

# 第二届中法金融论坛

## 2<sup>nd</sup> SINO-FRENCH FINANCIAL FORUM

### Civil Code Ownership vs. Securities Entitlement The Potential Impact of International Conventions (The Hague, UNIDROIT)

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***Two dates  
which changed significantly  
the global landscape of custody law...***

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## 1984, French Dematerialisation of all securities

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- Initial objective:
  - To ensure the **identification of the holders of existing bearer shares**
- Legal Effects:
  - « In rem » **Civil Code ownership on dematerialised securities**
  - Strengthening of the **direct legal relationship between issuers and investors,**

## 1984, French Dematerialisation of all securities

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- Operational Consequences:
  - The role of intermediaries is limited to the one of « facilitators » of this direct legal relationship
  - **Shareholders are easy to identify**
- **Main Beneficiaries of the Reform:**
  - The State (no more tax evasion)
  - Issuers (they are able to identify their shareholders)
  - Investors (their ownership rights are well protected)
  - Banks (they do not have to handle paper certificates anymore and benefit from the confidence of Issuers and Investors)

## 1994, US Reform of the Uniform Commercial Code Article 8

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- Initial objective:
  - To alleviate concerns of reclaim of securities for collateral takers (a post-1987 crisis concern that brokers may use securities of their customers without autorisation)
- Legal Effects; **Invention of the “securities entitlement”**, i.e:
  - **Suppression of the ownerships rights** of investors on securities
  - **Replacement with a personal right of each account holder on each account provider**, whatever this account holder beeing the final investor or not

## 1994, US Reform of the Uniform Commercial Code Article 8

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- Operational consequences:
  - **Reduction of the protection of the final investors** (intended to be addressed by the Congress with a guarantee fund, the SIPC)
  - Transformation of **intermediaries into Legal Shareholders**
  - **Systemic Over-Voting** in normal time
  - **Risk of disappearance of entitlement** in time of crisis
  - Opacity for Issuers, **unable to identify the final investors / « beneficial owners »**
  
- **Main (and only) beneficiaries:**
  - Banks and Brokers (collateral takers and Providers)

## **The US Model is Helped by Efficient US Government and US Industry Action**

**Post-1994: The US Department of State and the Federal Reserve launched several international negotiations with the aim to generalise the new US securities entitlement system, in close coordination with their banking industry**

**1987-1994**

**UCC article 8**

**Substantive  
Law  
and Conflict of  
Law Rule**

**1998-2002-...**

**The HAGUE  
Securities  
Convention**

**Conflict of Law  
Rule**

**2002-2009-...**

**UNIDROIT Draft  
Convention on  
Intermediated  
Securities**

**Substantiv. Law**

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## ***The Hague Securities Convention: a conflict of law rule which paradoxically would apply to most domestic situations***

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- **The Hague Convention determines the applicable law to securities accounts in all cases involving a choice between the laws of different states.**
  - Thus, The Hague Convention applies to all cross border holding chains.
- **The Hague Convention applies as well to most domestic situations.**
  - In the case of a security being held in a purely domestic holding chain (for instance a Chinese issuer's security held in China through a securities account maintained by a Chinese securities firm for a Chinese final investor)...
  - ...it is enough to have this Chinese securities firm maintaining other securities accounts in another country to fulfil the “internationality” criteria of the Convention, allowing to consider that there is a situation of conflict of law...
  - ...and therefore to trigger the application of The Hague Securities Convention.

## ***The Hague Convention Scope of Application is very Wide***

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- **The Hague Convention determines the law applicable to proprietary aspects of the holding, transfer and collateralisation of securities held with intermediaries.**
- In particular, the Convention determines the law applicable in respect with:
  - - the legal nature and effects of a credit of securities to an account held through an intermediary;
  - - the legal nature and effects of a disposition (i.e. any transfer of title) of securities held with an intermediary and the requirements for a perfection of a disposition;
  - - whether a person's interest in securities held with an intermediary extinguishes or has priority over another person's interest;
  - - the duties of an intermediary to a person other than the account holder who asserts in competition with the account holder; (...).

# The Hague Convention Enforces the Choice of Applicable Law for Securities

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## CHAPTER II –APPLICABLE LAW

### Article 4 Primary rule

- 1. The law applicable to all the issues specified in Article 2(1) is the law in force in the State expressly agreed in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law. The law designated in accordance with this provision applies only if the relevant intermediary has, at the time of the agreement, an office in that State**

## ***The Hague Convention Generates Many Major Difficulties. Among them:***

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- **The Convention reduces legal certainty for interested third parties (collateral takers).**
- **The Convention generates situations where each account, along the chain of holding of the same security, presents a different chosen law.**
- **The Convention might interfere with matters of tax law.**

## ***The Hague Convention has a competitive impact for securities services providers***

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- **The Convention might expand the use of non-EU non-Chinese law in financial transactions in Europe and China.**
  - This may affect in particular institutions offering local custody services to global custodians.
- **Being forced to agree on a foreign law will increase the need for legal advice and due diligence and probably increase capital requirements (due to the added legal and operational risk described supra).**
  - These risks and costs, which would be transferred to European and Chinese providers, are currently borne by global custodians, which in term of resources may be much better equipped to handle them.

