# EU Consultation on Harmonisation of Securities Law

The European Commission has launched a month ago a Consultation on the Harmonisation of Securities Law.

The objective of the consultation is to obtain

> *advice from Member States, market participants and other stakeholders, in particular investors, on a certain number of principles, on which the Commission could base its future legislative proposals in order to improve the EU-wide legal framework for cross-border transfers of securities*

Contributions are welcome until January 1st, 2011.

The consultation raises an interesting issue of choice of law:

> ***14 – Determination of the applicable law***
>
> *14.1 Principle*
>
> *1. The national law should provide that any question with respect to any of the matters specified in paragraph 3 arising in relation to account-held securities should be governed by the national law of the country where the relevant securities account is maintained by the account provider. Where an account provider has branches located in jurisdictions different from the head offices' jurisdiction, the account is maintained by the branch which handles the relationship with the account holder in relation to the securities account, otherwise by the head office.*
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> *2. An account provider is responsible for communicating in writing to the account holder whether the head office or a branch and, if applicable, which branch, handles the relationship with the account holder. The communication itself does not alter the determination of the applicable law under paragraph 1. The communication should be standardised.*
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> *3. The matters referred to in paragraph 1 are:*

*(a) the legal nature of account-held securities;*

*(b) the legal nature and the requirements of an acquisition or disposition of account-held securities as well as its effects between the parties and against third parties;*

*(c) whether a disposition of account-held securities extends to entitlements to dividends or other distributions, or redemption, sale or other proceeds;*

*(d) the effectiveness of an acquisition or disposition and whether it can be invalidated, reversed or otherwise be undone;*

*(e) whether a person's interest in account-held securities extinguishes or has priority over another person's interest;*

*(f) the duties, if any, of an account provider to a person other than the account holder who asserts in competition with the account holder or another person an interest in account-held securities;*

*(f) the requirements, if any, for the realisation of an interest in account-held securities.*

*4. Paragraph 1 determines the applicable law regardless of the legal nature of the rights conferred upon the account holder upon crediting of account-held securities to his securities account.*

*14.2 Background*

*Many dispositions in securities involve a cross-border element. Therefore, more than one jurisdiction may be relevant to these dispositions. As already mentioned, not only the legal concepts applying to securities held through account providers vary considerably, but similarly the conflict-of-laws rules do not conform to each other. Three directives address the issue, amongst other questions, notably Article 9(1) of the Financial Collateral Directive, Article 9(2) of the Settlement Finality Directive, and Article 24 of the Winding-Up Directive.*

*The status quo raises three questions: First, the conflict-of-laws rules as contained in the three directives are based on slightly different criteria. The envisaged legislation should bring the three rules in line with each other so as to ensure consistency and predictability.*

*Second, these rules exclusively apply to the relatively limited scope of the directives, notably to those organisations covered by their personal scope. The envisaged legislation should apply to all account holders and account providers. Consequently, a uniform conflict-of-laws rule for all market participants would be useful.*

*Third, taking Article 9(1) of the Financial Collateral Directive, which is the most recent one, as a conceptual starting point, it becomes clear that that in some (admittedly rare) cases the interpretation of where securities accounts are "located" could diverge. That means, before settling on a uniform conflict-of-laws rule for the entire environment, the rule itself needed to be clarified as regards the so called "connecting factor.*

*The connecting factor of the conflict-of-laws rule should be based on the factual criterion similar to the criterion used in the three directives, i.e. where a securities account is 'maintained'. However, more guidance is needed for proper interpretation of this criterion, in particular as regards multi-branch entities. In this respect, regard has to be given to the reasonable perspective of the account holder, which expects that the national law of the country is applicable where the branch is located which handles the relationship with the account holder in relation to the securities account. In deciding which branch is servicing the client, the question of through which branch the account was opened, which branch handles the commercial relationship with the account holder, and which branch administers payments or corporate actions relating to the securities credited to the securities account, and similar aspects, will have to be taken into account, whereas the place of the location of supporting technology or of call or mailing centres should be disregarded. However, these additional guidelines as to which branch handles the relationship should not figure as cumulative elements of the connecting factor but rather as clarifying elements of interpretation figuring in the recitals of the instrument (cf. paragraph 1 of the envisaged Principle).*

*In addition to clarifying the connecting factor itself improvement of ex-ante legal certainty is necessary. As the connecting factor is fact-based and subject to legal interpretation, ultimately confined to the judge, it is basically a criterion delivering an ex post view. However, increased legal certainty requires active reliable ex ante knowledge of the applicable law. Paragraph 2 of the envisaged Principle cuts the Gordian knot by prescribing a practical*

*solution, allowing for a fact based connecting factor while at the same time increasing ex ante predictability: account provider should always be in a position to tell where an account is maintained, i.e. which branch handles the client relationship. This certainty should be transferred to the account holder by communicating the relevant location. The account provider should be responsible for the correct fulfilment of this duty and the competent authority should be in a position to intervene where the communication does not reflect the location where the account is actually serviced. However, there needs to be a clarification that the approach remains entirely fact based and that the communication must not be able to alter the underlying analysis of where the account is actually maintained. A judge will have to look at the facts, not at the communication, in order to determine the applicable law. In case the factual analysis and the communication differ, the factual analysis prevails and the account provider will be responsible for any incorrect communication in this regard (cf. Paragraph 2 of the envisaged Principle).*

*There is agreement that a conflict-of-laws rule should roughly cover what is dealt with in the substantive law part regarding holding and disposition of account-held securities. However, there are additional elements which need to be covered by the conflict of laws rule, notably those that are closely connected to the matter but are, in the substantive law part, left to autonomous national legislation. For instance, the characterisation of the legal nature of the rights arising from crediting securities accounts would need to be included. Furthermore, there are aspects addressed in the substantive part which should not be governed by the conflict-of-laws rule, for instance the loss sharing mechanism in case of insolvency. Consequently, a detailed list of issues setting out the scope of the conflict-of-laws rule needs to be included in a separate paragraph, (cf. paragraph 4 of the envisaged Principle).*

*There needs to be a clarification that all securities credited to a securities account are covered by the conflict-of-laws rule, regardless the legal nature that national law attributes to them. This aspect is particularly important where national law characterises certain account-held securities in a cross-border context as being of contractual or similar nature ( cf. paragraph 5 of the envisaged Principle).*

*There might be additional benefit in harmonising the way by which the location is communicated to the account holder, for example in a separate document, on*

*the account statement, or even as part of the account number. This rather technical issue would benefit from some degree of standardisation.*

*14.3 Questions*

*Q27: Would a Principle along the lines described above allow for a consistent conflictof-laws regime? If not: Which part of the proposal causes practical difficulties that could be addressed better?*

*Q28: Would the mechanism of communicating to the client, whether the head offices or a branch (and if a branch, which one) is handling the relationship with the client, add to exante clarity? Is it reasonable to hold the account provider responsible for the correctness of this information? If applicable, would any negative repercussions on your business model occur?*

*Q29: The Hague Securities Convention provides for a global harmonised instrument regarding the conflict-of-law rule of holding and disposition of securities, covering the same scope as the proposal outlined above and the three EU Directives. Most EU Member States and the EU itself have participated in the negotiations of this Convention. The proposed principle 14 differ from the Convention as regards the basic legal mechanism for the identification of the applicable law. However, the scope of principle 14 is the same than the scope of the Convention: property law, collateral, effectiveness, priority. Do you agree that this will facilitate the resolution of conflicts with third country jurisdictions ? If not, please explain why.*

*Many thanks to Bram van der Eem for the tip-off.*