bank of New York

Mr. Harold S. Burman, Executive Director, Secretary of State's Advisory Committee on Private International Law

Mr. Allen S. Weiner, Legal Counselor, Embassy of the United States of America, The Hague

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