

**MODEL PROVISIONS ON SECURED TRANSACTIONS
FOR INTERMEDIATED SECURITIES**

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INSOLVENCY INSTITUTE¹*

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INTRODUCTORY NOTE

The International Insolvency Institute (III) is pleased to submit the following Model Provisions on Secured Transactions for Intermediated Securities (Model Provisions) for consideration by States. The III is hopeful that these provisions will be useful to States wishing to include intermediated securities in existing or future legislation on security rights in movable assets.

Intermediated Securities: Geneva Securities Convention and Hague Securities Convention.

Intermediated Securities (IMS)—securities held with intermediaries and credited to securities accounts—are the staple assets in the financial markets as both investments and collateral. IMS are used as collateral in commercial finance transactions, in financial market transactions such as swaps and other derivatives, repos, and securities lending transactions, and in connection with vital post-trade clearing and settlement processes. IMS are addressed by the UNIDROIT (Geneva) Convention on Substantive Rules for Intermediated Securities³ (GSC) and the Hague Conference Convention on the Law Applicable to Certain Rights in Respect

¹ These Model Provisions have been prepared by Charles W. Mooney, Jr., with the benefit of extensive consultations. They are not intended to represent an official policy or position of the International Insolvency Institute (III). For more information, please contact Professor Mooney at cmooney@law.upenn.edu. For information on the III, see <https://www.iiiglobal.org>.

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³ The text of the GSC may be found at <http://www.unidroit.org/instruments/capital-markets/geneva-convention>.

of Securities held with an Intermediary (HSC).⁴ The GSC is not as yet in force, but the HSC entered into force on April 1, 2017, having been ratified by a third State, the United States, in December 2016.⁵ States would be well advised to consider adopting the GSC and the HSC. States adopting the GSC would not find it necessary to adopt the Model Provisions.

UNCITRAL Model Law on Secured Transactions.

By way of background, the United Nations Commission on International Trade Law (UNCITRAL) approved the Model Law on Secured Transactions (Model Law or ML) in July 2016.⁶ More recently UNCITRAL's Working Group VI completed work on a Guide to Enactment for the Model Law, which was approved by UNCITRAL in July 2017.⁷ Primarily in deference to the work of the International Institute for the Unification of Private Law (UNIDROIT) in the field of capital markets law (but also because of the complexity of the matter and because many States had enacted specific legislation), the UNCITRAL Legislative Guide on Secured Transactions and earlier drafts of the Model Law did not cover security rights in securities.⁸ At a somewhat late stage in the development of the Model Law its scope was expanded to cover non-intermediated securities (NIMS) (*i.e.*, securities that are not held with intermediaries and, consequently, not credited

⁴ The text of the HSC may be found at <https://assets.hcch.net/docs/3afb8418-7eb7-4a0c-af85-c4f35995bb8a.pdf>.

⁵ Status Table, Home Instruments Conventions, Protocols and Principles 36: Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary, *available at* <https://www.hcch.net/en/instruments/conventions/status-table/?cid=72>. Other States Parties to the HSC are Switzerland and Mauritius. *Id.*

⁶ The text of the Model Law may be found at http://www.uncitral.org/uncitral/en/uncitral_texts/security/2016Model_secured.html. For background, see the preparatory documents of UNCITRAL Working Group VI, available at http://www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html.

⁷ Report of the United Nations Commission on International Trade Law, Fiftieth Session (Vienna, 3-21 July 2017) at 37, *available at* <https://documents-dds-ny.un.org/doc/UNDOC/GEN/V17/058/89/PDF/V1705889.pdf?OpenElement>.

