SECURITY INTERESTS IN INVESTMENT SECURITIES UNDER JERSEY LAW

Roy Goode*

This article examines the revolutionary changes to Jersey law on security interests in intangible movables made by the Security Interests (Jersey) Law 2012 ("SIJL 1") so far as it affects security interests in directly held and intermediated investment securities. It notes that the Law, which places Jersey among the forefront of jurisdictions with a developed legal regime for security interests in intangibles, is the first in a two-stage process the second stage of which will be to extend the Law to tangible movables in SIJL 2, a revised draft of which is expected to be published later this year. It is envisaged that SIJL 2 will also provide a coherent new legal regime for intermediated securities

1. Introduction: Jersey's great leap forward

1 The Security Interests (Jersey) Law 2012 ("SIJL 1") came fully into force on 2 January 2014. It revolutionises the law governing security interests in intangible movable property, replacing an antiquated and inadequate system with a modern, sophisticated legal regime designed to be responsive to the needs of the financial markets, industry and commerce. In particular, the Security Interests (Jersey) Law 1983, though a significant improvement on the existing law, was very short, limited in scope and in some respects uncertain. It did not permit security over future property, still less an all-assets security, nor did it allow a non-possessory security interest in goods or a hypothec (hypothecation, charge) over any kind of movable property, including short leases of land.[1] Security interests in investment securities could

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[1] That is, leases for nine years or fewer ("paper leases"), which are deemed to be movables and were therefore incapable of being given in security under the 1983 Law. A security interest in investment securities and insurance policies could be given either by possession of the relevant certificate or policy or by notified assignment and in a bank deposit by notified assignment

be taken only by possession of certificates (assuming the securities to be certificated) or by notified transfer of title. The concept of control as a means of perfection was limited to security given over deposit accounts and then only if in favour of the bank with which the deposit was held. Moreover, the 1983 Law contained no provisions for registration of a security interest or other means of giving notice, and it allowed only a single default remedy, sale. All this has changed, and security interests in intangible movables now operate in a highly liberal regime designed to facilitate the extension of commercial credit.

2 The present article focuses on directly held investment securities and securities accounts held with an intermediary. It will be assumed that the reader has a general conversance with the structure of SIJL 1, in particular the requisite connection to Jersey,[2] the concepts of attachment,[3] control,[4] perfection,[5] and notice filing.[6] These will not be

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or by giving control, though in the latter case only in favour of the bank itself, not of a third party.

[2] Article 4.

[3] See below. A security interest may now cover after-acquired property and attaches on acquisition by the debtor without the need for specific appropriation, attachment being retrospective to the time of the security agreement (arts 19, 29(3)). It was the writer who first advanced the proposition that the effect of the security agreement under English law was to create an inchoate security interest which, upon coming into existence, would operate retrospectively, giving as an analogy an unborn child which has no enforceable rights but acquires them at birth with effect from the time of conception. See *Goode on Legal Problems of Credit and Security* (5th edn, ed Louise Gullifer), para 2–13. The same passage in the 4th edition was cited with approval by the Supreme Court of Canada in *Royal Bank of Canada v Radius Credit Union* [2010] 3 SCR 38.

[4] Control represents a form of perfection available for securities accounts and registered certificated securities. See below.

[5] The further step necessary to make the security interest effective against third parties. There are four modes of perfection: possession, control, registration and, in favour of an intermediary, automatic perfection under art 20 without any active step (see below). Perfection, though necessary to preserve priority, does not always suffice for this purpose, since the priority rules may operate to subordinate or displace a perfected security interest.

[6] In contrast to traditional registration systems, which are based on the registration of completed transactions, a party can register an electronic notice that it has taken or intends to take a security interest over an item or category of collateral or, under SIJL 1, all collateral. Such a notice can cover future transactions without any new registration. The steps to perfection can

discussed further except in the context of securities accounts and investment securities. It will, however, be necessary to devote a few words to the concept of "security interest".

3 The writer has described elsewhere the history of the project, the working methods leading to its successful conclusion, which included the active participation of the banking lawyers and industry in the policies it embodies and, indeed, even in the drafting itself.[7] The 2012 Law is the first stage of a two-stage process. SIJL 1 deals with security interests in intangible movable property. SIJL 2, on which work is likely to resume in 2017,[8] will extend the Law to tangible movables and also make amendments to deal with any flaws in the original Law. Additionally, SIJL 2 is expected to introduce a detailed legal regime governing intermediated securities.

