

CONSULTATION DOCUMENT
on conflict of laws rules for third party effects of transactions in securities and claims
QUESTIONS AND RESPONSES

Introduction

The European Focus Committee of the Association of Global Custodians¹ (“AGC-EFC” or the “Committee”) welcomes the opportunity to respond to the above-captioned Consultation Document. Established in 1996, the Association of Global Custodians (the “Association”) is a group of 12 global financial institutions that each provides securities custody and asset-servicing functions primarily to institutional cross-border investors worldwide. As a non-partisan advocacy organization, the Association represents members’ common interests on regulatory and market structure. The member banks are competitors, and the Association does not involve itself in member commercial activities or take positions concerning how members should conduct their custody and related businesses.

We acknowledge the extensive regulatory focus on the securities custody industry since the 2008 financial crisis, including work undertaken by authorities on securities law reforms and related conflict of laws reform. The Association has engaged extensively with government and regulatory authorities throughout the world to support their work to better understand our industry and ensure the safe and efficient provision of securities custody services for the benefit of investors and the financial system as a whole. The Association continues to support these efforts and stands ready to provide assistance and information – within the boundaries of competition and antitrust constraints - as authorities require.

For the time being, we respond below to various issues that concern the Association and as to which the Committee believes a response is appropriate.

2. WHAT IS THE ISSUE AND HOW DO MARKETS DEAL WITH IT?

Question 1

Do you observe in practice that legal opinions on cross-border transactions in securities and claims contain an analysis of which law is applicable (conflict of laws)? Please elaborate on your reply if you have further information.

- Yes, always where relevant
- In general yes, but not in all relevant situations
- In rare cases yes, but often not

¹ The members of the Association of Global Custodians are: BNP Paribas; BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; Northern Trust; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company.

- No, in general legal opinions do not include an analysis of which law applies
- I don't know / I am not familiar with legal opinions

RESPONSE: No. In the experience of the AGC-EFC, the majority of legal opinions addressing cross-border securities transactions include an assumption that local law of a particular State will apply and leave the recipient to consider how to reconcile such opinion with the laws of other States that might be applicable, whether or not within the custody chain.

Nevertheless, there are circumstances in which a conflict of laws opinion is specifically requested. Assume that Customer, located in State A, maintains securities in an account at Bank, located in State B. Bank obtains a security right in the securities to secure obligations owed by Customer to Bank, and obtains priority for that security right by complying with the rules of State B.

However, Bank does not know if creditors of Customer will try to reach the securities by using judicial process in State A or whether an insolvency administrator in State A will recognize Bank's security right. Accordingly, Bank often will obtain a legal opinion from counsel in State A that the conflict of laws rules in State A would point to the laws of State B on priority. If the conflict of laws rule in Country A point to the law of State A or to some State other than State B, then Bank will need to consider obtaining priority for the security right under the laws of State A or the other applicable State.

The need for the legal opinion would be significantly reduced if it were transparent that States A and B had the same conflicts of law rule that pointed to the same applicable law. In that case, whether a dispute is heard in a forum in State A or in State B, the law applied by the forum would be the same.

Question 2

Do you think that default of a large participant in the financial market who holds assets in various Member States could possibly create difficult conflict of laws questions, putting in doubt who owns (or has entitlement to) which assets?

- Yes
- No
- I don't know

If no, please explain why.

If yes, please provide concrete examples or specify in which legal context this problem might arise, pointing also to relevant national provisions where possible.

If yes, please give an estimate of the magnitude of the issue (e.g. number or value of transactions that might be concerned).

If yes, please explain how market participants deal with such legal uncertainty.

RESPONSE: Yes. If a participant defaults, the same conflict of laws questions will arise. The insolvency administrator of the participant will need to determine what law applies to the ownership of and entitlements to the securities maintained by the participant and may

challenge ownership or entitlements if the insolvency administrator determines, based on the conflict of laws rules of the insolvency forum, that an owner or entitlement holder had not complied with the applicable law to obtain a proprietary right in the securities. The problem is compounded to the extent that securities are maintained in different States.

Many national laws have historically provided that proprietary rights in an asset are determined by the law of the State in which the asset is located - so called “lex rei sitae.” Even among States that apply that rule, the varying interpretations and lack of clarity under national laws of the locations of intangible assets consisting of intermediated securities create grounds for confusion as to the law applicable to determining proprietary rights.

Market participants try to manage the uncertainty through due diligence and, to account for uncertainty, pricing adjustments. Often external legal counsel is consulted, resulting in added expense to the transaction.