⁸ UNCITRAL LEGISLATIVE GUIDE ON SECURED TRANSACTIONS, U.N. Sales No. E.09.V.12 (2010), I.A.2.(e), at 40, *available at* http://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf.

to securities accounts).⁹ However, the Model Law in its final form excludes from its scope IMS.¹⁰

The Model Provisions fill this gap in the Model Law's coverage. They provide additional and replacement definitions and additional and revised articles that, when incorporated into the text of the Model Law, would expand its scope to include security rights in IMS. Moreover, the Model Provisions provide a useful guide for including IMS within the scope of secured transactions laws in States that have not adopted or do not choose to adopt the Model Law. However, the Model Provisions take the form of a supplement to the Model Law in recognition of the significance of the Model Law as an internationally recognized standard for the adoption of modern principles of secured transactions law.

Intermediated Securities Legislation.

Some States have enacted freestanding IMS statutory regimes that include the treatment of security rights.¹¹ Some other States have included security rights in IMS within their generally applicable laws on secured transactions.¹² In any case, it is reasonable to expect that States enacting the Model Law (or using it as template or checklist for reforming secured transactions laws) and which have not adopted the GSC would include security rights in IMS within the scope of their secured transactions legislation. The Model Provisions are designed to facilitate that inclusion.

The Model Provisions assume that the law of an enacting State has established a system for holding intermediated securities, could feasibly establish such a system, or at a minimum provides for or recognizes IMS as a category of personal property. A State's enactment of the Model Law with IMS included within its scope would facilitate secured financing with IMS as collateral. However, such an enactment would not alone provide a comprehensive legal regime for IMS. States that have not enacted such a comprehensive regime (and that have not adopted the GSC) would be well advised to consider adoption of the provisions of the GSC which are not embraced by the Model Provisions. In addition, States would be well advised to consider adoption of supplemental provisions concerning IMS, including adjustments to relevant insolvency laws. In this connection,

⁹ Report of Working Group VI (Security Interests) on the Work of its Twenty-Seventh Session (New York, 20-24 April 2015) at 3, *available at* <https://documents-dds-ny.un.org/doc/UNDOC/GEN/V15/029/20/PDF/V1502920.pdf?OpenElement>.

¹⁰ Model Law, art. 1(3)(c).

¹¹ *See, e.g.*, Japan's Book-Entry Transfer Act. The Act on Transfer of Bonds, Shares, etc., Act No. 75 of 2001, as amended in 2002 (Act 65 of 2002), 2004 (Act 88 of 2004), and 2014 (Act No. 91 of 2014).

¹² *See, e.g.*, New York's Uniform Commercial Code Article 9, N.Y. U.C.C. Law §§ 9-101 *et seq.* (McKinney). Under Ontario law security interests in securities are covered by its Personal Property Security Act as well as its Securities Transfer Act. Personal Property Security Act, R.S.O. 1990, c P 10; Securities Transfer Act, R.S.O. 2006, c. 8.

UNIDROIT has produced the UNIDROIT Legislative Guide on Intermediated Securities.¹³ States may wish to consider adoption of some of the definitions and other provisions included in the Model Provisions in a more comprehensive statutory regime for IMS.

Model Provisions: Scope and Approach.

The substance of the Model Provisions is based on two overarching principles. First, the provisions on IMS should in general be consistent with the other provisions of the Model Law. For example, Article 97*bis* of the Model Provisions, which addresses the law applicable to a security right in IMS, is based on Article 97 of the Model Law, which addresses the applicable law for security rights in funds credited to a bank account. Second, the provisions on IMS should be consistent with the relevant provisions of the GSC. Every effort has been made to achieve the same effects under the Model Law as supplemented by the Model Provisions that would result from the application of the corresponding provisions of that Convention. Of course, some modifications of the text of the GSC are necessary to accommodate the Model Law. Some of these modifications conform style and terminology to those of the Model Law. Some other adjustments in the GSC's text are necessary to take account of inherent differences between domestic statutory provisions and those of a multilateral international convention. For guidance on the Model Provisions that are drawn from the text of the GSC, reference should be made to the GSC Official Commentary. KANDA, *ET AL.* OFFICIAL COMMENTARY TO THE UNIDROIT CONVENTION ON SUBSTANTIVE RULES FOR INTERMEDIATED SECURITIES (2012) (GSC OFFICIAL COMMENTARY).