4 While drawing on art 9 of the American Uniform Commercial Code and equivalent personal property security legislation in Canada, New Zealand and Australia, SIJL 1 nevertheless reflects the view expressed by Jersey's legal profession that rather than attempting to cover every possible fact situation it should adopt a broad brush approach and leave leeway for the courts to fill in the gaps: in other words, relative simplicity was to be preferred to completeness and complexity. In the three years since the Law entered into full force there has not been a single reported case concerning its provisions, which suggests that the Law has worked well. Its effect is undoubtedly to place Jersey in the top tier of jurisdictions with highly developed rules governing security interests in intangible movables.

Sphere of application

5 The Law applies only where the following conditions are satisfied—

(1) a security interest as defined by art 1A has attached to collateral;

(2) the interest is in intangible movable property as defined by art 1;

(3) the interest is not excluded by art 8;

(4) the transaction is not one of a kind excluded by art 9;

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be taken in any order (art 21(2)) and when the security agreement is concluded priority goes back to the time of registration.

[7] Goode and Rainer, "Reforming the Law of Secured Transactions in Jersey", in Gullifer and Akseli (eds) *Secured Transactions Law Reform*, Chapter 9.

[8] Much preliminary work has already been done but the project was put on hold for some two years because other important matters had to be given priority.

(5) the interest is not a continuing security interest as defined by art 1 as amended;

(6) there is a connection between the security interest and Jersey as provided by art 4 as qualified by art 2 of the Security Interests (Application of Law—Exceptions) (Jersey) Order 2013, which relates to private trusts.

"Security interest"

6 Under art 1A a security interest means an interest in intangible movable property,[9] being an interest that, under a security agreement, secures payment or secures the performance of an obligation, and includes the interest of a secured party under a transfer of title by way of security, under a mortgage, pledge or contractual lien, or under any other encumbrance that is by way of security. So the new Law covers not only security by possession or transfer of title but also a hypothec (hypothecation, charge), which operates as an incumbrance on the debtor's asset but does not entail a transfer of title. The phrase "under a security agreement" denotes that the Law is limited to consensual security interest and the point is rammed home by art 8, which excludes, among other things, a lien, or other encumbrance or interest in movable property, created by any other enactment or by the operation of any rule of law. So the non-contractual lien falls outside the scope of the Law, as does a right of set-off given by law.

7 Article 1A further provides that the form of the transaction and the person who has title to the relevant collateral do not matter. This provision reflects Jersey case law which, like English case law, will strike down a purported sale followed by a letting back to the seller on hire-purchase where it is clear that there was no intention on the part of the supposed seller to transfer title and that the transaction is a disguised mortgage.[10] Article 1A is reinforced by art 7, under which the application of the Law is not affected by the fact that the secured party and not the grantor holds title to the collateral. Article 7 will be of particular relevance when SIJL 2 extends the law to cover goods, since the current proposal, which will no doubt be the subject of debate, is to extend the concept of security interest to cover retention of title under sales and similar transactions. Article 1A thus embodies

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[9] "Intangible movable property" means movable property other than goods, and includes cash that is not money and licences and quotas having commercial value, whether or not they are transferable (art 1).

[10] *Re Knights (Jersey) Ltd* 1962 JJ 207; *North Central Wagon Finance Co Ltd v Brailsford* [1962] 1 All ER 502. For a detailed discussion, see Goode, *Hire-Purchase Law and Practice* (2nd edn), at 81 *et seq*.

the concept of substance over form. A transaction structured so as to provide security will be treated as creating a security interest. But so far as SIJL 1 is concerned the impact is limited in that the Law does not seek to go beyond the traditional conception of security. What it does do, however, is to merge the traditionally distinct forms of security—mortgage, pledge, hypothec,[11] contractual lien—into a single concept, the security interest. So instead of having separate rules for each type of security interest SIJL 1 lays down a uniform regime which differentiates not by legal form but by the purpose for which the collateral is held and the extent to which the secured party financed its acquisition. The Law encompasses the security trust, which is not an independent security device, merely a form of mortgage by which the debtor declares himself a trustee of the asset for the creditor or transfers the asset to a trustee to hold on trust for the creditor.[12] For the avoidance of doubt art 6 provides that a bank with an obligation to a depositor and an intermediary with an obligation to deliver or transfer securities may take a security interest in its own obligation, while a company incorporated with a share capital may take a security interest in its own shares from any of its shareholders.[13]