The Lehman insolvency showed challenges in identifying who owned which securities and where securities were located. Those challenges were related partly to conflict of laws questions, mainly positive conflicts (i.e. more than one jurisdiction claiming the securities were of their competence). They are also partly related to the layered holding chain and different approaches to securities holdings.

There also was major litigation in England on the conflict of laws issue.² In that case, there was a priority dispute between a purported owner of shares in a Delaware company held in an account at Depository Trust Company in New York and various borrowers and pledgees of the shares. One of the key issues in the case was whether the laws of New York or England should be applied to resolve the priority dispute. The court applied a typical choice of law rule that looked to the substantive law of the jurisdiction in which the shares were viewed to be located to resolve the dispute. Since the shares were viewed to be located in New York, New York substantive law was applied.

The collapse of Lehman Brothers in particular has shone a spotlight on cases where assets were locked up in the insolvency and, for a variety of reasons, could not be extricated for a long time; examples are given in the case study below. The examples demonstrate the difficulties that arise when conflict of laws rules do not apply the same applicable law or the applicable law is not harmonized. If the applicable law is harmonized among States, of course, the need for a conflict of laws rule would be significantly mitigated.

Example 1

Trapped assets

In another Lehman Brothers-related case,³ various claimants asserted that their assets were trapped in the administration of Lehman Bros. International (Europe) Ltd. (“LBIE UK”), and applied to the court for relief, claiming that the administrators were

² *Macmillan Inc. v Bishopsgate Investment Trust Plc (No. 3)*, [1996] 1 W.L.R. 387; [1996] 1 All E.R. 585.

³ *Four Private Investment Funds v Lomas and ors* [2008] All ER (D) 237.

delaying dealing with their case, which was causing them loss. The court ruled that the claimants had to wait until the administrators had determined who was entitled to what.

In the case of one investment fund's request for emergency relief⁴ - sought very soon after the commencement of the Lehman insolvency - the claimant investment fund asserted a "proprietary claim" against LBIE UK which acted as the investment fund's custodial agent holding U.S. Treasury Bills. To hold U.S. Treasury Bills in a UK custody account, a U.S. sub-custodian would be required in order to access the Federal Reserve System, acting as depository for the issuer, which is the U.S. government. The U.S. Treasury Bills needed to be returned to RAB so they could be liquidated to fund investors' redemption requests. The investment fund soon had to produce a net asset value for the fund, which was necessary to facilitate the redemption requests on the forthcoming valuation date. A lack of liquidity caused by the unavailability of the U.S. Treasury Bills would therefore harm investors.

In the emergency hearing before the Companies Court, the lawyer for RAB stated:

"If there is an issue as to its title, or we cannot recover these bills, then the Fund itself would go into suspense and that would have a knock on effect on others, including the first Applicants, who have invested in it, and ultimately would lead to a number of funds seizing up and a consequent liquidity [issue?] and damage in the market."

A lawyer for the LBIE UK Administrators stated:

". . . I should make quite clear that although it looks most likely that this is simply a security issue, we cannot be satisfied, my Lord, that at the end of the day they will end up with a proprietary claim."

The judge, Mr. Justice Morgan, observed, "The only thing that is causing the problem here is the accounting and the mechanics."

In its findings, the Court wrote:

". . . [O]n the information available it looks very likely as if the English company (in administration) is not the de facto custodian of the relevant assets. Those assets are in New York where the sub-custodian is an American company in liquidation. The American company has already been requested to return these assets to the English subsidiary in administration and that has not yet produced a return of the assets. So even if we all ran very fast, tried very hard, and the Claimant did get an order against the English company, it would have to be that the English company did what it could to get the assets from

⁴ JUDGMENT, IN THE HIGH COURT OF JUSTICE, COMPANIES COURT, Monday, 22nd September 2008, Before: MR. JUSTICE MORGAN, B E T W E E N : (1) RAB CAPITAL PLC, (2) RAB CAPITAL MARKET (MASTER) FUND (Applicants), and LEHMAN BROTHERS INTERNATIONAL (EUROPE) (Respondents)

the United States, and that might just repeat today's problem for a second time, but this time dealing with the company in the United States in liquidation and under a different legal code.”

It is worth noting that the Court's statements indicate that it would not have mattered had the sub-custodian been in a jurisdiction other than the U.S.: another EU jurisdiction would have led to the same conclusion by the judge (e.g., Germany).

Example 2

Security Interests

In providing securities settlement services, banks and other service providers can provide credit in relation to the trading activity of their clients. A bank or settlement agent may agree with the client to provide the necessary funds for settlement, and to receive a contractual or statutory security interest over the incoming purchased securities as a risk-mitigant. In this way, the bank or settlement agent can be protected with security over an asset of approximately equal value to the price which it has agreed to lend. This type of arrangement is referred to in this Report as a “**custody pledge**”.

