

THE ASSOCIATION OF GLOBAL CUSTODIANS

The Bank of New York
Brown Brothers Harriman
The Chase Manhattan Bank
Citibank, N.A.
Deutsche Bank AG
Investors Bank & Trust Company
Mellon Trust/Boston Safe Deposit
& Trust Company
The Northern Trust Company
State Street Bank and Trust Company

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October 31, 2001

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

Attn: Christophe Bernasconi, First Secretary

Re: Proposed Convention on the Law Applicable to Proprietary Rights in Indirectly Held Securities

Ladies and Gentlemen:

I am writing on behalf of the Association of Global Custodians ("Association"), an informal group of nine U.S. banks that are major providers of global custody services to U.S. institutional investors. The members of the Association, which are listed above, would be directly affected, both in their capacity as custodians and in their capacity as holders of security interests, by the provisions of the proposed Convention on the Law Applicable to Proprietary Rights in Indirectly Held Securities. Accordingly, the Association has followed closely the Conference's drafting efforts, and several of the Association's members have participated in the deliberations of various groups that have commented on the Proposed Convention. Because of the importance of this effort to global custodian banks, the Association has decided to submit this comment.

Objectives of the Association's Proposed Article 5

We have focussed our attention solely on the text of Article 5 ("Determination of the place of the relevant intermediary"). While we recognize that other provisions raise

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important issues, Article 5 is the heart of the Proposed Convention. In the Association's view, Article 5 should accomplish five important objectives –

- The standards by which the place of the relevant intermediary is determined should provide as much certainty as possible. If the Convention does not provide certainty with respect to the law applicable to interests in accounts held by an intermediary, it will not have attained its goals.
- All parties should have an objective and easily accessible way of determining the place of the relevant intermediary with respect to a particular account so that they can ascertain and protect their rights under the appropriate law. The risk that a court will hold, after the fact, that a security interest in an account was not validly perfected because the secured party relied on the wrong set of laws should be very limited. To the greatest extent possible, the rights of the third parties that have acted in good faith should be protected.
- The intermediary and the account holder should have reasonable latitude, consistent with the norms of international law, to select the office or branch of the intermediary at which the account is deemed to be maintained. While we recognize that this proposition is controversial, we believe that an agreement between the parties, subject to appropriate limitations on the location they may select, is the most workable solution to the problem of creating certainty.
- The Convention should not require the re-negotiation of existing custody agreements. Therefore, the Convention should contain a mechanism for establishing the place of the relevant intermediary under existing agreements.
- As a corollary, the Convention should also provide a mechanism for addressing changes in the location of an account. Third parties who have perfected their rights based on the original location should be afforded a reasonable opportunity, after receiving notice of the change, to re-perfect in the new location or otherwise to protect their interests.

Summary of the Association's Proposed Article 5

To implement these objectives, the Association has drafted a version of Article 5 that combines aspects of Options B and C of the "Account Approach" set forth in the

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“Annotated July 2001 Draft” circulated by the Permanent Bureau. The Association's proposal consists of a three-tiered framework for determining the place of the relevant intermediary.

- Tier #1: Agreement - As under Option B of the Account Approach, a securities account would be deemed maintained at the place of the office or branch of the relevant intermediary as agreed between the account holder and the intermediary. Third parties could rely on a “Notice of Agreement” issued by the intermediary specifying the place where the account is maintained. The Notice of Agreement concept is intended to provide certainty concerning the place to which the intermediary and the account holder have agreed, without requiring that the custody contract itself be delivered to third parties or that third parties concern themselves with issues regarding the validity of that contract.
- Tier #2: Certificate – Absent an agreement, the intermediary could issue a “Certificate of Place” designating the place of the office or branch where the securities account is maintained. This aspect of the proposal mirrors Option C of the Account Approach. Such certificates could be issued in the case of contracts that contain no agreement regarding the place of the account. Certificates of Place could therefore be employed with respect to both existing and future contracts that are silent on the place of the relevant intermediary. As in the case of Notices of Agreement, a third party could rely on such a certificate in determining how to protect its rights.
- Tier #3: Fallback – In the event there is neither an agreement between the intermediary and the account holder concerning the place of the office or branch, nor a Certificate of Place issued by the intermediary, the parties (or a court) would look to a series of factors to determine the place where the account is maintained. Our proposal incorporates the factors in the July 2001 Draft. However, under our proposal, the need to apply these factors should be rare, since it should always be possible for the intermediary to issue a certificate.