As with other provisions of the Model Law, an enacting State may adapt the provisions as appropriate to fit IMS into its own legal system (approaches that are inherent in the concept and approach of a “model law”). Note also that, as with NIMS, the Model Provisions address only security rights in IMS (but not outright transfers of IMS), with two exceptions. The first exception relates to the innocent acquisition by transferees, including outright transferees, of IMS resulting from a credit to a securities account. See Model Provision Article 51*bis*. An enacting State might wish to expand the coverage of the innocent acquisition protections beyond such transferees (as does GSC) in order to cover all conflicts between a security right in IMS and the rights of transferees (including all outright transferees) of the same IMS. See GSC Articles 17, 18. The enacting State might achieve this result by extending the scope of the third party effectiveness rules under Model Provision Article 27*bis* and the innocent acquisition rules under

¹³ **[UPDATE:]**The text of the Legislative Guide may be found at <http://www.unidroit.org/english/governments/councildocuments/2017session/cd-96-05-e.pdf>. It was approved by the UNIDROIT Governing Council at its meeting on May 10-12, 2017, <http://www.unidroit.org/english/governments/councildocuments/2017session/cd-96-misc02-e.pdf>.

Model Provision Article 51*bis* to buyers and transferees other than secured creditors. The second exception relates to the priority between security rights granted by an intermediary and the rights of account holders of the intermediary. See Model Provision Article 51*quater*.

Finally, the Model Provisions do not include provisions modelled on Chapter V of the GSC (Special Provisions in Relation to Collateral Transactions). The GSC affords Contracting States the opportunity to opt out of Chapter V, entirely or in part. An enacting State may wish to adopt the Chapter V provisions, in whole or in part, including GSC Article 34 on the use of IMS. See Model Law Article 55 (use of encumbered assets by secured creditor in possession).

**MODEL PROVISIONS ON SECURED TRANSACTIONS FOR
INTERMEDIATED SECURITIES (SUPPLEMENTING THE TEXT OF THE
UNCITRAL MODEL LAW ON SECURED TRANSACTIONS)**

Article 1. Scope of application

[Delete Article (1)(3)(c), which excludes intermediated securities from the scope of the UNCITRAL Model Law on Secured Transactions (ML).]

Article 2. Definitions

(a[^]) “Account agreement” means, in relation to a securities account, the agreement between the account holder and the relevant intermediary governing the securities account;

(a^{^^}) “Account holder” means a person in whose name an intermediary maintains a securities account, whether that person is acting for its own account or for others (including in the capacity of intermediary);

(*fbis*) “Control agreement” with respect to intermediated securities means an agreement in relation to intermediated securities between an account holder, the relevant intermediary and the secured creditor [or between an account holder and the relevant intermediary or between an account holder and the secured creditor of which the relevant intermediary receives notice],¹⁴ evidenced by a signed writing, which includes either or both¹⁵ of the following provisions:

(i) that the relevant intermediary is not permitted to comply with any instructions given by the account holder in relation to the intermediated securities to which the agreement relates without the consent of the secured creditor;

(ii) that the relevant intermediary is obliged to comply with any instructions given by the secured creditor in relation to the intermediated securities to which the agreement relates in such circumstances and as to such matters as may be provided by the agreement, without any further consent of the account holder;

(*jbis*) “Designating entry” means an entry in a securities account made in favour of a secured creditor (which may be the relevant intermediary) in relation to intermediated securities, which, under the account agreement, a control agreement, the uniform rules of a securities settlement system or any other rule of law, has either or both of the following effects:

¹⁴ The enacting State may choose to include or exclude the language in square brackets.

¹⁵ The enacting State may specify that only clause (i) or only clause (ii) applies.