As a vital component of the post-trade market, the Financial Collateral Directive ("FCD") sought in principle to give clear support to custody pledges and other protected financial collateral arrangements. Despite this, in cross-border settings, several shortcomings can be identified as set forth in our response to question 3.

3. BOOK-ENTRY SECURITIES (PRIMARYLY RELEVANT FOR THE SECURITIES INDUSTRY, ISSUERS AND INVESTORS)

Question 3

Are you aware of actual or theoretical situations where it is not clear how to apply EU conflict of laws rules, or their application leads to outcomes that are inconsistent?

- Yes
- No
- I don't know.
- If yes, which rules, what is their interpretation and in which Member State(s)? What is the impact of such ambiguity? How does the market deal with this ambiguity?
- If no, please explain how you interpret and apply the Place of the Relevant Intermediary Approach (PRIMA), in which types of transactions and in which Member State(s)?

RESPONSE: Yes. Please note this response is divided between (a) Member State approaches to resolving conflicts of laws and (b) EU legislation approaches.

a. Member State Approaches

Across the EU, Member States have developed their own legal mechanisms intended to ensure that an end investor within their jurisdiction is treated as having “in rem” ownership of securities, notwithstanding that a chain of intermediaries may separate the end investor from the issuer. These mechanisms work reasonably well within each Member State. Therefore, there is no serious problem regarding conflict of law rules *within* each Member State.

However, mechanisms within Member States differ from each other, and can come into conflict if a chain of intermediaries crosses borders.⁵ Indeed, cross-border investment ordinarily does involve the use of intermediaries, conflict of laws are therefore an inevitable by-product of the lack of legal harmony *across* Member States.

To illustrate: in a multi-layer custody chain, assume an account agreement between the end investor (“A”) and its bank (“B”) is governed by French law which confers a right in rem on A but the account agreement between B and another bank acting as custody bank in Ireland (“C”) is governed by Irish law which may consider the person registered in the issuer’s register to be the legal “owner” of the security (albeit not a “beneficial owner”, in keeping with Irish law). The person registered in the Irish issuer’s register is the Irish bank and therefore both French and Irish law identify an owner but they don’t point to the same person.

The uncertainty described and its potential impact above is not confined to securities issued in EU Member States. An investor located in a Member State may hold with its bank custodian in the same Member State a non-EU security, which typically requires B to extend the cross-border custody chain outside the EU to a non-EU sub-custodian.

As stated above, within Member States there is no issue since only that State’s law applies. However, as also noted above, as soon as an interest is deposited in a CSD in a jurisdiction other than that State, potential issues arise in respect of holding and dispositions to the extent that the national law of a foreign jurisdiction conflicts with that of that Member State.

b. European Legislation

Settlement Finality Directive (the “SFD”)

National implementation of the SFD has not been carried out consistently. In particular:

- a. The concepts of ‘relevant register, account or system’ has been transposed or interpreted in divergent ways.

⁵ The variety of concepts and the difficulties caused in a cross-border context are summarised in several papers, e.g. a paper by Thiebald Cremers, “Reflexion on intermediated securities” in the Geneva Securities Convention”, European Banking and Finance Law Journal, 1 (2010-1) pp. 93; another paper by Philipp Paech, *Market Needs as Paradigm: Breaking Up the Thinking on EU Securities Law*, SSRN ID 2150156, [LSE Legal Studies Working Paper No. 11/2012](#).

- b. The T2S advisory group has reported on inconsistent transposition of the SFD.⁶ The issue was originally identified as problematic in 2006 by EBA Clearing.⁷
- c. The various current explications of ‘settlement finality’ (SF1: irrevocability of instructions/transfer orders; SF2: irrevocability of matching; SF3: finality and irreversibility of settlement book-entries) are not reflected in the SFD, leading to different interpretations of what the SFD intends to achieve.
- d. The SFD does not demand a notification procedure for when a participant becomes insolvent.
- e. The SFD does not impose a common standard for the ‘moment of entry’ of a transfer order into the designated system, for the purposes of article 3(1).