Exclusions generally

8 The Law is wide-ranging but certain interests are excluded by art 8[14] and certain categories of transaction by art 9.[15]

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[11] Jersey law did not previously recognise a hypothecation of movables: *Re Lawrence* 1963 JJ 341; *Hayley v Bartlett* (1861) 14 Moo PCC 251.

[12] *Goode on Legal Problems of Credit and Security* (5th edn, ed Louise Gullifer), para 1–53.

[13] This is designed to address a problem first raised by the writer in *Legal Problems of Credit and Security* suggesting that it was conceptually impossible for a creditor to hold security against itself. This was borrowed (albeit without acknowledgment!) by Millett J in *Re Charge Card Services Ltd* [1987] Ch 150 and was followed by the Court of Appeal in *Re Bank of Credit and Commerce International SA (No 8)* but on appeal to the House of Lords [1998] AC 214 at 226–228 Lord Hoffmann, in an *obiter dictum*, opined that there was no reason why this could not be done. Whatever the conceptual difficulty it is common practice for such a security to be taken and it has been covered by legislation in certain other jurisdictions, so art 6 is realistically responding to the practices of the market.

[14] Non-consensual rights or interests and contractual rights of set-off, netting and combination of accounts.

[15] For the reasons set out in the Government White Paper issued in June 2009, eg because they are transactions which do not serve a commercial purpose, do not deprive the assignor of beneficial ownership or are excluded

Exclusion of continuing security interests and the "tipping point" issue

9 Security interests created under the 1983 Law and still in existence consequent to a security agreement entered into before 2 January 2014 and which remain in force on that date are excluded from the Law and remain governed by the prior law.[16] A typical security agreement is expressed to secure all present and future liabilities owing or incurred by the debtor under the finance documents, defined to cover not only the original agreement but any future documents designated as finance documents, including those amending any finance document. Under these provisions additional obligations may be imposed by amendment without affecting the continuity of the security interest or creating a new security interest.

10 English case law has established in relation to guarantees that the courts have a fairly liberal attitude to variations which expand the scope of the security interest to include post-agreement obligations. However, they have also held that there may be a "tipping point" beyond which purported amendments will be regarded as so substantial and outside the purview of what the parties would reasonably have contemplated that they are not covered by the guarantee. Similar considerations apply to documents expanding the scope of a security interest beyond the purview of the parties' contemplation and thus giving rise to a new security interest. That would be advantageous in one sense, in giving the creditor a much stronger security interest, but could also expose the creditor to subordination to an existing security interest and to avoid as a preference under insolvency law.

11 Proposals have been made to override the "general purview" principle and treat continuing security as covering even fundamental new obligations going beyond the contemplation of the parties at the time of the original agreement. But this would retrospectively increase the liability of guarantors under existing guarantees and potentially affect the existing priority of earlier secured creditors and would almost certainly fall foul of human rights law, which has set its face against retrospective legislation.[17]

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for policy reasons. For the avoidance of doubt sale and repurchase agreements ("repos") and stock or securities lending are also excluded because both types of transaction constitute outright transfers the reverse leg of which involves a purely personal obligation to redeliver.

[16] Schedule, paras 1 and 2; art 1.

[17] See, for example, the decision of the Supreme Court in *Re Recovery of Medical Costs for Diseases (Wales) Bill* [2015] AC 1016, where a Bill to

2. Investment securities: attachment and perfection of the security interest

Forms of holding of investment securities

12 Article 1 defines "investment security" in broad terms to cover an investment specified in any of paras 1–8 and 10 of Schedule 1 to the Financial Services (Jersey) Law 1998 and a unit trust not so specified, but excluding money. So stocks and shares, debenture stock, loan stock, bonds, certificates of deposit, units in a unit trust, warrants entitling the holder to any of the above and certificates representing securities all constitute investment securities for the purposes of SIJL 1. The Law divides investment security holdings into two categories, securities held direct from the issuer and "securities accounts", that is, intermediated securities held through an account with a bank, broker or other securities intermediary.

