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Hague Securities Convention: Changes to Perfection and Priority of Securities Collateral

The Convention on the Law Applicable to Certain Rights in Respect of Securities Held With an Intermediary went into effect in the United States on April 1, 2017. Also known as the Hague Securities Convention, the international treaty preempts the Uniform Commercial Code rules of perfection and priority of certain securities collateral in cross-border transactions. The Convention applies to all cross-border transactions governed by the law of a country that has adopted the Convention (like the United States), regardless of whether the parties involved in the transaction are party to the Convention. If a security interest is not perfected in accordance with the Convention, it could lose its priority to a subsequent security interest that was perfected accordingly. Thus far, only Mauritius, Switzerland and now the United States have adopted the Convention, but other countries are expected to sign on in the near future.

The Rules

The Convention provides rules for determining the applicable law for the perfection and priority of a security interest in securities held in a securities account with an intermediary. These rules are divided into the “primary rules” (Article 4) and the “fall-back rules” (Article 5).

Primary Rules

To determine the governing law, the Convention focuses on the account agreement between the securities intermediary and the account holder.

The law chosen in the account agreement or the law otherwise specified to govern the perfection and priority issues identified in Article 2(1) of the Convention will govern, provided that at the time the parties entered into the account agreement, the securities intermediary had an office that engages in the business of maintaining securities accounts in the chosen jurisdiction. This is known as the “Qualifying Office” test. For multiunit nations like the United States, the Qualifying Office test is satisfied if the securities intermediary maintains an office in any unit or state within the multiunit nation.

Fall-back Rules

If the criteria for applying the primary rule are not met, then the governing law is determined according to the fall-back rules, which provide that (i) the law of the jurisdiction of the office through which the securities account was created applies, provided that (a) such location is expressly and unambiguously stated in the account agreement and (b) the Qualifying Office test is otherwise satisfied; (ii) if clause (i) does not apply, then the law of the jurisdiction of the organization of the relevant intermediary (defined as the intermediary that maintains the account for the account holder) applies; and (iii) if clauses (i) and (ii) do not apply, then the law of the jurisdiction of the relevant intermediary’s principal place of business at the time the securities account agreement was entered into, or

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if there is no account agreement, when the securities account was opened, applies.

The Changes

Perfection by Control

Control is the preferred method for perfecting a security interest in a securities account. Under the UCC, the applicable law for perfection and priority by control is determined by the jurisdiction of the securities intermediary. Under the Convention, however, the jurisdiction of the securities intermediary is irrelevant and the applicable law is instead the law specified in the account agreement. An exception to this rule applies for account agreements entered into prior to the effective date of the Convention. Under the special transition rules of the Convention (Article 7), if an account agreement entered into prior to April 1, 2017, is governed by the law of one jurisdiction and the law of a different jurisdiction is selected as the securities intermediary's jurisdiction, the law of the jurisdiction chosen as the securities intermediary's jurisdiction will govern.

Perfection by Filing

When perfection occurs by filing and the law specified under the account agreement is the law of a jurisdiction in the United States, the rules for perfection by filing under the UCC and the rules under the Convention will generally produce the same outcome. The two laws differ, however, when the law of a United States jurisdiction is applicable under both the UCC and the Convention and the debtor is located in a jurisdiction outside the United States.

Under the UCC, if the foreign jurisdiction where the debtor is located has a public recordation system that satisfies the requirements of the UCC, filing in this foreign jurisdiction is required.

Under the Convention, however, filing would be required in the United States under the jurisdiction governing the account agreement, not the jurisdiction of the debtor. Under these circumstances, in an

abundance of caution, filing in both the foreign jurisdiction and the United States jurisdiction that governs the account agreement may be the best practice.

The Practical Application

Account agreements and control agreements should include language specifying the governing law for issues covered by Article 2(1) of the Convention. This includes any amendments to agreements entered into prior to April 1, 2017, as the Convention's governing law rules apply to priority between security interests arising before and after the Convention went into effect.

Examples of this language include:

- The [relevant entity maintaining the securities account][represents/confirms] that the agreement governing the [relevant securities account] is stated to be governed by the law of the [State of New York]. The [relevant entity maintaining the securities account] [represents/confirms] that it has, and at all times since the [relevant account agreement] was entered into has had, an office in the [United States which in the ordinary course of business maintains securities accounts for others.]
- The “securities intermediary’s jurisdiction” and the “bank’s jurisdiction” are the [State of New York], and the law applicable to all the issues in Article 2(1) of the Hague Securities Convention is the law in force in the [State of New York]. The parties agree that the foregoing sentence amends any applicable customer agreement that could comprise part of an account agreement governing the [relevant securities account]. The [relevant entity maintaining the securities account] [represents/confirms] that it has an office in the United States which in the ordinary course of business maintains securities accounts for others.

Lenders may want to start requesting copies of the underlying securities account agreements from debtors as part of the diligence review and adding

language referencing the Convention to their form security documents.

Additional Resources

This Finance Law Alert is intended only as a brief overview of the impact of the Convention on the choice of law governing the perfection and priority of securities held with a securities intermediary. For more information, please see the resources below or contact any of the finance attorneys at Loeb.

[Full text of the Convention](#)

[Detailed commentary](#)

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