The FCD

In respect of the above-mentioned FCD, various issues have arisen with differences in transposition and interpretation of the FCD between Member States. The most significant of these appear to be:

- a. Scope issues, with differences in relation to the parties eligible to participate in a protected financial collateral arrangement, the assets which may be treated as ‘financial collateral’, and the ‘relevant financial obligations’ which may be collateralised.⁸
- b. Absence of legal certainty as to the acquisition of collateral ownership rights (ie priority of interests and good faith acquisition). Member States are not currently obliged to have legal rules which recognise collateral acquired in another Member State by credit/debit of an account, earmarking, conclusion of a control arrangement or conclusion of an agreement in favour of the account provider.
- c. We understand that five Member States retain ‘perfection’ requirements, and a further 14 Member States have abolished ‘perfection’ requirements only in relation to purely domestic transactions (i.e., those requirements still apply where the collateral is non-local or the counterparty is non-local, and in two such Member States the requirements are regarded as a significant challenge.⁹

⁶ See T2S Advisory Group, ‘Conflict Of Laws Issues In T2s Markets - a fact finding exercise’, ECB (December 2015), pages 3 and 56

⁷ see http://ec.europa.eu/internal_market/financial-markets/docs/settlement/consultation-results/eba_en.pdf

⁸ As to the diverging implementation of the FCD across EU Member States see *Evaluation report on the Financial Collateral Arrangements Directive* (December 2006) COM(2006)833 final

http://ec.europa.eu/internal_market/financial-markets/docs/collateral/fcd_report_en.pdf

⁹ Data obtained from CS Analytics service, October 2016

- d. ‘Providing’ the collateral in relation to non-marketable collateral, where in some Member States it is not certain what steps need to be taken to ensure that the collateral-taker has ‘possession or control’ of collateral.¹⁰

A further concern relating to the implementation of the FCD relates to the ability of a collateral-taker to ‘use’ or ‘re-use’ for its own account any securities collateral which it has taken under a security interest. This right was contemplated in respect of financial collateral arrangements between qualifying parties in the FCD, but more recent legislation has in some respects constrained the ability of parties to enter into arrangements which involve rights of use. The following observations can be made:

- Uncertainty continues regarding the treatment of rehypothecated/re-used assets in case of bankruptcy of the collateral taker. The collateral provider has an unsecured claim, but in some jurisdictions where the collateral provider has a set-off right this is economically similar to a collateral arrangement without a right of use. However, this is not assured in all jurisdictions as set-off rights in insolvency are not comprehensively and uniformly adopted.
- Furthermore, the definitions of rights of re-use are not identical across EU legislation, which adds complexity to the problem.¹¹
- Uncertainty may exist as to the extent to which clients’ assets have been rehypothecated: there are differing consent requirements under different EU legal acts, and differing restrictions in relation to title transfer collateral arrangements (which are economically equivalent to the right of re-use).¹²

The following additional comments may be made with regard to the FCD.

- (i) Lack of clarity as to the “possession” or “control” test: Article 1(5) FCD states that the Directive applies to financial collateral, once “it has been provided”. However, FCD lacks rules on the “provision” of collateral. Recital 9 of the FCD merely provides that “the only perfection requirement which national law may impose in respect of financial collateral should be that the financial collateral is delivered, transferred, held, registered or otherwise designated so as to be *in the possession or under the control* [emphasis added] of the collateral taker [...]”. Therefore, the FCD seems to rely on a “possession” or “control” test for the perfection of financial collateral arrangements. However, it does not specify what is involved in taking ‘possession’ of financial collateral (is it sufficient for the collateral to be in the collateral-taker’s account at the CSD? Is it sufficient to be “earmarked” in the collateral provider’s account?) or “control” (is it sufficient that the collateral-taker has a legal right to refuse a request from the collateral-taker to withdraw collateral?). The CJEU ruling in the case *Private Equity Insurance*

¹⁰ Cf (United Kingdom) *Gray v G-T-P Group* [2010] All ER (D) 90; *Re Lehman Brothers* [2012] EWHC 2997 (Ch); also *Private Equity Insurance Group SIA v Swedbank AS* ECJ Case C-156/15, awaiting judgment

¹¹ FCD, art. 2(1)(m); UCITS V, art 22(7); SFTR, art 3(12)

¹² see MiFID II (Article 16(8)-(10)) and MiFID II delegated directive of 7.4.2016 (Articles 5 and 6)

*Group v Swedbank*¹³ does not provide sufficient clarity as regards the “possession” or “control” test under the FCD.