We recognize that the certificate approach, described in Tier #2, has been previously discussed and that there may be sentiment to limit the ability of intermediaries to issue certificates to a fixed period of time (e.g., two years) following the effective date of the Convention. While we believe that it would be preferable to

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make the certificate option permanent, the most important function of intermediary certificates would be to avoid the need for amendments to existing contracts. We are open to debate and discussion as to whether this power should be permanent or time-limited.

Nexus Between the Intermediary and the Place of the Account

As noted above, the Association's proposal follows in form the "Account Approach" set forth in the July 2001 Draft. The Account Approach provides that "[t]he place of the relevant intermediary is the place where the securities account with that intermediary is maintained." A fundamental issue is, of course, the nature of the nexus required between the place specified in an agreement or certificate and the intermediary. Under the Association's proposal, any place could be agreed upon between the parties, or designated in a Certificate of Place, provided that two requirements were met –

- (1) the intermediary must have an office or branch (or other form of legal presence) in that place; and
- (2) the intermediary must be either
 - (a) authorized to do business by a local regulatory authority in such place, or
 - (b) supervised by a local regulatory authority in such place.

The intent of this provision is to require that the intermediary have sufficient legal nexus to, and presence in, the place selected so that the intermediary would be subject to the jurisdiction of the local courts in litigation to enforce the rights of persons claiming an interest in the account.

Commentary

Two versions of our proposal are attached. The text of Article 5 in both versions is identical. The version headed Association of Global Custodians Proposal (without commentary) contains only the text of proposed Article 5. The other version, which is

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headed Association of Global Custodians Proposal (with commentary), contains various explanatory comments.

The comments in the second version of our proposal are intended to serve two functions. Some comments describe how the proposal would function and are designed to aid the reader in understanding the text of our proposed Article 5. Other comments address issues that are not expressly covered in the text. These comments clarify additional substantive issues and explain how we would expect the courts to address interpretative issues. Consideration should be given to whether it would be desirable to codify some or all of the comments of this nature in the text of Article 5.

* * *

The Association supports the efforts of the Hague Conference to address the important and difficult issue of creating greater certainty concerning the law that governs cross-border financial collateral arrangements in the globalized securities markets. We would be pleased to work with the Permanent Bureau and other interested parties to address these issues. If you have any questions concerning these comments, or if there are specific issues concerning the activities and practices of global custodians that would be of interest, please contact the undersigned at 202/452-7013.

Sincerely,



Daniel L. Goelzer

Enclosures:

A -- Association of Global Custodians Proposal (with commentary)

B -- Association of Global Custodians Proposal (without commentary)

Doc. #7119514.1

Hague Conference

ASSOCIATION OF GLOBAL CUSTODIANS PROPOSAL (with commentary)

October 31, 2001

Article 5 Determination of the place of the relevant intermediary

- (1) The place of the relevant intermediary is the place where the securities account with that intermediary is maintained.
- (2)(a) For the purposes of this Convention, the securities account is maintained at the place of the office or branch (or other form of legal presence) of the relevant intermediary agreed in writing between the account holder and the intermediary, provided that it is a place where the intermediary is authorized to do business, or where the intermediary is supervised, by a local regulatory authority.

COMMENT #1: *The account holder and the intermediary can agree on the place where the account is maintained. The parenthetical reference to other forms of legal presence is intended to incorporate evolving concepts of where an intermediary is located as electronic commerce, including internet-based banking, become more common.*

COMMENT #2: *The limitations on the ability of the account holder and the intermediary to agree on the place are that the place selected must (i) be the place of an office or branch (or other form of legal presence) of the intermediary, and (ii) be a place where the intermediary is either authorized to do business by a local regulatory authority, or supervised by a local regulatory authority. The intent of this provision is to require that the intermediary have sufficient legal nexus to, and presence in, the place selected so that the intermediary would be subject to the jurisdiction of the local courts in litigation to enforce the rights of persons claiming an interest in the account.*

COMMENT #3: *We intend that, if a court holds that the agreement concerning the place of the account is invalid because the place selected does not meet the requirements of Article 5(2)(a), or for any other reason, the selection of that place is still valid (with respect to rights that arose prior to the court's decision) as between the account holder and the intermediary. However, if one of these parties*

* Consideration should be given to including the substance of all comments that are denoted by an asterisk in the text of Article 5. Comments that are not denoted by an asterisk are merely explanatory of the existing text.

