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## The Law of Intermediated Securities

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## Intermediated securities

### n What?

- § Fully dematerialized or immobilized securities
- § Held through intermediaries such as banks, brokers, CSDs
- § Transferred and charged by book entries... or other methods

### n Why today?

- § Law of intermediated securities at the crossroad of **financial stability** and **shareholder rights**





## Relevance to financial stability

- n Committee on Payment and Settlement Systems and IOSCO Technical Committee
  - § Recommendations for securities settlement systems (2001), soon to be replaced by --
  - § Principles for financial market infrastructures (2011, consultative report)
  
- n Credit risk
  
- n Liquidity risk
  
- n Settlement risk
  
- n Access and interoperability





## Relevance to financial stability (cont'd)

- n (Intermediated) securities are the **only collateral** used for –
  - § Monetary policy operations (repos)
  - § Inter-bank money market (repos)
  - § Settlement systems (central counterparty, securities lending)
  
- n Legal certainty is critical to these functions
  - § Rule of conflict
  - § Substantive rules





## Relevance to investor protection

- n Physical & non-physical custody creates intermediary risk
- n Right of use of intermediary to obtain financing?
- n Ring-fencing in intermediary's insolvency
- n Allocation of shortfalls





## Relevance to shareholder rights

- n Holding securities through intermediaries raises well-identified issues
  - § Who votes?
  - § How complicated is it for investor to vote their shares?
  
- n Some holding patterns legally disenfranchise shareholders (shares in street name, use of nominee) unless measures support the flow of information to beneficial shareholders and proxy voting





## Relevance to EU single market

- n Giovannini Reports (2001 & 2003) identifies 15 barriers to more efficient cross-border clearing and settlement of securities transactions, including 3 barriers relating to legal certainty:
  - § 13 – No EU framework for treatment of interests in securities
  - § 14 – National differences in treatment of bilateral netting
  - § 15 – Uneven application of national rules of conflict



## Global vs European harmonisation of law



Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary (2006)



UNIDROIT (Geneva)  
Convention on substantive rules regarding intermediated securities (2009)



Settlement finality directive (1999)

Financial collateral directive (2002)

MiFID (2004)

Securities law directive (tbd)  
(public consultation Nov 2011)

CSDs and certain aspects of securities settlement (tbd)  
(public consultation Jan 2011)





## Opposition or reluctance of some EU members against global harmonisation

Why?

n Confrontation of legal models and doctrines

§ See Paech, Cross-border issues of securities law..., May 2011 (EU Parliament)

§ But... all five core models nonetheless present within EU

n Different weights among policy choices

§ Integrity of issue (no excess securities) vs liquidity of markets

§ Extent of custodian's liability

§ ...

n Emphasis on specific legal and operational arrangements

§ "No credit without debit" vs netting

§ Control agreement vs earmarking

§ Direct voting vs proxy voting





## Opposition or reluctance of some EU members against global harmonisation

### Implicitly

- n Protection of commercial relationship between domestic issuers and domestic investment banks
- n Protection against perceived expansionism of US custody, clearing and settlement service providers
- n Appeal of a European club deal where some major Member States might prevail on issues where they could not prevail globally
- n Defence of lead positions by national legal experts



## Issues with rules of conflict



Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary (2006)



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## Issues with rules of conflict (cont'd)

- n Traditional look-through approach
  - § Lex chartae sitae
  - § Different laws govern transfer of a portfolio's various securities
  
- n PRIMA = Place of the Relevant Intermediary Approach
  - § Determines the applicable law in respect of the securities account through which the transfer is effected
  - § Focus on localisation of the account
  - § Underlies 3 EU directives





## Issues with rules of conflict (end)

- n PRIMA concept evolved during the Hague negotiations toward a (limited) choice among the laws of places where the relevant intermediary maintains securities accounts
  - J Ex ante certainty
  - J Choice may be limited by regulation
  - K Looks like a contractual approach
  - L Perceived loss of sovereignty over accounts maintained in a jurisdiction
  
- n Hague Convention signed by US, ratified by Switzerland and Mauritius, implemented in Switzerland since 1 Jan. 2019
  
- n SLD consultation document suggests PRIMA plus non-determinative statement of the applicable law by relevant intermediary
  - L No ex ante certainty





## Issues regarding substantive rules



Settlement finality directive (1999)

Financial collateral directive (2002)

MiFID (2004)

Securities law directive (tbd)  
(public consultation Nov 2011)

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UNIDROIT (Geneva)  
Convention on substantive  
rules regarding  
intermediated securities  
(2009)





## Intermediation: a semantic issue?



n Intermediary

n Account provider

n Intermediated securities

n Account-held securities

n Debit and credit

n Debiting and crediting

n Designating entry

n Earmarking

n ...

n ...