- (ii) Ambiguity in insolvency laws as to whether collateral provided after the opening of insolvency proceedings is covered by FCD protections: Article 8(2) FCD requires Member States to safeguard financial collateral that has been provided on the day of, but after the moment of the commencement of insolvency or reorganisation proceedings, and the same is enforceable and binding on third parties if the collateral taker proves that he was not aware, nor should have been aware, of the commencement of such proceedings¹⁴. However, it is not clear which steps and events are protected by Article 8(2) FCD: Is it sufficient that the collateral taker was unaware of the opening of insolvency proceedings at the time the collateral agreement is concluded (transaction)? Or must he be unaware of the opening of the proceedings at the moment of the delivery, transfer, holding, registering etc. of financial collateral so as to be in the “possession” or under the “control” of the collateral-taker?
- (iii) Legal uncertainty as to the applicable law to book entry security collateral: The conflict of laws rule of Article 9(1) FCD points to the law of the place of the “relevant account”. A fundamental problem is that an account itself, strictly speaking, has no location; their location is to be determined with reference to other factors. The connecting factor of Article 9(1) FCD would gain in being made clearer on two aspects: (1) It should be made clear that the word “relevant” refers to the layered approach, i.e. on each distinct level of the securities holding chain, the relevancy of the account needs to be tested. In other words: when there are 4 intermediaries (including the CSD) between the issuer and the investor, there are 4 relevant accounts, not 1 per holding chain. (2) The question of the identification of the relevant account can lead to different possible connecting factors. We suggest that, if the FCD is to continue its current approach of looking to the “location” of the securities account, the location be made more precise, for example by referring to the jurisdiction of the supervisory authority that is competent for supervising the custodian, or by referring to the place where the custodian offers its business.
- (iv) The FCD leaves open to question an important case, commonly encountered in post-trade collateral arrangements. That is the situation where a financial intermediary, such as a clearing member or a custodian providing settlement services, receives securities from its client into an account provided by the intermediary. In this simple case, how the FCD works when the intermediary

¹³ Judgment of 10 November 2016, *Private Equity Insurance Group v Swedbank*, C-156/15, ECLI:EU:C:2016:851, paragraph 38-44. In the UK, courts had to rule in two cases whether financial collateral in the sense of the Financial Collateral Regulations, which implemented the FCD in the UK, has been “provided” (*Gray and others v G-T-P Group Limited: Re F2G Realisations Limited (in liquidation)* [2010] EWCH 1772 (Ch) and *Lehman Brothers International (Europe) (In Administration)* [2012] EWHC 2997 (Ch)).

¹⁴ The CJEU reiterated the provision of Article 8(2) FCD in its Judgment of 10 November 2016, *Private Equity Insurance Group v Swedbank*, C-156/15, ECLI:EU:C:2016:851, paragraph 46.

wishes to take a security interest over the securities it holds is unclear. The FCD states that the relevant legal system is that of the 'relevant account', but the tests for determining which is the relevant account can lead to two answers: the accounts on the intermediary's books, or the account where the intermediary's entitlement to the securities is recorded (such as the CSD).¹⁵

- (v) The FCD does not unambiguously characterise the claim which a clearing member has against a CCP (or the claim which a client has against a clearing member) as 'financial collateral'. The result is that national law obstacles to the creation of security interests persist in relation to such claims, whereas for the purposes of client (or indirect client) protection in a clearing context it is frequently desirable to facilitate the transfer of such claims under a security interest.

The FCD protects close-out netting, but (like the SFD) cannot be said to provide a comprehensive 'netting law' consistent with the Unidroit Principles on Close-out Netting Provisions.¹⁶

Question 4

a) In your Member State, which financial instruments are considered to be covered by the EU conflict of laws rules? Please provide references to relevant statutory rules, case law and/or legal doctrine.

RESPONSE: All financial instruments that are credited to securities accounts. Although there is no definition of securities accounts in European Law, securities accounts are taken as a criterion of the scope of several texts, including the FCD, SFD, and the Geneva Securities Convention in addition to several member States' applicable laws and regulation. Given the possible differences among national laws in terms of defining the kinds of instruments that may be credited to securities accounts and under what circumstances they may be so credited, it is important to have uniform coverage in the conflicts rule. We would urge such a rule to be a flexible one so that it can accommodate changes in the market place. In theory, whatever financial obligation may be credited to a securities account should be included within the coverage of the rule.

b) In particular, are registered shares considered to be covered by the EU conflict of laws rules in your Member State?

- Yes
- No
- I don't know

¹⁵ Cf Member States' divergence on renvoi issues: see *Conflict Of Laws Issues In T2S Markets: A Fact Finding Exercise*, p. 6 ff. http://www.ecb.europa.eu/paym/t2s/progress/pdf/ag/mtg29/item_4_20151116.pdf

¹⁶ <http://www.unidroit.org/instruments/capital-markets/netting>

- If no, what could be the appropriate conflict of laws solution for those assets in your opinion?

RESPONSE: YES. But these rules are inadequate to across a multi-jurisdictional custody chain. Also, as noted above in response to Question 3.a, an EU intermediary may hold non-EU securities for its customers.

c) In particular, are exchange-traded derivatives considered to be covered by the EU conflict of laws rules in your Member State?

- Yes
- No
- I don't know
- If no, what could be the appropriate conflict of laws solution for those assets in your opinion?

