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Draft Model Law on Secured Transactions: Security Interests in Non-Intermediated Securities

Note by the Secretariat

The Commission may wish to note that, at its forty-sixth session, it agreed that whether the draft Model Law should include provisions on security rights in non-intermediated securities would be assessed at a future time (see A/68/17, para. 332). The Commission may also wish to note that, to facilitate consideration of that matter by the Commission, the Working Group, at its twenty-fifth session (New York, 31 March-4 April 2014), considered a set of draft definitions and provisions and adopted a recommendation to the Commission that security rights in non-intermediated securities should be addressed in the draft Model Law along those lines (see A/CN.9/802, para. 93). To assist the Commission in reaching a decision, the draft definitions and provisions have been revised as agreed upon by the Working Group (see A/CN.9/802, paras. 72-92) and are presented in the annex to this note. As the annex shows, the matter may be addressed by way of a few draft definitions and provisions, together with some brief comments. Thus, the Commission may wish to consider that the draft Model Law should include provisions on security rights in non-intermediated securities and refer that matter to the Working Group. In this connection, the Commission may wish to note that the Working Group is expected to complete its work and submit the draft Model Law to the Commission for consideration and adoption at its forty-eighth session in 2015 (see A/CN.9/807, para. 7). The Commission may also wish to note that the Working Group is expected to require two sessions after 2015 to complete the guide to enactment of the draft Model Law (see A/CN.9/807, para. 12 (c)).



Annex

[Note to the Commission: The Commission may wish to note that non-intermediated securities (“NIS”) are regularly used in commercial finance transactions as security, in particular by small- and medium-size enterprises. In addition, the Commission may wish to note that NIS are not addressed in the Unidroit Convention on Substantive Rules for Intermediated Securities (the “Unidroit Securities Convention”), the Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary (the “Hague Securities Convention”) or the UNCITRAL Legislative Guide on Secured Transactions (the “Secured Transactions Guide”). If the Commission decides that security rights in NIS should be covered in the draft Model law, article 1, subparagraph 3 (d) of the draft Model Law should be revised to exclude only intermediated securities from the scope of the draft Model Law (see A/CN.9/WG.VI/WP.59). In addition, definitions along the lines of those below should be inserted in article 2 of the draft Model Law (see A/CN.9/WG.VI/WP.59), and provisions along the lines of the four provisions set out below should be inserted in the asset-specific sections of the third-party effectiveness, priority and conflict-of-laws chapters of the draft Model Law. In this connection, the Commission may wish to note that, as is the case with other asset-specific provisions of the draft Model Law, a State may not need them or may adapt them as appropriate to fit them in its own legal system (a feature that is inherent in a model law in any way). The Commission may also wish to note that the Working Group considered that only security rights in NIS (including transfers for security purposes but not outright transfers of NIS), should be covered (see A/CN.9/802, para. 80). The Working Group also agreed that, to ensure that all priority conflicts will be covered, priority conflicts between a security right in NIS and the right of a transferee of the same NIS should be addressed (see A/CN.9/802, para. 81, and article 3 below).]

A. Definitions

(a) “Securities” means:

[(i)] Any share or similar right of participation in an issuer, an obligation of 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, of shares, participations or obligations; and

b. Is, or is of a type, dealt in or traded on securities exchanges or financial markets, or is a medium for investment in the area in which it is issued or dealt in or traded; [or]

[(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) and (ii) of this general definition, such as mutual funds;]

(b) “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;

(c) “Non-intermediated securities” means securities other than intermediated securities;

(d) “Certificated non-intermediated securities” means non-intermediated securities represented by a paper certificate;

(e) “Uncertificated non-intermediated securities” means non-intermediated securities not represented by a paper certificate;

(f) “Control agreement” means an agreement among the issuer of uncertificated non-intermediated securities, the grantor and the secured creditor, evidenced by a signed writing, according to which the issuer has agreed to follow instructions from the secured creditor with respect to the securities to which the agreement relates without further consent from the grantor.