(i) that the relevant intermediary is not permitted to comply with any instructions given by the account holder in relation to the intermediated securities as to which the entry is made without the consent of the secured creditor;

(ii) that the relevant intermediary is obliged to comply with any instructions given by the secured creditor in relation to the intermediated securities as to which the entry is made in such circumstances and as to such matters as may be provided by the account agreement, a control agreement or the uniform rules of a securities settlement system, without any further consent of the account holder;

(pbis) “Intermediary” means a person (including a central securities depository) who in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity;

(pter) “intermediated securities” means securities credited to a securities account or rights or interests in securities resulting from the credit of securities to a securities account;

(dd)¹⁶ “Receivable” means a right to payment of a monetary obligation, excluding a right to payment evidenced by a negotiable instrument, a right to payment of funds credited to a bank account, ~~and~~ a right to payment under a non-intermediated security and a right to payment arising out of intermediated securities or a securities account;

(eebis) “Relevant intermediary” means, in relation to a securities account, the intermediary that maintains that securities account for the account holder;

(hh)¹⁷ “Securities” as used with reference to non-intermediated securities means:

[(i)] an obligation of an issuer or any share or similar right of participation in an issuer or the enterprise of an issuer that:

a. Is one of a class or series, or by its terms is divisible into a class or series; [and]

b. Is of a type dealt in or traded on a recognized market, or is issued as a medium for investment;

[and

(ii) the enacting State to specify any additional rights that should qualify as securities even if they do not satisfy the requirements expressed in subparagraphs (i)(a) and (i)(b);]

(hhbis) “Securities” as used with reference to intermediated securities means any shares, bonds or other financial instruments or financial assets (other than funds) which are capable of being credited to a securities account and of being acquired and disposed of in accordance with the provisions of the applicable law;

(iibis) “Securities clearing system” means a system that:

¹⁶ This definition would replace the corresponding definition found in the ML.

¹⁷ This definition would replace the corresponding definition found in the ML.

(i) clears, but does not settle, securities transactions through a central counterparty or otherwise; and

(ii) is operated by a central bank or central banks or is subject to regulation, supervision or oversight, on the ground of the reduction of risk to the stability of the financial system, by a governmental or public authority in relation to its rules;

(iiter) “Securities settlement system” means a system that:

(i) settles, or clears and settles, securities transactions; and

(ii) is operated by a central bank or central banks or is subject to regulation, supervision or oversight, on the ground of the reduction of risk to the stability of the financial system, by a governmental or public authority in relation to its rules;

(mmbis) “Uniform rules” means, in relation to a securities settlement system or securities clearing system, rules of that system (including system rules constituted by the applicable governing law) which are common to the participants or to a class of participants and are publicly accessible.

* * * *

Article 27bis. Intermediated securities

1. A security right in intermediated securities is made effective against third parties by credit of securities to the secured creditor’s securities account.

2. In the case of a credit pursuant to paragraph 1, no further step is necessary, or may be required by any other rule of law, including any law applicable in an insolvency proceeding, to render the security right effective against third parties.

3. A security right in intermediated securities may also be made effective against third parties by:¹⁸

(a) the creation of a security right in favour of the relevant intermediary;

(b) the conclusion of a control agreement; [or]

(c) a designating entry in favour of the secured creditor[; or

(d) a notice with respect to the security right that is registered in the Registry].¹⁹

4. A security right in intermediated securities may be rendered effective as against third parties under this Article:

¹⁸ An enacting State may elect to omit either or both of the steps specified in subparagraphs 3(b) and 3(c).

¹⁹ Subparagraph (d) would be redundant under the Model Law by virtue of Article 18(1). However, if the provisions on intermediated securities are the subject of a separate enactment then an explicit reference to effectiveness by registration would be necessary.

(a) in relation to a securities account (and such a security right extends to all intermediated securities from time to time standing to the credit of the securities account); and

(b) in relation to a specified category, quantity, proportion or value of the intermediated securities from time to time standing to the credit of a securities account.