RESPONSE: Such instruments generally are not considered “securities”. Rather, such instruments create “contract rights” between parties, giving rise to rights *in personam*, rather than rights *in rem*, and relegating each of the parties to being exposed to the insolvency risk of the other(s). In addition, derivatives are not usually credited to securities accounts.

However, some instruments can become “securities” where they become subject to an “option” and the test of a “security” is satisfied.

In the UK, “[t]he natural legal characterisation of . . . a custody relationship is as a trust, so that the rights of the client are equitable and not legal.” [Yates & Montague, *The Law of Global Custody*, 4th Ed., p. 21] Holding bearer (materialised) securities is traditionally considered “bailment”, which is characterised by physical possession of the certificate. In the case of intangible (book-entry) securities, the custodian’s role is as “trustee”. [Ibid., 30]

Question 5

In your Member State, how do statutory rules, case law and/or legal doctrine answer the question which is the relevant ‘record’ for conflict of laws purposes? Please provide references.

RESPONSE: The relevant “record” exists at each level of intermediary, which maintains an “account” on the basis of this “record”. For each intermediary, PRIMA is applied.

Question 6

a) Please describe how exactly you define and apply in practice the Place of the Relevant Intermediary Approach (PRIMA) in your Member State? If appropriate, please provide references to relevant case law and/or legal doctrine that corroborate your interpretation.

RESPONSE: We understand the concept of “relevant account” to refer to each account identified as such in the securities holding chain. For example, where a French investor holds a securities account with a French intermediary that in turn holds securities with subcustodians in Belgium, Italy, Germany, South-Africa and China since the investment securities were initially issued in those jurisdictions, trying to identify a single relevant account would lead to applying Belgian, Italian, German, South-African and Chinese law to acquisitions, dispositions and holding of securities in the securities account maintained in France.

This is also related to the scope of the conflicts of law rule. The scope cannot be “ownership rights” as those don’t exist in all jurisdictions. The “proprietary effects” concern all legal acts and deeds that have an impact on the property in securities. This could include (or not) relevant regulations, such as the obligation to reconcile positions, obligations to avoid inflation and deflation of securities or custody liens.

The “Super-PRIMA” concept would lead to disapplying French laws and regulations to an unknown extent and to apply the laws of five different other countries to holding, acquisition and disposition of securities in that account.

This is contrary to the French public policy. This is contrary also to the legal certainty and simplicity needed in business.

b) In your experience, do different substantive laws in one cross-border holding chain interact smoothly or do they create problems in practice? Please provide examples.

RESPONSE: Please refer to examples provided in response to Question 2 above. It should be noted that concerns that we have expressed ordinarily do not present problems in practice under ordinary circumstances. We believe concerns would most likely manifest themselves and confront market participants in times of stress or significant market disruption. The 2008 financial crisis provided an example of this.

Question 7

In your experience, what is the scale of difficulties encountered because of dispersal of conflict of laws rules in EU directives and national laws? Please provide examples.

RESPONSE: Potentially very significant for the reasons cited in the examples provided in our response to Question 2

The lack of a uniform conflict of laws rule globally for intermediated securities is a problem. It is often uneconomic or impractical for transacting parties to comply with the substantive laws of multiple States. Yet, compliance may be prudent because of the risk that a dispute in one forum would lead to the application, under the forum State’s conflict of law rules, of a substantive law different from the substantive law determined if a dispute were in a forum in another State after applying the other State’s conflict of laws rules. However, it is often difficult to identify all of the States in which a dispute is likely to occur, let alone to determine the conflict of laws rules

of a forum in each of the States and the resulting applicable substantive law that would be applied by the forum.

Question 8

Do you see added value in Union action to address issues identified in Section 3.1. of this public consultation?

- Yes
- No
- I don't know
- If no, what would be the appropriate action in your view?

RESPONSE: Yes, focusing on harmonising outcomes through revisions to the FCD, the SFD and, if possible, insolvency laws across member states.

We believe that a general conflict of laws rule for all dispositions and acquisitions of securities is needed.

It does not make sense to try to determine one single applicable law as between or among intermediaries in the custody chain – a so-called “Super-PRIMA rule” – for the reasons set out in our response to Question 12.

Question 9

Do you think that targeted amendments to the relevant EU legislation containing conflict of laws rules would solve the identified problems?

- Yes
- No
- I don't know
- If yes, do you have specific proposals as to which issues should be addressed and how? What would be the order of priority for addressing these issues?

RESPONSE: Yes, as noted in our response to Question 2 above.

