

ISDA

International Swaps and Derivatives Association, Inc.
One New Change
London, EC4M 9QQ
Telephone: 44 (20) 7330 3550
Facsimile: 44 (20) 7330 3555
Email: isda@isda-eur.org
Website: www.isda.org

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Permanent Bureau
Hague Conference on Private International Law
Scheveningseweg 6
2517 KT The Hague
Netherlands

For the attention of: Christophe Bernasconi, First Secretary

Dear Sirs,

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

In anticipation of the meeting of the Drafting Committee in London on 21st and 22nd May, 2002, you have kindly invited us to comment on Preliminary Document No. 10 of April 2002 (the "**April Draft Convention**"), setting out a preliminary draft of a Convention on the law applicable to certain rights in respect of securities held with an intermediary. You have also invited us to comment on the following additional Preliminary Documents in connection with our review of the April Draft Convention (which we do, in each case, in the appropriate place below):

Preliminary Document No. 11 of April 2002 (Explanatory Note on Article 9)
Preliminary Document No. 12 of May 2002 (Transfers Involving Several Intermediaries)
Preliminary Document No. 13 of May 2002 (Proposal for a Redraft of Articles 4 and 4bis)

We are grateful for the opportunity to have been involved in the development of the proposed Convention, including participation as an observer at the experts' working group meeting in January 2001 and the Special Commission in January 2002. We are also grateful to have been invited to comment on prior preliminary drafts of the Convention, most recently the January 2002 preliminary draft, which we addressed in our letter of 13th March, 2002.

We continue strongly to endorse the work of the Hague Conference on these important issues for the financial markets, and in particular the proactive role played by the Permanent Bureau and the Drafting Committee in managing and driving forward the informal working process on the project. We are pleased

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that Commission I on General Affairs and Policy of the XIXth Session of the Hague Conference endorsed the continuation of the informal working process, which we believe has been commendably open, transparent, and productive. It is highly desirable that the text of the draft Convention be finalised as rapidly as possible with a view to its adoption at the Diplomatic Session tentatively scheduled for October 2002.

We would like to offer the following comments:

1. **Articles 4 and 4bis.** Subject to the comments below, we support the proposed redrafting of Articles 4 and 4bis suggested in Preliminary Document No. 13. Our comments on that redrafting are:
 - (1) We have not had time to consult sufficiently widely among ISDA's members on the wording in square brackets in the new Article 4(1), so we are not able to say that a consensus exists among our members for the deletion of those words. However, informal soundings among members of the ISDA Working Group on the proposed Hague Convention suggest support for the deletion of those words, essentially for the reasons set out in the Explanatory Notes to Preliminary Document No. 13.
 - (2) We propose that sub-clauses (b) and (c) of new Article 4(1) be replaced by the following:
 - "(b) the management or administration of securities accounts or securities held with the intermediary is performed at such office;
 - (c) services are provided to account holders by the intermediary at such office;"

Some members of our Working Group felt that sub-clause (b) of Article 4bis as set out in Appendix 1 to Preliminary Document No. 10 was more specific than it needed to be, and that the more general wording we have suggested above is clearer and simpler.

Informal soundings of members of the Working Group also support the inclusion of sub-paragraph (e), without the bracketed language (in keeping with the proposed deletion of the bracketed language from the introductory wording of Article 4(1)).

We note that in Preliminary Document No. 13, you have eliminated the bracketed language that appeared in Article 4(1) of the April Draft Convention, namely, "[at the time of the event giving rise to the relevant issue.]" In case that wording makes a reappearance at some later stage, we wish to note that, while we sympathise with the concern of some commentators that led to its inclusion in the April Draft Convention, we are not in favour of its retention. It is generally agreed that a court should not determine the law applicable to an issue specified in Article 2(1) at the time the court is considering the issue, but instead the court should make the relevant determination at the time it would according to its own domestic principles. It does not seem unreasonable to leave this issue to the court to decide, as it would normally do in any case where it is required to apply a choice of law rule.

On the other hand, the inclusion of the proposed words might, in some cases, lead to a result inconsistent with the result the court would otherwise reach applying its normal rules. There are broadly two concerns. One is that under a court's normal rules, the relevant time might be determined according to a local mandatory policy that requires the law to be determined as of a time falling before or after the relevant "event". For example, the local policy might require the

applicable law be determined as of the opening of an insolvency proceeding or the making of a liquidation order.

The other more compelling concern is that the word "event" in the proposed bracketed language is potentially ambiguous. The situation giving rise to the question referred to in Article 2(1) may be composed of a number of events. A single event may be composed of different stages, occurring at different times (a disposition, for example, being composed of one or more instructions and corresponding debits and credits at different stages in the chain from the transferor to its intermediary to the transferee's account with its own intermediary). For example, in a priority dispute falling within Article 2(1)(d) between two secured parties claiming an interest in the same collateral, the question arises whether the relevant event in the priority dispute is the creation (or attachment) of the second secured party's security interest or its subsequent perfection. A court in attempting to interpret the Convention might feel constrained to reach a result inconsistent with its normal rules for determination of the relevant time. This could lead to uncertainty, inconsistent with one of the primary objectives of the proposed Convention.

Accordingly, we would recommend that the proposed bracketed language not be included in Article 4(1), but that instead clear guidance be given in the official Explanatory Memorandum accompanying the proposed Convention that Article 4(1) is not intended (a) to displace a court's normal rules for determining the time at which the applicable law is to be determined or (b) to require that the court make that determination as of the time it is considering the issue.