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Article 51bis. Intermediated securities: acquisition by innocent person

1. In this Article and Article 51*quater*:

(a) “acquirer” means:

(i) an account holder to whose securities account securities are credited; or
(ii) a secured creditor²⁰ whose security right in intermediated securities or in relation to a securities account has been made effective as against third parties;

(b)²¹ in determining whether a person ought to know of an interest or fact:

(i) the determination must take into account the characteristics and requirements of securities markets, including the intermediated holding system; and
(ii) the person is under no general duty of inquiry or investigation;

(c) an organisation actually knows or ought to know of an interest or fact from the time when the interest or fact is or ought reasonably to have been brought to the attention of the individual responsible for the matter to which the interest or fact is relevant;

(d) “defective entry” means a credit of securities or designating entry that is invalid or liable to be reversed, including a conditional credit or designating entry that becomes invalid or liable to be reversed by reason of the operation or non-fulfilment of the condition;

(e) “relevant time” means the time that a credit is made or the time referred to in Article 51*ter*(3).

2. Unless an acquirer actually knows or ought to know, at the relevant time, that another person has an interest in securities or intermediated securities and that the credit to the securities account of the acquirer or the security right made effective against third

²⁰ The enacting State may wish to expand the applicability of this provision to include *all* transferees as is provided by the GSC. See GSC Articles 12, 17, 18.

²¹ In adopting and applying paragraph (b), the enacting State should take into account the explanation provided in the GSC Official Commentary. GSC OFFICIAL COMMENTARY ¶¶ 17-8 to 17-14.

parties in favour of the acquirer violates the rights of that other person in relation to its interest:

- (a) the right or interest of the acquirer is not subject to the interest of that other person;
- (b) the acquirer is not liable to that other person; and
- (c) the credit or security right made effective is not rendered invalid, ineffective against third parties or liable to be reversed on the ground that the credit or security right violates the rights of that other person.

3. Unless an acquirer actually knows or ought to know, at the relevant time, of an earlier defective entry:

- (a) the credit or security right made effective against third parties in favour of the acquirer is not rendered invalid, ineffective against third parties or liable to be reversed as a result of that defective entry; and
- (b) the acquirer is not liable to anyone who would benefit from the invalidity or reversal of that defective entry.

4. Paragraphs 2 and 3 do not apply to an acquisition of intermediated securities, other than the creation of a security right, made by way of gift or otherwise gratuitously.

5. To the extent permitted by any rule of law other than this Law, paragraph 3 is subject to any provision of the uniform rules of a securities settlement system or of the account agreement.

6. This Article does not modify the priorities determined by Article 51*ter* or Article 51*quater*.

Article 51*ter*. Intermediated securities: priority among competing security rights

1. This Article determines priority between security rights in the same intermediated securities which have been made effective against third parties, between such security rights and interests of an intermediary, and between such security rights and non-consensual interests.

2. Security rights made effective against third parties under Article 27*bis*(b), (c), or (d) have priority over a security right that is made effective against third parties by registration of a notice in the Registry.

3. Security rights made effective against third parties under Article 27*bis*(b), (c), or (d) rank among themselves according to the time of occurrence of the following events:

- (a) if the relevant intermediary is itself the secured creditor in whose favour a security right has been made effective and the security right is effective against third parties under Article 27*bis*(3)(d), when the agreement granting the interest is entered into;

(b) when a designating entry is made;²²

(c) when a control agreement is entered into [or, if the relevant intermediary is not a party to the control agreement, when the relevant intermediary receives notice of it].²³

4. If an intermediary has a security right that has become effective against third parties under this Law or any other rule of law and makes a designating entry or enters into a control agreement with the consequence that a security right of another person becomes effective against third parties, the security right of that other person has priority over the interest of the intermediary unless that other person and the intermediary expressly agree otherwise.

5. Subject to Article 37, a non-consensual interest in intermediated securities arising under the law of this State has such priority as is afforded to it by that law.