## ***The Hague Convention will not be signed by the EU***

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- **The Hague Securities Convention is opposed by a majority of Member States of the European Union** (representing twice as many countries as the ones which support the Convention). **The Hague Convention is opposed by the European Parliament and by the European Central Bank,**
- **The Hague Convention is opposed as well by many market providers,** which consider that the Convention will actually bring much more legal uncertainty and operational risks, and therefore costs, than it could actually bring benefits.
  - This is especially true for European banking providers, which are satisfied by the current European regime, based on the location of the securities accounts principle, which works efficiently and brings full legal certainty to market operations.

## ***The UNIDROIT Draft Convention: a very Useful Tool but which presents potential side effects***

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**UNIDROIT**  
**Gouvernement Experts Sessions (2003-2007)**  
**First Diplomatic Conference (September 2008)**

**October 2008- May 2009:**  
**Drafting of the Official Commentary of the Draft Convention**

**September 2009:**  
**Final UNIDROIT Diplomatic Conference...**

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## ***The UNIDROIT Draft Convention: a very Useful Tool but which presents potential side effects***

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### **Functionnal Approach**

- ❖ Originally Intended to reproduce the UCC art 8 securities entitlement approach...
- ❖ ... but made neutral during the negotiations (the intermediary-account holder relationship has no legal characterisation in UNIDROIT)
- ❖ However, in case a State has to reform or complement its internal Law in order to make it « UNIDROIT compatible », the UCC article 8/securities entitlement « tool kit » is much easier to use ...

## ***The UNIDROIT Draft Convention: a very Useful Tool but which presents potential side effects***

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### **References to Non Conventional Law and Declarations by States**

- ❖ Many references to “non Conventional Law”, intended to be the “domestic” law of the State...
- ❖ ... however determined by the applicable Conflict of Law Rule (dangerous in case of signing of The Hague Convention).
- ❖ Protection by a system of “Declarations” of National Specificities by States ;
- ❖ ... **however the Declarations are made by the State of which the Law is applicable according to the Conflict of Law Rule (dangerous in case of signing of The Hague)**

## ***The Draft UNIDROIT Convention Imposes Intermediation on China***

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### **Article 29**

*(Position of issuers of securities)*

- 1. The law of a Contracting State shall permit the holding through one or more intermediaries of securities that are permitted to be traded on an exchange or regulated market (...)**

## ***The Draft UNIDROIT Convention Imposes Intermediation on China***

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- **Through the UNIDROIT Convention, China will import, in its securities law, an intermediated holding pattern for securities** (Art 29.1 of the draft UNIDROIT Convention).
  - Therefore Chinese and Foreign securities firms would be allowed to hold securities accounts for customers, while in the current regime only SD&C holds securities accounts (the accounts held by securities firms are only technical accounts, not representing any ownership on securities).

## ***The Draft UNIDROIT Convention Imposes Intermediation on China***

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### **Article 29**

*(Position of issuers of securities)*

- 2. In particular, the law of a Contracting State shall recognise the holding of such securities by a person acting in its own name on behalf of another person or other persons (...)**

## ***The Draft UNIDROIT Convention Imposes Intermediation on China***

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- **Additionally, China would have to recognise indirect holding** (distinction between legal and beneficial ownership), through the legal characterisation of the holding in own name on account of others, in its internal domestic law (Art 29.2 of the draft UNIDROIT Convention).
- Transforming Chinese Securities Law to allow intermediation will allow the Application in China of The Hague Securities Convention (if the latter Convention is signed )

## ***The Draft UNIDROIT Convention Imposes Intermediation on China***

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- Transforming Chinese Securities Law to allow intermediation will allow the Application in China of The Hague Securities Convention (if the latter Convention is signed )

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## ***The Verdict of the Market: French Model Holds Very Well***

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- **Three of the Top 12 Custodian Banks Worldwide are French...**
- **The French Securities Market itself is dynamic and innovative (Euronext activity, Derivatives, Asset Management).**

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## ***The Verdict of the Market: French Model Holds Very Well***

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- **The French Custody Legal Framework is in line with the importance of the French custody industry and Securities Market.**
  - This Legal Framework offers a perfect balance between the needs of the financial markets worldwide and investor protection.
- **The example of France shows that it is possible to successfully “modernise” the holding pattern of securities (i.e. introducing intermediation in securities holding) without abandoning the traditional civil law concept of direct ownership by the final investor.**

***Xiexie !***

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