*entered into the agreement regarding the selection of the place in bad faith, the place selection should be voidable at the option of the innocent party.**

- (b) If the intermediary and the account holder have agreed as to the place of the office or branch of the relevant intermediary as set forth in Article 5(2)(a), the intermediary may issue a notice ("Notice of Agreement" or "NOA") stating the place of such office or branch (or other form of legal presence). In determining the rights of any person who receives an NOA from the relevant intermediary and acts in reliance thereon, the account shall be deemed conclusively to be maintained at the place specified in the NOA.**

COMMENT: *The purpose of an NOA is to provide evidence upon which a third party can rely concerning the selection of an account location in the agreement between the intermediary and the account holder. By receiving an NOA, a third party avoids the need to review a copy of the agreement itself. An NOA is only conclusive as to the rights of a third party if that third party has received the NOA directly from the intermediary. That is, NOAs, or copies of NOAs, that are received from some other source (e.g., the account holder) do not have conclusive legal effect.*

- (c) (i) If an account holder and an intermediary agree as to the place of the office or branch (or other form of legal presence) at which the account is maintained, and the intermediary subsequently ceases to maintain an office or branch (or other form of legal presence) in such place, or the intermediary ceases to be authorized to do business, or to be supervised, by a local regulatory authority in such place, the account shall continue to be deemed to be maintained at the place specified in the agreement unless and until the account holder and the intermediary agree otherwise.**

COMMENT: *This provision preserves the effect of an agreement as to the place of the relevant office or branch that was valid when made, but subsequently becomes invalid. The parties should be afforded ample time to amend their agreement without jeopardizing rights based on the prior agreement.*

- (ii) A change in the agreement between the intermediary and the account holder as to the place of the office or branch (or other form of legal presence) at which the securities account is maintained shall have no effect on the rights of any person who has received an NOA from the**

intermediary pursuant to the prior agreement unless and until a reasonable period of time after such person has received actual notice of such change.

COMMENT #1: *This provision preserves the rights of third parties who have not received notice of a change in the agreement between the account holder and the intermediary with respect to the place of the relevant office or branch. A change in the place of the account is not effective as to such a person until it has received actual notice of the change and has had a reasonable period of time to perfect its rights in the account or to otherwise protect its interests in light of the change. Invalidity of the selection of a place in the agreement between the intermediary and the account holder (e.g., as a result of a judicial holding that the place selected is inconsistent with Article 5(2)(a), or of a change in circumstances, such as the intermediary's ceasing to maintain an office or branch or other form of legal presence in that place) will not effect the rights of a third party who has received an NOA from the intermediary, except to the extent that, as a result of such invalidity, the parties amend the agreement and give notice of such amendment to the third party.*

COMMENT #2: *We intend that, unless the successors expressly agree otherwise, an agreement between an account holder and an intermediary as to the place at which the account is maintained shall be binding as between a successor in interest to either the intermediary or the account holder, or both, to the same extent as between the original parties to the agreement.**

(3)(a) **If the relevant intermediary and the account holder have not agreed as to the place of the office or branch of the relevant intermediary as set forth in Article 5(2)(a), the intermediary may issue a certificate ("Certificate of Place" or "COP") designating the place of such office or branch (or other form of legal presence), provided that it is a place where the intermediary is authorized to do business, or where the intermediary is supervised, by a local regulatory authority.**

COMMENT #1: *This provision provides a mechanism by which an intermediary can address the situation in which its agreement with an account holder does not specify the place of the relevant office or branch. A COP could be issued in the case of a custody agreement entered into prior to the adoption of the Convention, in the case of a post-Convention agreement that is silent with respect to the place of the relevant office or branch, or in the case of an agreement that contains a place selection that is invalid under Article 5(2). In these situations, the intermediary could designate the place of the relevant office or branch (or other form of legal*

presence) by issuing a COP. The intermediary's ability to designate a place would be limited by the same nexus requirements as limit the ability of the intermediary and an account holder to agree on a place.