Question 10

If there was a targeted solution clarifying which record is relevant for determining the applicable law, do you expect problems if within one Member State the legal relevance of record(s) for conflict of laws purposes does not coincide with the legal relevance of record(s) under substantive law?

- Yes
- No
- I don't know
- If yes, please explain your opinion and indicate the relevant national provisions that could generate problems.

- If no, please explain your opinion.

RESPONSE:

There could be problems. Unless the two rules coincide, there is a risk that a conflict of laws rule will require the application of the substantive law of a Member State to a record when that Member State's substantive law does not recognize the record. Such a result would create uncertainty as to the outcome of a dispute in the Member State.

However, our experience is that the question of what constitutes a relevant record is less important than the need for a uniform conflict of laws rule for proprietary issues when under national law a record reflects a credit to a securities account. We have not encountered any particular issues in practice over what constitutes a relevant record in this context.

Question 11

Do you think that an overarching reform of conflict of laws rules on third party effects of transactions in book-entry securities is needed to provide for legal certainty?

- Yes
- No
- I don't know

RESPONSE: Yes, we believe this would be helpful.

Question 12

If you prefer an overarching reform, what would be the appropriate connecting factor in your view?

- (1) the law of the Place of the Relevant Intermediary Approach (PRIMA);
- (2) the law governing the contract (please select among the following options)
 - (i) the applicable law is chosen by the parties to the account agreement provided that the intermediary has a 'qualifying office' in the country whose law has been chosen, and in the absence of such a choice, determined by objective rules based on the PRIMA connecting factor (the approach of the Hague Securities Convention);
 - (ii) the applicable law is chosen by the participants of the securities settlement system designated under the Settlement Finality Directive;
 - (iii) the applicable law is chosen by the parties to the transaction, and in the absence of such choice, determined by objective rules in accordance with the Rome I Regulation;
- (3) the law under which the security is constituted;
- (4) other solution(s) – please specify.

You can select more than one option in response to Question 12. When making your choice please also explain:

- a) the reasons for your preference,
- b) which classes of book-entry securities you think each selected option should cover,
- c) in which scenario the selected option should apply in your view.

RESPONSE: Please see our response to Question 8, including our rationale.

Sub-question to Question 12 answer (1)

a) Please select how should PRIMA be determined:

- (1) separately at each level of the holding chain, or
- (2) globally for the whole holding chain (Super-PRIMA). If you prefer Super-PRIMA, please specify which account should be solely relevant for conflict of laws purposes in your view.

RESPONSE: Please see our response to Question 8, including our rationale. We urge the EC to recognise that a conflict of laws rule that applies the same applicable law for all stages of a multi-tiered system transaction - the so-called “Super-PRIMA” rule - is not desirable. It would increase the costs of transactions, decrease the availability of credit and generally create random risks for transacting parties and even third party creditors. Consider the following transaction if the Super-PRIMA rule were based on the law applicable to the ultimate intermediary:

Bank located in State A maintains securities for Customer. The securities consist of those held by Bank through CSD 1, securities held by Bank through CSD 2, securities held by Bank through Subcustodian X which in turn holds the securities through CSD 3, and securities held by Bank through Subcustodian Y which in turn holds the securities through CSD 4.

Under a “Super-PRIMA” conflict of laws rule, the third party effects of Customer holding the securities through Bank would be determined by looking to the law applicable to each of Clearing Corporation 1, 2, 3 and 4. If the law applicable each of Clearing Corporation 1, 2, 3 and 4 were those of different States and Customer wished to grant a security right in the portfolio of securities to obtain credit, the priority of the security right would be determined under the law applicable to each Clearing Corporation for the securities held by the Clearing Corporation. Accordingly, the secured creditor, before extending credit, would need to investigate how the securities are held and ultimately will need to comply with four different sets of laws to obtain priority for the security right. These due diligence and execution burdens would significantly increase the costs of the transaction to Customer. In some cases, the transactions costs would be make the transaction prohibitively expensive and leave Customer without access to credit.

Even if the transaction costs were borne at the outset of the transaction, the costs would likely be ongoing or the costs of the credit would increase because of the risks involved. To protect

itself against Bank or a Subcustodian switching Clearing Corporations or holding new securities through a different Clearing Corporation that results in a change in applicable law, the secured creditor would need to monitor how the securities are held continuously or to enter into contractual arrangements with the Bank and the Subcustodians to restrict them, without the secured creditor's consent, from using a new Clearing Corporation for which a new law would be applicable for the priority of the security right. If, as could be expected, Bank and the Subcustodians were not willing to agree to the restrictions, the secured creditor would be taking the risk that a loss of priority of its security right may occur outside of the control of either Customer or the secured creditor if Bank or either Subcustodian used a new Clearing Corporation for which the applicable law were that of another State. These risks would then be factored into the cost of credit to Customer.