[Note to the Commission: The Commission may wish to note that the definition of the term “securities above is narrower than the definition of that term in article 1, subpara. (a) of the Unidroit Securities Convention. The reason is that, while a broad definition is appropriate for the purposes of the Convention, it is overly broad for the purposes of the draft Model Law and could result in subjecting security rights in receivables, negotiable instruments and other generic intangible obligations to the special rules applicable to security rights in NIS (see A/CN.9/802, para. 74). In addition, the Commission may wish to note that the definition of the term “non-intermediated securities” above is exactly the same as the definition of that term in article 1, subpara. (b) of the Unidroit Securities Convention, and is included here as the term is used in article 1, subpara. 3 (d) of the draft Model Law (see A/CN.9/WG.VI/WP.59), in order to define “non-intermediated securities” by reference to “intermediated securities”. The Commission may also wish to note that the guide to enactment of the draft Model Law (the “Guide to Enactment”) will explain that any reference to “paper certificate” throughout the draft Model Law is intended to cover electronic equivalents.]

B. Draft model provisions

[Note to the Commission: The Commission may wish to note that the Guide to Enactment will clarify that: (a) NIS are created and issued in accordance with the applicable business organizations laws; (b) the rights of the holders of NIS are determined by the applicable securities holding and transfer laws; (c) the issuer of NIS usually maintains a securities register in which the issue is recorded; and (d) securities transfer laws typically provide that the person to whom NIS have been issued may transfer the NIS by: (i) delivery of the certificate to the transferee in the case of certificated NIS in bearer form; (ii) delivery and endorsement of the certificate in the case of certificated securities issued to a named holder and, for the transfer to be effective against the issuer, registration of the securities in the name of the transferee in the books of the issuer; and (iii) registration of the NIS in the name of the transferee in the books of the issuer in the case of uncertificated NIS. The Guide to Enactment will also clarify that, with the exception of the asset-specific provisions set out below, the other provisions of the draft Model Law would be applicable to a security right in NIS.]

Article 1. Third-party effectiveness

1. A security right in certificated non-intermediated securities is made effective against third parties by:

- (a) Delivery of the certificate to the secured creditor; [or]
- (b) Registration of a notice with respect to the security right in [the enacting State to specify its general security rights registry]; [or]
- (c) Endorsement of the certificate in a manner indicating the intention to create and make effective against third parties a security right.]¹

2. A security right in uncertificated non-intermediated securities is made effective against third parties by:

- (a) Registration of a notice with respect to the security right in [the enacting State to specify its general security rights registry];
- (b) Notation of the security right or registration of the name of the secured creditor as the holder of the securities in the books maintained for that purpose by or on behalf of the issuer; or
- (c) The conclusion of a control agreement.

[Note to the Commission: The Commission may wish to note that subparagraph 1 (c) of this article and paragraph 1 of article 2, both of which appear within square brackets for further consideration, may be necessary to avoid a conflict with article 19 of the Geneva Uniform Law for Bills of Exchange, according to which a pledge of certificated securities may be created erga omnes by endorsement on the certificate, with the statement “value in security” (“valeur en garantie”), “value in pledge” (“valeur en gage”), or any other statement implying a pledge (art. 22 of the United Nations Convention on International Bills of Exchange and International Promissory Notes contains a similar rule). The Commission may also wish to note that similar text may need to be included in the articles of the draft Model Law dealing with security rights in negotiable instruments (and perhaps negotiable documents). The Commission may also wish to note that the Guide to Enactment will clarify that: (a) a security right in NIS (as in any other asset) that is made effective against third parties is also effective against the grantor’s insolvency representative and the grantor’s judgment creditors; and (b) the rights of transferees and competing secured creditors are not necessarily ordered temporally according to the time of third-party effectiveness but are rather subject to the special priority rules in articles 2 and 3 below.]

Article 2. Priority among security rights

[1. A security right in certificated non-intermediated securities made effective against third parties by endorsement of the certificate in a manner indicating the

¹ This alternative may be included by enacting States that have implemented the Geneva Uniform Law for Bills of Exchange or the United Nations Convention on International Bills of Exchange and International Promissory Notes.

intention to create a security right has priority over a security right in the same securities made effective against third parties by any other method.]²

2. A security right in certificated non-intermediated securities made effective against third parties by delivery of the certificate to the secured creditor has priority over a security right in the same securities made effective against third parties by registration of a notice with respect to the security right in [the enacting State to specify its general security rights registry].