COMMENT #2: *We intend that, if the relevant intermediary has issued a COP as set forth in Article 5(3)(a), the place designated therein is conclusive as between the intermediary and the account holder, unless the COP is contrary to the place selected in an agreement between the intermediary and the account holder in accordance with Article 5(2)(a). We also intend that a COP is conclusive with respect to the rights of a person (other than the account holder) who receives the COP directly from the intermediary and acts in reliance thereon.**

COMMENT #3: *We intend that, unless the successors expressly agree otherwise, a COP shall continue to be effective as between a successor in interest to either the intermediary or the account holder, or both, to the same extent as between the original parties to the agreement.**

COMMENT #4: *We intend that, if a court holds that the place designated in the COP is invalid for any reason, the designation of that place is still valid as between the account holder and the intermediary, unless it can be shown that the intermediary acted in bad faith in designating such place or in issuing the COP. In that event, the place designation should be voidable at the option of the account holder.**

- (b) In determining the rights of any person who receives a COP (or a copy thereof) from the relevant intermediary and acts in reliance thereon, the account shall be deemed conclusively to be maintained at the place specified in the COP.**

COMMENT: *A COP is only conclusive as to the rights of a third party if that third party has received the COP (or a copy) directly from the intermediary. That is, COPs, or copies of COPs, that are received from some other source (e.g., the account holder) do not have conclusive legal effect.*

- (c) (i) If the relevant intermediary has issued a COP designating the place at which a securities account is maintained, and the intermediary subsequently ceases to maintain an office or branch (or other form of legal presence) in such place, or the intermediary ceases to be authorized to do business, or to be supervised, by a local regulatory authority in such place, the account shall continue to be deemed to be maintained at the place specified in the**

COP unless and until the intermediary rescinds the COP in writing.

COMMENT: *This provision preserves the effect of a COP that was valid when issued, but subsequently becomes invalid. The intermediary should be afforded ample time to issue a new COP without jeopardizing rights based on the prior designation.*

- (ii) **The rescission of a COP shall have no effect on the rights of any person who has received the COP (or a copy thereof) from the intermediary unless and until a reasonable period of time after such person has received actual notice of such rescission.**

COMMENT: *This provision preserves the rights of third parties who have not received notice of the rescission of a COP. We intend that third parties should be able to rely on a COP in determining or perfecting their rights without having to perform additional due diligence concerning the validity of the COP. The intermediary and the account holder should have the burden of informing third parties of the rescission of a COP. The rescission of a COP is not effective as to a third party until it has received actual notice of the change and has had a reasonable period to protect its interests in light of the rescission. Invalidity of the designation of a place in a COP (e.g., as a result of a judicial holding that the place designated is inconsistent with Article 5(3)(a), or of a change in circumstances, such as the intermediary's ceasing to maintain an office or branch in that place) will not effect the rights of a third party who has received the COP from the intermediary, except to the extent that, as a result of such invalidity, the intermediary rescinds the COP and gives notice of such rescission to the third party.*

(4)(a) If the place of the relevant intermediary cannot be determined under paragraphs (2) or (3) of this Article 5, the factors that may be considered in determining the place of the relevant intermediary include the following:

- (i) **the location of the office or branch (or other form of legal presence) where the relevant intermediary treats the securities account as being maintained for regulatory, accounting or internal or external reporting purposes;**
- (ii) **the location of any office or branch (or other form of legal presence) of the relevant intermediary with which the account holder deals;**

- (iii) **the terms of the custody agreement, account agreement or any other agreement relating to the securities account between the relevant intermediary and the account holder;**
 - (iv) **the terms of account statements or other reports prepared by the relevant intermediary that reflect the balance of the account holder's interest in the securities account; and**
 - (v) **the State whose law governs the agreement establishing the securities account.**
- (b) **In applying the provisions of this paragraph, no account shall be taken of the following factors:**
- (i) **the places where certificates representing or evidencing securities are located;**
 - (ii) **the places where any register of holders of securities maintained by or on behalf of the issuer of the securities is located;**
 - (iii) **the place where the issuer of the securities is organized or incorporated or has its statutory seat, central administration, principal place of business or its registered office;**
 - (iv) **the place where any intermediary other than the relevant intermediary is located; or**
 - (v) **the places where the technology supporting the bookkeeping or data processing for the securities account is located.**

COMMENT: *In the event that the intermediary and the account holder have not entered into an agreement with respect to the place of the relevant office or branch and the intermediary has not issued a COP, the place of the relevant office or branch would be determined by application of the factors in Article 5(4). We assume that the need to resort to these factors would arise only rarely.*