We note that the old "black list" has been reorganised as part of the redrafting suggested in Preliminary Document No. 13. We have no additional items to add to Article 4(2), but would suggest the deletion of the bracketed language in sub-clause (b), which does not appear to be necessary.

2. **Article 8.** We understand that both paragraphs (1) and (2) are intended to be subject to paragraph (3). For consistency between paragraphs (1) and (2), we suggest the addition of the words "Subject to paragraph 3," at the beginning of paragraph (1).
3. **Article 9.** As in our letter of 13th March, 2002, we note that Article 9 continues to attract significant attention. The provision is clearly one that will affect all ISDA members, but it is not one on which ISDA members have a single formulated view. Accordingly, we have no specific comments on Article 9 in the April Draft Convention or on Preliminary Document No. 11. The overriding concern shared by all ISDA members is that the final rule should meet the objective of providing *ex ante* certainty, avoiding surprising results that would defeat the presumed intention of the parties. We are pleased to see that this attention is getting careful attention, and it appears as though the issues raised by Article 9 are on the way to being satisfactorily resolved.
4. **Article 17.** Regarding Article 17, there appears to be general support for the inclusion of Option A and the deletion of Option B. In the text of Option A, we suggest that the words "and/or perfected" be added after the words "disposition made".
5. **Article 17bis.** We support the inclusion of Article 17bis in the proposed Convention and believe that the version of this article in the April Draft Convention is an improvement over the version in the January 2002 preliminary draft.

We are concerned, however, that it still might not be broad enough to cover the situation under a pre-Convention agreement in which an account holder and an intermediary have not expressly agreed on the location of the securities account but where the location would have been considered reasonably clearly established by the circumstances. For example, we understand that when a German intermediary enters into a custody agreement with a German account holder, the agreement does not normally deal expressly with the question of the location of the account. It is simply taken for granted that the account will be located in Germany. There may be many other markets where, at least in a domestic context, it has not traditionally been considered necessary for the intermediary-account holder agreement to deal expressly with this issue.

It may be that the words "or implied" in paragraph (1)(b) are broad enough to cover this situation, however it would be helpful if the Explanatory Memorandum made this clear. If the word "implied" in this context is meant to be construed consistently with Article 4(3), that is, "implied from the terms of the contract", then it might not be broad enough to cover the situation described above. If so, the Drafting Committee may wish to consider the following alternative approach:

- (1) delete the words "or implied" from paragraph 1(b); and
- (2) add an additional paragraph (3) that reads as follows:

"If it is reasonably evident that, at the time when the agreement between the account holder and the relevant intermediary was made, it was the (explicit or implied) understanding of those parties that the account was to be maintained in a specific jurisdiction, this shall be treated for the purposes of Article 4(2) as an agreement that the securities account will be maintained within that State."

The Drafting Committee will recall that this wording was originally proposed by the Bundesverband deutscher Banken, in its comment letter on the January 2002 preliminary draft, although we do not know if the BdB supports the specific proposal above.

The drafting of paragraph (2) has also caused some confusion and could perhaps be improved or clarified in the Explanatory Memorandum. The concern centers on the words "under the law governing that agreement" and what they are intended to signify in this context. Some appear to read this to mean that the governing law of the Agreement should be treated *ipso facto* as the PRIMA law, which would, apparently, be consistent with the approach taken in the United States under §8-110(e)(1) of the Uniform Commercial Code.

Others read this to mean that one looks first to the law governing the agreement between account holder and intermediary and then, under the governing law's choice of law rules, one determines the substantive law applicable to any of the issues specified in Article 2(1). This would, of course, encompass the US example mentioned above, where the governing law is, under local law, also the PRIMA law.

While the latter broader approach might seem to be the more likely intention of paragraph 2, there appears, in that case, to be a possible conflict with Article 7, which requires that the term "law" be construed without reference to choice of law rules.

It may be that paragraph 2 could be clarified simply by deleting the words "under the law governing that agreement", which are implicit. This would also appear to have the advantage of avoiding or minimising the potential conflict with Article 7. Perhaps these issues could be clarified in the Explanatory Memorandum.

6. **Article 18.** Some ISDA members have requested guidance on the interpretation of the denunciation clause and its intended effect on priority as between dispositions occurring before and after a denunciation. It would be useful if this could also be dealt with in the Explanatory Memorandum. This issue affects the volume of on-going monitoring work that will have to be performed by a collateral taker in order to protect its legal position in relation to cross-border dispositions of collateral.

We welcome the guidance in Preliminary Document No. 12 on the issues raised by transfers involving intermediaries in different jurisdictions (the so-called "page 37" issue). We have not had time to consider in detail or to consult widely on Preliminary Document No. 12, and so, in particular, we cannot comment on the specific examples given to support the arguments set out in that Preliminary Document. But we support the pragmatic approach of the Preliminary Document. We agree that the suggested unitary solution (the so-called "Super-PRIMA" approach) is unworkable in practice, as we commented in our letter to the Permanent Bureau of 2nd October, 2001. It would be helpful if these issues are dealt with in the Explanatory Memorandum.

As before, you may count on our continuing support for this important project, which the financial markets would very much like to see completed during the course of this year.

Yours faithfully,

Richard Metcalfe
Director of European Policy
Co-Head of the European Office