# Semantic issues

## Bundesgesetz über Bucheffekten (Bucheffektengesetz, BEG)

vom 3. Oktober 2008

Die Bundesversammlung der Schweiz  
gestützt auf die Artikel 98 Absatz 1  
nach Einsicht in die Botschaft des F  
beschliesst:

### 1. Kapitel: Zweck, Geltungsbereich

**Art. 1** Gegenstand und Zweck  
1 Dieses Gesetz regelt die Verwahrung  
Verwahrungsstellen und deren Übertragung.  
2 Es gewährleistet den Schutz der  
Es trägt bei zur Rechtssicherheit  
Abwicklung von Effektenengeschäften.

**Art. 2** Geltungsbereich  
1 Dieses Gesetz findet Anwendung  
einem Effektenkonto gutgeschrieben.  
2 Es lässt Vorschriften über  
unberührt.

## Loi fédérale sur les titres intermédiés<sup>\*</sup> (LTI)

du 3 octobre 2008

*L'Assemblée fédérale de la Confédération suisse,*  
vu les art. 98, al. 1, et 122, al. 1, de la Constitution<sup>1</sup>,  
vu le message du Conseil fédéral du 15 novembre 2006<sup>2</sup>,  
*arrête:*

### Chapitre 1 But, champ d'application et définitions

#### Art. 1 Objet et but

<sup>1</sup> La présente loi règle la conservation des papiers-valeurs et des droits-valeurs par les dépositaires ainsi que leur transfert.

<sup>2</sup> Elle garantit la protection des droits de propriété des investisseurs. Elle contribue à assurer la sécurité juridique dans les rapports internationaux, l'efficacité du règlement des opérations sur titres ainsi que la stabilité du système financier.

#### Art. 2 Champ d'application

<sup>1</sup> La présente loi s'applique aux titres intermédiés qu'un dépositaire a inscrits au crédit d'un compte de titres.

<sup>2</sup> Elle ne porte pas atteinte aux dispositions sur l'inscription d'actions nominatives au registre des actions.

#### Art. 3 Titres intermédiés





## Non-Convention law: too much deference to national laws?

- n Geneva Convention does not purport to unify the law of intermediated securities, must be supported by national, non-Convention law
  - § Functional approach
  - § Core harmonisation
  
- n Many choices open within the limits of the core policies promoted by the Convention
  - § On many listed issues and many more, Convention defers to non-Convention Law
  - § Some choices must be publicised by a declaration





## Geneva Convention and corporate law

### *Article 8* *Relationship with issuers*

2. This Convention does not determine whom the issuer is required to recognise as the shareholder, bondholder or other person entitled to receive and exercise the rights attached to the securities or to recognise for any other purpose.





## Geneva Convention and corporate law

### *Article 8*

#### *Relationship with issuers*

1. Subject to Article 29(2), this Convention does not affect any right of the account holder against the issuer of the securities.

### *Article 29*

#### *Position of issuers of securities*

2. In particular, the law of a Contracting State shall recognise the holding of such securities by a person acting in its own name on behalf of another person or other persons and shall permit such a person to exercise voting or other rights in different ways in relation to different parts of a holding of securities of the same description; but this Convention does not determine the conditions under which such a person is authorised to exercise such rights





## Geneva Convention and corporate law

### *Article 29*

#### *Position of issuers of securities*

1. The law of a Contracting State shall permit the holding through one or more intermediaries of securities that are permitted to be traded on an exchange or regulated market, and the effective exercise in accordance with Article 9 of the rights attached to such securities that are so held, but need not require that all such securities be issued on terms that permit them to be held through intermediaries.





## Concluding remarks

- n Legal certainty in respect of rights in securities held through intermediaries are important to financial stability
- n Claims that either convention would disrupt or distort the exercise of shareholder rights are unfounded
- n Such claims serve the purpose of maintaining national barriers across financial market infrastructures and upholding entrenched interests





## Should the future EU Securities Law Directive be compatible with the Geneva Securities Convention?

- n Diversity of legal systems and need for increased legal certainty are similar within and without EU
- n EU can achieve a higher degree of harmonisation than, without derogating from, both international instruments
- n Emerging markets show strong interest for the Geneva Securities Convention: diverging from it would send the wrong signal
- n Because of very significant cross-border securities holdings between EU and rest of the world, legal certainty should improve within and across EU border