3. A security right in uncertificated non-intermediated securities made effective against third parties by the conclusion of a control agreement has priority over a security right in the same securities made effective against third parties by registration of a notice with respect to the security right in [the enacting State to specify its general security rights registry].

4. Priority among security rights in uncertificated non-intermediated securities made effective against third parties by the conclusion of control agreements is determined by the temporal order of conclusion of the control agreements.

5. A security right in uncertificated non-intermediated securities made effective against third parties by a notation of the security right or registration of the name of the secured creditor as the holder of the securities in the books maintained for that purpose by or on behalf of the issuer has priority over a security right in the same securities made effective against third parties by any other method.

Article 3. Priority between a security right and the right of a transferee

Option A

1. If encumbered non-intermediated securities are transferred and a security right in those securities is effective against third parties at the time of the transfer, the transferee acquires them subject to the security right.

2. Notwithstanding paragraph 1 of this article, a transferee acquires the encumbered securities free of the security right if:

(a) The secured creditor authorized the transfer free of the security right; or

(b) At the time of the transfer, the transferee had no knowledge that the transfer violated the right of the secured creditor.

3. This article does not adversely affect the rights of the holders of non-intermediated securities under other law relating to the transfer of securities.

Option B

A security right in non-intermediated securities is subordinate to any superior rights acquired by a transferee of the securities under other law relating to the transfer of securities.

[Note to the Commission: The Commission may wish to note that: (a) paragraph 1 of option A parallels general rules of the draft Model Law and may thus not be necessary; (b) paragraph 2 of option A parallels the rule applicable to

² This rule is to be enacted only by States that have adopted article 1, subparagraph 1 (c).

transferees of money and may need to be repeated with respect to transferees of NIS; and (c) option B parallels the rule applicable to negotiable documents.]

Article 4. Applicable law

1. The law applicable to the effectiveness of a security right in certificated non-intermediated securities as against the issuer is the law of the State under which the issuer is constituted.
2. The law applicable to the creation, third-party effectiveness and priority of a security right in certificated non-intermediated securities is the law of the State in which the certificate is located.
3. The law applicable to the enforcement of a security right in certificated non-intermediated securities is the law of the State in which enforcement takes place.
4. The law applicable to the effectiveness against the issuer, the creation, the effectiveness against third parties, the priority and the enforcement of a security right in uncertificated non-intermediated securities is the law of the State under which the issuer is constituted.

[Note to the Commission: The Commission may wish to note that paragraph 1 of this article may not need to be retained as it deals with the relationship between the holder and the issuer of NIS. With respect to certificated NIS, the Commission may wish to note that the Guide to Enactment will clarify that, under the general rule of the draft Model Law dealing with the relevant time for determining location (see A/CN.9/WG.VI/WP.57/Add.4, Annex II, article 7), the relevant time for determining the location of the certificate or the issuer, for creation issues, is the time of the putative creation of the security right and, for third-party effectiveness and priority issues, is the time when the issue arises.]

C. Coordination with other law

[Note to the Commission: The Commission may wish to note that the definitions mentioned above are also intended to avoid any overlap with the law relating to intermediated securities, while article 3 is intended to ensure that the rights of holders of NIS are not adversely affected. The Commission may also wish to note that further NIS-specific rules may be required to avoid conflicts with other law, such as the European Union Collateral Directive (2002/47/EC), as amended by Directive 2009/44/EC (the “Financial Collateral Directive”). For example, an NIS-specific provision or other adjustment to the chapter on enforcement may be necessary to ensure that the draft Model Law is consistent with article 4 of the Financial Collateral Directive. Such NIS-specific or other provision may need to clarify that: (a) a security right in NIS may be enforced by collection, set-off, a proposal for the acquisition of the securities by the secured creditor in full or partial satisfaction of the secured obligation or by a sale or other disposition of the NIS; and (b) subject to contrary agreement of the parties, a secured creditor may enforce its security right in NIS without giving any notice of its intention to enforce.]