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ASSOCIATION OF GLOBAL CUSTODIANS PROPOSAL
(without commentary)

October 31, 2001

Article 5 Determination of the place of the relevant intermediary

- (1) The place of the relevant intermediary is the place where the securities account with that intermediary is maintained.**
- (2)(a) For the purposes of this Convention, the securities account is maintained at the place of the office or branch (or other form of legal presence) of the relevant intermediary agreed in writing between the account holder and the intermediary, provided that it is a place where the intermediary is authorized to do business, or where the intermediary is supervised, by a local regulatory authority.**
- (b) If the intermediary and the account holder have agreed as to the place of the office or branch of the relevant intermediary as set forth in Article 5(2)(a), the intermediary may issue a notice ("Notice of Agreement" or "NOA") stating the place of such office or branch (or other form of legal presence). In determining the rights of any person who receives an NOA from the relevant intermediary and acts in reliance thereon, the account shall be deemed conclusively to be maintained at the place specified in the NOA.**
- (c) (i) If an account holder and an intermediary agree as to the place of the office or branch (or other form of legal presence) at which the account is maintained, and the intermediary subsequently ceases to maintain an office or branch (or other form of legal presence) in such place, or the intermediary ceases to be authorized to do business, or to be supervised, by a local regulatory authority in such place, the account shall continue to be deemed to be maintained at the place specified in the agreement unless and until the account holder and the intermediary agree otherwise.**
- (ii) A change in the agreement between the intermediary and the account holder as to the place of the office or branch (or other form of legal presence) at which the securities account is maintained shall have no effect on the rights of any person who has received an NOA from the**

intermediary pursuant to the prior agreement unless and until a reasonable period of time after such person has received actual notice of such change.

- (3)(a) If the relevant intermediary and the account holder have not agreed as to the place of the office or branch of the relevant intermediary as set forth in Article 5(2)(a), the intermediary may issue a certificate ("Certificate of Place" or "COP") designating the place of such office or branch (or other form of legal presence), provided that it is a place where the intermediary is authorized to do business, or where the intermediary is supervised, by a local regulatory authority.**
- (b) In determining the rights of any person who receives a COP (or a copy thereof) from the relevant intermediary and acts in reliance thereon, the account shall be deemed conclusively to be maintained at the place specified in the COP.**
- (c) (i) If the relevant intermediary has issued a COP designating the place at which a securities account is maintained, and the intermediary subsequently ceases to maintain an office or branch (or other form of legal presence) in such place, or the intermediary ceases to be authorized to do business, or to be supervised, by a local regulatory authority in such place, the account shall continue to be deemed to be maintained at the place specified in the COP unless and until the intermediary rescinds the COP in writing.**
- (ii) The rescission of a COP shall have no effect on the rights of any person who has received the COP (or a copy thereof) from the intermediary unless and until a reasonable period of time after such person has received actual notice of such rescission.**
- (4)(a) If the place of the relevant intermediary cannot be determined under paragraphs (2) or (3) of this Article 5, the factors that may be considered in determining the place of the relevant intermediary include the following:**
- (i) the location of the office or branch (or other form of legal presence) where the relevant intermediary treats the**

- securities account as being maintained for regulatory, accounting or internal or external reporting purposes;**
- (ii) the location of any office or branch (or other form of legal presence) of the relevant intermediary with which the account holder deals;**
 - (iii) the terms of the custody agreement, account agreement or any other agreement relating to the securities account between the relevant intermediary and the account holder;**
 - (iv) the terms of account statements or other reports prepared by the relevant intermediary that reflect the balance of the account holder's interest in the securities account; and**
 - (v) the State whose law governs the agreement establishing the securities account.**
- (b) In applying the provisions of this paragraph, no account shall be taken of the following factors:**
- (i) the places where certificates representing or evidencing securities are located;**
 - (ii) the places where any register of holders of securities maintained by or on behalf of the issuer of the securities is located;**
 - (iii) the place where the issuer of the securities is organized or incorporated or has its statutory seat, central administration, principal place of business or its registered office;**
 - (iv) the place where any intermediary other than the relevant intermediary is located; or**
 - (v) the places where the technology supporting the bookkeeping or data processing for the securities account is located.**