Directly held securities

13 Directly held securities are themselves of three kinds, negotiable investment securities (bearer shares, bearer bonds and negotiable certificates of deposit); registered certificated securities and registered uncertificated securities. The issue and transfer of uncertificated securities in Jersey companies were at one time severely restricted because of the general requirement for a written transfer and certificate,[18] but the rules were relaxed and currently uncertificated securities can be issued and transferred through (a) an approved central securities depository such as CREST[19] or (b) a CSD relating to one of the approved stock exchanges or by a computer system, where in either case the transfer is in accordance with the relevant laws applicable to, and relevant rules and regulations of, the approved stock exchange on which the securities are listed.[20] However, legal title can only be transferred by entry in the company's register.

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increase the liability of health insurers retrospectively was struck down. *A fortiori* this is likely to apply where the interests to be promoted are purely private interests.

[18] Companies (Jersey) Law 1991, art 42(1). By contrast unit trust instruments periodically provide that unit certificates do not have to be issued.

[19] Operated by Euroclear UK and Ireland and recognised as a overseas operator by the Companies (Uncertificated Securities) (Jersey) Order 1999. See further below as to CREST.

[20] Companies (Transfer of Shares— Exemptions) (Jersey) Order 2014, which in relation to shares extended the 1999 Order.

Attachment of security interest to directly held investment securities

14 Attachment of a security interest denotes that it has become enforceable against the grantor as a fixed security interest following compliance with the formalities for agreement (possession or agreement in writing). Attachment is not the same as creation. An oral security agreement unaccompanied by delivery of possession creates a security interest but not one that has attached so as to be enforceable against the grantor. The conditions of attachment are that value has been given, the grantor has rights in the collateral and either the secured party has taken possession or control of the collateral or there is a security agreement in writing signed by or on behalf of the grantor and containing a description of the collateral enabling it to be identified.[21] Contrary to the previous law, attachment is not affected by the fact that the grantor retains, in the absence of a contrary direction from the secured party, power to deal with the collateral free from the security interest and without a duty to account for the proceeds or replace the collateral.[22]

Perfection of security interest in directly held investment securities

15 Under art 21 a security interest is perfected when the security interest has attached and any further steps required for perfection have been completed. A security interest in all types of investment security can be perfected by registration[23] but this is very much a second-best option because the registrant will be postponed to a secured creditor whose security interest enjoys a stronger form of perfection (possession or control) and because the rapid daily turnover of securities makes registration an inefficient method of perfection, with security interests constantly having to be taken off the register and new registrations effected. A security interest in a negotiable

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[21] Article 18(1). For this purpose it suffices if the collateral is identified by item or by type or if the description is a statement that the security agreement covers all present and future collateral or all present and future collateral except for specified items or types, and the collateral is not within those exceptions (art 18(2)).

[22] Article 18(3). For the previous law see Jones, "Bank Accounts: Secure or Insecure" 2007 J&GLR 1 suggesting, mainly in the light of English cases, that an assignment of a deposit account was ineffective if the debtor was left free to manage the account. This is because such an assignment would be treated in English law as a floating charge, a form of security not recognised by Jersey law.

[23] An exception is a security interest given over intermediated securities by an account holder in favour of its own intermediary. See below.

investment security can be perfected by possession of the relevant certificate; a security interest in a certificated registered investment security which is not a bearer security can be perfected by registration with the issuer as holder or by possession of the certificate.[24]

Intermediated securities

16 By contrast with an investor holding directly, a customer holding intermediated, or book-entry, securities has no relationship with the issuer[25] or with an intermediary ranking above his own ("higher-tier intermediary"); his relationship is solely with the particular intermediary with whom he holds his securities account.[26] The customer's securities are acquired by credit to his account, which thus become the root of title, and are disposed of by debit to his account. The account thus becomes the root of title. Credits and debits on different accounts between the same parties may be merged into a single delivery obligation under close-out netting provisions.[27] Intermediated securities include Jersey securities held in an account with CREST. But dealings in these are governed by English law and fall outside SIJL 1.[28]

What is a securities account?

17 Article 1 defines a securities account in the following terms—

> "securities account"—
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> (a) means an account maintained by an intermediary, being an account to which investment securities may be credited or debited; and
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> (b) includes a reference to the investment securities so credited."

