

**UNIDROIT CONVENTION ON
SUBSTANTIVE RULES FOR INTERMEDIATED SECURITIES**

Security Interests in Intermediated Securities

*Michel Deschamps*¹

The purpose of the Unidroit Convention on substantive rules for intermediated securities (the “Convention”) is to establish a common legal framework for the holding and disposition of intermediated securities². Intermediated securities are securities held with an intermediary; they are often referred to as indirectly-held securities although that term is not used in the Convention³. A simple case of intermediated securities is the following: ABC, a publicly traded company, has issued shares; the registered holder of the shares in the books of ABC is CDS; Y, a securities broker, has an account with CDS in which shares of ABC are held. Z, an investor, has a securities account with X in which shares of ABC are held.

The rights of the investor with respect to the shares of ABC credited to his account are called “intermediated securities”. In the United States and Canada, intermediated securities are named securities entitlements. The Convention aims at providing basic legal rules on the acquisition and disposition of intermediated securities, including the acquisition of a security interest in them⁴.

The provisions of the Convention on security interests deal principally with three issues:

- effectiveness against third parties⁵;
- priority; and
- enforcement.

On effectiveness, the Convention provides that a security interest in intermediated securities may become effective against third parties if the securities are held in an account in the name of the secured creditor⁶. The Convention contemplates that effectiveness against third parties of a security interest may also be achieved by the holder of the securities granting the control of the securities to the secured creditor⁷.

Control is acquired by the secured creditor by way of an agreement between the account holder, the securities intermediary and the secured creditor whereby the latter becomes empowered to block a disposition of the securities by the account holder or to dispose of them without any further consent

¹ The author is a partner of the Canadian law firm McCarthy Tétrault LLP and participated in the elaboration of the Convention as one of the Canadian delegates.

² See the preamble to the Convention.

³ The drafters of the Convention have attempted to avoid characterizing the legal nature of intermediated securities.

⁴ The Convention uses the term “security interest”, and not “security right”.

⁵ Perfection, in the legal parlance of some legal systems.

⁶ Articles 9 and 11.

⁷ Article 12.

<p style="text-align: center;">UNCITRAL - Third International Colloquium on Secured Transactions Presentation by Michel Deschamps</p>

of the account holder. An entry made in the securities account in favour of a securities account may also have the same effect as a control agreement.

The Convention recognizes that a Contracting State may in its laws provide for other methods to render a security interest effective against third parties. For instance, a State may decide that such effectiveness may also be achieved by registration in a security right registry⁸.

The rules on priority may be summarized as follows:

- A secured creditor who becomes the account holder in respect of intermediated securities ranks ahead of any competing claimant⁹;
- A secured creditor whose security interest has been made effective by control has priority over any security interest perfected by any other method provided by non-Convention law (e.g. by registration);
- If two persons obtain control of the same intermediated securities, the first in time to obtain control will prevail;
- However, if a securities intermediary who holds a security interest in a securities account maintained by it subsequently permits another secured creditor to obtain control of the account, the other creditor will rank first.

The Convention also provides that a security interest granted by an intermediary in intermediated securities held with another intermediary prevails over the rights of the account holder of the first intermediary if the security interest has been made effective by control¹⁰. As a secured creditor of an account holder cannot enjoy greater rights than those of the latter, this rule may affect the secured creditors of an account holder. This is not however a priority rule in the strict sense because in the circumstances envisaged by the rule, a secured creditor of the account holder and a secured creditor of the intermediary would not hold security over the same intermediated securities.

The provisions of the Convention on enforcement are optional and are intended to supplement domestic laws. It must also be noted that the Convention recognizes a title transfer agreement for security purposes as a distinct legal institution; accordingly, such a transfer would not be subject to the legal regime applicable to security interests.

Essentially, the provisions of the Convention on enforcement permit the secured creditor, if the debtor is in default, to dispose of the intermediated securities privately without any prior notice or court supervision requirement. As well, the Convention provides that the commencement of insolvency proceedings against the debtor may not stay the enforcement rights of the secured creditor.

* * *

⁸ Article 13.

⁹ Articles 11 and 18.

¹⁰ Article 20.