Similar issues would arise for other third party effects where the applicable law is determined by the happenstance of through which Clearing Corporation Customer's securities are held. For example, a third party creditor, such as a holder of a judgment against Customer, would be disadvantaged since the creditor would likely need to commence a lawsuit and conduct discovery on Bank and the Subcustodians merely to determine the law governing how the creditor may use judicial process to reach the securities to satisfy the creditor's claim.

Like concerns would arise if the Super-PRIMA rule were based on the law applicable to the issuer of the securities or to the investor. For example, in either case the intermediary and other transacting parties would need to look to the laws of multiple States for third party effects when securities were issued by issuers in different States or the intermediary were holding securities for investors from different States, thus driving up the diligence and compliance costs of transactions or making them prohibitively expensive.

The cost and availability of credit against the securities would also be affected. If the Super-PRIMA rule were based on the law applicable to the issuer of the securities, obtaining an extension of credit against a portfolio of securities issued by issuers in different States would require diligence and compliance with the law of each affected State for the lender to obtain priority for its security right. Even if the Super-PRIMA rule were based on the law applicable to the investor, a buyer of the securities on enforcement of a security right in the securities would need to determine the law applicable to the investor in order to know the extent of the buyer's proprietary rights when purchasing the securities at a foreclosure sale. If the investor were located in a State that had weak protections for foreclosure buyers, it would be difficult for the investor to obtain credit even though the securities were maintained for the investor in an account of an intermediary in another State. or the account agreement were governed by law of another State, where the law was more protective of the foreclosure buyer.

b) Please select how should the place of the relevant intermediary be determined:

- (1) the intermediary's registered office; or
- (2) the intermediary's central administration; or
- (3) the intermediary's branch through which the account agreement is handled:

(i) identified by an account number, code or other objective means of identification (Please specify which means should be used to identify the *branch*) or

(ii) as contractually stipulated in the account agreement; or

(4) other – please specify.

RESPONSE: Please see our response to Question 8, including our rationale.

Sub-question to Question 12 answer (2)(i)

a) If you support option (2)(i), do you think the best way is for the Union to become party to the Hague Securities Convention?

- Yes

- No

- I don't know

- If yes, do you have data that could help assessing the benefits of a global solution for the EU?

- If no, do you have data that could help assessing the drawbacks of the Hague Securities Convention for the EU?

RESPONSE: Not answered.

b) Do you consider the Hague Securities Convention should be supplemented by the adoption of a regulatory framework to address potential problems identified so far in discussions on its signature by the Union?

-Yes (please explain how)

-No (please explain why)

-I don't know.

RESPONSE: Not answered.

Question 13

For each of the options (1)-(4) in Question 12 above, as you defined these in your answers, please indicate the scale of advantages – disadvantages in terms of:

a) an estimated increase / decrease of the number or value of transactions which you are able to undertake in your business (please quantify if possible)

b) an estimated increase / decrease of your legal due diligence costs (please quantify if possible)

c) an estimated increase / decrease of the profitability of your business (please quantify if possible)

d) a change in your business model and the way in which you operate your business

e) any other advantages (please specify and provide relevant data if possible)

f) any other disadvantages (please specify and provide relevant data if possible)

RESPONSE: Not answered.

Question 14

In your view, on which of the following issues would options (1)-(4) in Question 12 above have any positive or negative impact:

- a) taxation (please specify and quantify if possible)
- b) transfer of risks between central depositaries, banks and depositors (please specify and quantify if possible)
- c) the effectiveness of clearing and settlement systems (please specify and quantify if possible)
- d) the identification of credit institutions' insolvency risks (please specify and quantify if possible)
- e) the exercise of voting rights attached to securities (please specify and quantify if possible)
- f) the remuneration of the ultimate owners of securities (please specify and quantify if possible)
- g) combating market abuse (please specify and quantify if possible)
- h) combating money laundering and terrorist financing (please specify and quantify if possible)

RESPONSE: Not answered.

Question 15

Which issues should be covered by the scope of the applicable law determined by such conflict of laws rules on third party effects of transactions in book-entry securities:

- the steps necessary to render rights in book-entry securities effective against third parties
- priority issues
- other (please specify)

RESPONSE: As noted above in our response to Question 11, we believe securities law reform – not necessarily “conflicts of law reform” – could be effective in clarifying across the EU the steps necessary to render rights in book-entry securities effective against third parties as well as addressing priority issues.

Question 16

Do you have other suggestions for conflict of laws rules for third party effects of transactions in book-entry securities or opinions on this topic that you have not expressed yet above?

RESPONSE: No.