18 Several points arise from this definition. First, it is confined to accounts maintained by an intermediary. As will be seen, not all those maintaining records of securities held in an account are intermediaries. Secondly, it is not necessary that there should be any investment securities credited to the account at any given time. It suffices that it is an account to which securities "may" be credited or debited. Thirdly, a security interest in a securities account is not limited to securities held

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[24] Articles 22, 3(4),(5).
[25] Except on such conditions as may be provided by a trust deed or deed poll.
[26] See below.
[27] See below.
[28] See below.

in the account at the time of the security agreement. It extends to all securities currently or subsequently credited to the account except so far as the parties otherwise agree. It would in theory be open to the parties to agree that the security interest should be confined to a specified category, quantity, proportion or value of securities from time to time credited to the account or should be limited to securities already credited to the account at the time of the security agreement, hence the provision that "securities account" includes a reference to the securities credited to the account.

19 What is the position of the secured party as regards investments which the intermediary has acquired for the account holder but which do not yet appear as a credit to the securities account? There appears to be no reported case on this point but an analogy can be drawn with the time when a credit to a bank account of funds collected is considered to take effect, which is when the bank has decided to make the credit and has taken the first step to give effect to that decision, any overnight processing to complete the process and effect the credit entry being regarded as purely mechanical.[29]

20 A final question is whether the definition of a securities account covers cash, that is, money and deposit accounts.[30] An intermediary may, of course, transfer cash to a deposit account, but what is the position if cash, eg dividend receipts, is retained in the investment account? The view of the writer is that in relation to cash the account is not a securities account but a deposit account, though in most cases the difference is not likely to be material because all the methods of control of a securities account under art 3(4) are also available for

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[29] *Momm v Barclays Bank International Ltd* [1977] QB 790; Michael Brindle and Raymond Cox, *Law of Bank Payments* (4th edn), paras 3–133 – 3–135. Of course the effect is different in that credit to a bank account is deemed a loan to the bank, whereas the acquisition of securities for a customer and the determination to credit these to the securities account give the customer a co-proprietary interest in them with other account holders holding investments in the same investment security. art 8–501(b) of the (American) Uniform Commercial Code addresses the question expressly by providing that with some exceptions a person acquires a securities entitlement if a securities intermediary (1) indicates by book entry that a financial asset has been credited to the person's securities account; (2) receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account, or (3) becomes obligated under other law, regulation, or rule to credit a financial asset to the person's account.

[30] Article 1.

control of a deposit account under art 3(3),[31] and the same priority rules apply under art 30.

Who is an intermediary?

21 Article 1 gives a definition of "intermediary" which is partially derived from art 1(1)(c), (3) and (4) of the 2006 Hague Securities Convention.[32] An intermediary means a person who maintains for others, or both for others and on his or her own account, registers of accounts to which investment securities may be credited or debited, but excludes a person who (a) acts as registrar or transfer agent for the issuer of investment securities, (b) records in the person's own books details of investment securities accounts maintained by an intermediary for other parties for whom the person acts as manager or otherwise in a purely administrative capacity, or (c) maintains registers or accounts in the capacity of operator of a settlement system. The maintenance of securities accounts is a key function of the definition. So a bank holding physical custody of certificated securities under a custody agreement is not an intermediary for this purpose but a bailee.

22 The tiered system described below means that a person maintaining securities accounts for others other than as first-tier intermediary usually acts in two capacities: as intermediary for its customers and as customer of its own, higher-tier, intermediary. Examples of intermediaries for this purpose are clearing houses, securities firms and banks. International central securities depositories (ICSDs) and central securities depositories (CSD) would also normally qualify as intermediaries, at any rate where records of transfers in their books do not constitute the primary record of entitlement as against the issuer. However, Jersey does not have its own clearing house,[33] ICSD or CSD, and Jersey securities are in the first instance transferred through CREST under a transfer governed by English law and conferring an equitable title on the transferee before

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[31] See below.

[32] Hague Convention on the Law Applicable to Certain Rights in respect of Securities Held with an Intermediary, For a detailed analysis of "intermediary" for the purposes of the Convention see Goode, Kanda and Jreuzer, with assistance from Bernasconi, *Hague Securities Convention Explanatory Report*, paras 1–10, 1–32 *et seq*, much of which is relevant to an understanding of the definition in SIJL 1.