[6. As between persons entitled to any security rights or interests referred to in paragraphs 2, 3 and 4 and, to the extent permitted by the relevant law, paragraph 5, the priorities provided by this Article may be varied by agreement between those persons, but any such agreement does not affect third parties.]²⁴

Article 51^{quater}. Intermediated securities: priority of interests granted by an intermediary

A security right in intermediated securities granted by an intermediary which has become effective against third parties has priority over the rights of account holders of that intermediary unless, at the relevant time, the secured creditor in whose favour the security right has become effective actually knows or ought to know that the security right granted violates the rights of one or more account holders.²⁵

²² An enacting State may elect to include a provision to the effect that, subject to paragraph 3, a security right that has become effective against third parties by a designating entry pursuant to Article 27^{bis}(3)(c) has priority over any security right made effective pursuant to any other method provided by Article 27^{bis}(3).

²³ The language in square brackets should be included if the enacting State chooses to include the language in square brackets in the definition of “control agreement.”

²⁴ Paragraph 6 would be redundant under the Model Law by virtue of Article 18(1). However, if the provisions on intermediated securities are the subject of a separate enactment then paragraph 6 would be necessary.

²⁵ The enacting State may find it necessary to adjust this article to ensure consistency with any applicable regulatory, insolvency or other rules of the enacting State for the protection of account holders. This article establishes a priority rule but it does not address the circumstances under which a secured creditor may be entitled to exercise a “right of use” (e.g., by way of rehypothecation or securities lending) of intermediated securities. GSC Article 34 addresses the right of use. Chapter V of the GSC, which includes Article 34, is subject to a Contracting State’s ability to opt out of Chapter V, in full or in part, as discussed in the Introductory Note.

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Article 71. Rights as against the issuer of intermediated securities or non-intermediated securities²⁶

The rights of a secured creditor that has a security right in non-intermediated securities or intermediated securities as against the issuer of the securities are determined by [the relevant law relating to the obligations of the issuer of non-intermediated securities ~~to be specified by the enacting State~~].²⁷

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Article 97bis. Security rights in intermediated securities

1. Subject to Article 98, the law applicable to the creation, effectiveness against third parties, priority and enforcement of a security right in intermediated securities, as well as rights and duties of the relevant intermediary with respect to the intermediated securities, is

Alternative A²⁸

the law of the State in which the relevant intermediary with which the securities account to which the intermediated securities are credited has its place of business.

2. If the relevant intermediary has places of business in more than one State, the law applicable is the law of the State in which the office maintaining the securities account is located.

Alternative B

the law of the State expressly stated in the account agreement with respect to the securities account to which the intermediated securities are credited as the State whose law governs the account agreement or, if the account agreement expressly provides that the law of another State is applicable to all such issues, the law of that other State.

2. The law of the State determined pursuant to paragraph 1 applies only if the relevant intermediary has, at the time of the conclusion of the account agreement, an office in that State that is engaged in the regular activity of maintaining securities accounts.

3. If the applicable law is not determined pursuant to paragraph 1 or 2, the applicable law is to be determined pursuant to [the default rules based on article 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, to be inserted here by the enacting State].

²⁶ Article 71 as revised would replace the corresponding provision found in the Model Law.

²⁷ The language in the bracketed note has been deleted. That language does not make sense when the law of a State other than the enacting State governs the issuer's obligations.

²⁸ The enacting State may adopt alternative A or alternative B of this article.

Article 98. Third-party effectiveness of a security right in certain types of asset by registration²⁹

If the law of the State in which a grantor is located recognizes registration of a notice as a method for achieving effectiveness against third parties of a security right in a negotiable instrument, negotiable document, right to payment of funds credited to a bank account ~~or~~, certificated non-intermediated security securities or intermediated securities, the law of that State also is the law applicable to the third-party effectiveness of the security right in that asset by registration.

²⁹ Article 98 as revised would replace the corresponding provision found in the Model Law.