ALERT MEMORANDUM

The Hague Securities Convention Goes Live April 1, 2017

March 29, 2017

Following its ratification by the United States late last year, the Hague Securities Convention (formally known as the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary) will become effective as a matter of U.S. federal law on April 1, 2017. The Convention sets forth choice-of-law rules for a number of issues related to securities held through intermediaries. As a self-executing treaty, the Convention preempts the choice-of-law rules found in Articles 8 and 9 of the Uniform Commercial Code (the "UCC") and federal book-entry regulations as to matters within its scope. However, subject to certain exceptions, the Convention's rules will typically lead to the same results as would flow from the application of existing law.

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The Hague Securities Convention is designed to apply to a broad range of commercial law issues in any transaction or dispute "involving a choice" between the laws of two or more nations. The explanatory report makes clear that any number of factors that would ordinarily be ignored in applying existing UCC choice-of-law rules – such as an issuer's jurisdiction of organization or where an underlying certificate may be located – can provide the necessary international component to trigger the Convention's applicability. As a result, market participants and practitioners should have the Convention rules in mind in planning or analyzing virtually every transaction involving intermediated (indirectly held) securities.

The scope of the Convention is aligned with, but in some aspects broader than, the issues to which the "securities intermediary's jurisdiction" under the UCC relates. Like the choice-of-law provisions of Articles 8 and 9 of the UCC, the Convention's rules apply to issues of perfection and priority and freedom from adverse claims as well as the duties of an intermediary to its account holder and third parties. The Convention also addresses which law determines the nature of an interest (ownership versus security interest) and the requirements that a secured party or other acquirer must follow in exercising remedies against intermediated securities. The definition of the term "securities" in the Convention also differs somewhat from that found in the UCC – most notably by the Convention's exclusion of cash and the absence of any "opt in" feature that would permit parties to a transaction to expand the scope of assets covered. However, both are designed to be flexible and have broad reach. In referring to "exchange traded financial futures and options", among other asset types, the explanatory report suggests that securities held with an intermediary for purposes of the Convention could encompass some assets that might not be considered securities or other financial assets under the UCC.

The Convention divides its choice-of-law rules into two components: the "primary rule" (found in Article 4) and the "fallback rules" (found in Article 5). Taken together these sets of rules follow quite closely the waterfall of rules laid out in UCC Section 8-110(e), with two salient differences:

(1) The Convention gives effect to the choices of law made by an account holder and its intermediary **only if** the intermediary has an office that engages in the business of maintaining securities accounts in the country whose law is chosen. Although not required under existing U.S. commercial law, this shift was seen as a necessary adjustment to better align with other legal regimes that could not accommodate complete party autonomy in the context of choice of law rules affecting third party rights.

(2) The precise wording of the Convention, unlike that in UCC Section 8-110(e), only gives effect to the parties' choice of law if that choice of law is made in the account agreement itself. Accordingly, a choice-of-law clause in a stand-alone control agreement may not be determinative, unless that clause amends or becomes part of the relevant account agreement.

The Convention will apply in the United States whether or not the law to which the Convention points is that of a country that has adopted the Convention. (Currently the only other countries to have adopted the Convention are Switzerland and Mauritius, although we understand discussions are taking place in several non-European countries, including Japan and Canada.) Further, the Convention requires the application of the substantive law of the selected jurisdiction, not that jurisdiction's choice of law rules. This is similar to the UCC's reference to the "local law" of the securities intermediary's jurisdiction. There is one exception that was designed to accommodate choice of law rules **internal to** a Multi-unit State (such as the United States) solely for purposes of determining the law applicable to perfection of security interests by filing or recording.

The foregoing description is intended as a high level summary only – there are many technicalities in the application of the Convention, including a special set of rules for application to pre-Convention account agreements and the way in which transition issues are handled generally. The full text of the Convention and

an extensive explanatory report can be found on the website of the Hague Conference on Private International Law.[1]

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[1] https://assets.hcch.net/docs/3afb8418-7eb7-4a0c-af85-c4f35995bb8a.pdf

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