

The first member states of the Hague Conference on Private International Law are due to sign a new convention (the Hague Securities Convention) in the course of this year. The convention - whose official and full name is "The Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary" - aims at giving market participants holding securities via intermediaries a greater degree of legal certainty and predictability on a number of crucial issues in cross-border securities transactions.

The Hague Conference

The Hague Conference on Private International Law is an intergovernmental organisation set up in The Hague in 1893, with the purpose of ensuring the greatest possible transparency and clarity in cross-border private law issues. This takes the form of "conventions" which are drawn up in collaboration with representatives from the member states and which the members undertake to adhere to on a voluntary basis. The Hague Conference currently comprises 64 countries. There are conventions covering 35 different areas of law. It is important to know that the Hague conventions are not in themselves legally binding texts. They are more like guidelines providing clarity as to which particular law governs a complex, cross-border issue. In legal language: the Hague conventions deal with "conflict of laws" questions. More information about the Hague Conference can be found on www.hcch.nl

The Hague Securities Convention

Legal experts from 44 member states and from 20 industry associations were involved in drafting the Hague Securities Convention. It is a project answering a strong industry need, brought to the attention of the Hague Conference in 2000. The convention is the result of intense industry consultation. It contains important issues for any bank carrying out securities transactions abroad and using custodians in the home market of the securities in question for this purpose, in line with customary market practice. As a result these banks must be in a position to protect legal rights abroad both for themselves and their clients. Christophe Bernasconi explained the significance of the convention using an example:

A foreign based client holds a custody account with Swiss Bank in Switzerland. He takes out a loan with a different bank in Singapore. He pledges his internationally diversified securities portfolio held through Swiss Bank, as collateral for the loan. Swiss Bank, however, does not hold the borrower's securities in custody in its own vault, but through a chain of intermediaries in the countries of the respective issuers.

If the borrower became insolvent, the lender would be faced with the question of which law applies to the enforcement of its rights to the pledged securities against the claims of other creditors. The core questions for the lender are: "Do I have a good interest in the collateral? What law governs the perfection requirement? How can I, as the collateral taker, ensure that I have a good interest that is valid against anyone else, in particular against the third party creditors of my debtor?"

Without the Hague Securities Convention, two types of uncertainty arise. First, it needs to be determined which law applies. The parties concerned and the securities serving as collateral are governed by a variety of different laws which all need to be analysed in terms of their applicability. A time-consuming, extremely complex, costly and highly uncertain undertaking. Second, even if the first question is answered, it might be impractical, if not impossible, to enforce the applicable law under the actual circumstances of the case.

In a situation like this the Hague Securities Convention provides a very useful orientation guide. It determines unambiguously which law is applicable to a range of key issues, including:

- transfer of the collateral to the pledgee
- power of disposal over the collateral
- the enforceability of one's own claims against competing claims of other creditors
- the order in which creditors have rights to the collateral
- the duties of the intermediary actually holding the pledged securities in custody
- the correct procedure for realising the collateral
- rules regarding claims to dividends and other distributions which may become payable with respect to the securities during the period in which they are pledged.

The new convention deals not just with future contractual relationships but also with those existing before the convention comes into force - a highly important aspect of the convention for practitioners in this area.

Clear identification of the applicable law is an important step. However, this obviously does not provide any certainty that the problem will be solved as the lender might wish. Applicable law can be very different from the legislation in the lender's domicile and may have some unpleasant surprises in store. The international harmonisation of the varying provisions of private law is not a matter for the Hague Conference, but an initiative of *Unidroit*, based in Rome.

Outlook

The Hague Securities Convention is not in force yet. A detailed explanatory report is in its final drafting stage and will be published in the near future. It is expected that the formal signing process by the Hague member countries will begin in late 2004, with the European Union members signing collectively, followed by a number of other countries with mature financial markets. Signing is followed by the ratification process which is a parliamentary procedure in each individual country. The convention could finally become legal reality from early 2006.

The Group of Thirty, in its Recommendation 15, calls for the quick ratification of the Hague Securities Convention. Other private sector organisations having an interest in the subject matter, such as ISSA, are encouraged to consider the possibility of adopting a recommendation towards the signing and ratification of the convention.

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