[33] The Channel Islands Securities Exchange, on which securities may be issued, listed and traded, is based in Guernsey with an office in Jersey.

legal title is transferred by registration of the transfer in the Jersey company's register.

23 Exception (a) excludes registrars and transfer agents because their function is essentially to act as record keeper and to effect transfers on behalf of the issuer, not to maintain securities accounts for customers. Exception (b) deals with the case where a bank, instead of holding the customer's securities itself, arranges for these to be held by a third-party intermediary, for example a sister bank, and credited to a securities account in the customer's name with that third party, the first bank maintaining a parallel account purely for record purposes. This account is not a securities account, and the bank maintaining it is not an intermediary, because it is not the party holding the securities for the customers and transfers may not be effected across its books.

24 Exception (c) excludes those maintaining accounts as operator of a settlement system. A perfection rule for these was originally included in art 3(6) as a third category but this provision was repealed by reg 4 of the Security Interests (Amendment of Law) (Jersey) Regulations 2013 when it was realised that Jersey securities are outside the CREST system. So Jersey securities held in CREST are intermediated securities and, in contrast to the position as regards CREST holdings of UK securities, CREST is not the direct holder from the issuer but an intermediary, and the primary record of entitlement to the securities is not CREST but the register maintained by the Jersey issuer.

Nature of the account holder's interest

25 Most securities accounts are fungible, that is, the securities credited to them are held in an omnibus account for all account holders of the security in question *pro rata* without segregation of particular items to particular account holders. So the account held by the intermediary with its own (higher-tier) intermediary is in the lower-tier intermediary's own name and without designation of its own account holders. Nothing, therefore, is earmarked to a particular account holder in the books of the higher-tier intermediary. This facilitates dealings because the securities credited to the accounts with the lower-tier constitute an undivided pool from which transfers from one account holder to another may be effected in-house. By contrast, there may be customers for whom securities are held in a segregated, or non-fungible, account, where the intermediary's account with its own intermediary shows that its holding is for the designated customer and is thus outside the pool represented by the omnibus account. But this is atypical and is not discussed further.

26 The key point to emphasise is that the account holder, and accordingly the secured creditor, has no direct interest in the underlying investment security, only a co-proprietary interest in

whatever is held by its intermediary, together with contractual and other personal rights against the intermediary. This bundle of proprietary and personal rights is conveniently termed "securities entitlement" in art 8 of the Uniform Commercial Code. It will be apparent that account holders, and those holding security interest in the account, cannot have greater rights than those of their intermediary, whose own rights in turn are limited to what is held by its higher-tier intermediary. It is therefore possible, particularly where the intermediary is fraudulent, that account holders find that their intermediary's holding is subject to security interests or rights of set-off or was never validly acquired in the first place.[34]

27 While a proportionate interest in the securities results from a credit to the account, the quantum of that interest depends on the terms of the agreement between transferor and transferee. It may be a proportionate ownership interest, a proportionate security interest or some other limited interest, according to the terms of the transfer.

Attachment of security interest in intermediated securities

28 The rules of attachment previously described apply to security interests in intermediated securities. However, there is one rule special to such security interests. Where the intermediary buys securities for an account holder and credits them to the account before being put in funds a security interest automatically attaches and is perfected in favour of the intermediary without the need for a security agreement.[35] As will be seen,[36] this is relevant to priorities. However, the rule is limited to purchase-money finance. It does not apply to finance provided by the intermediary against securities credited to the account and already paid for by the account holder.

Control

The concept of control

29 Control is a means by which a secured creditor holding non-negotiable certificated securities or holding intermediated securities through a securities account has the means of denying access to the collateral to the grantor of the security interest. Control is both a means of perfection and a determinant of priority. The Law distinguishes perfection by possession from perfection by control.

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[34] For a description of the tiering system see below.

[35] Article 20.

[36] See below. As noted earlier, this priority, linked to automatic attachment and perfection under art 20, is limited to a purchase-money security interest.

Perfection by possession is confined to negotiable investment securities, where the share or bond certificate is not merely evidence of title but embodies the title, which can be transferred by delivery of the certificate. Perfection by control applies to registered certificated securities and to securities accounts. In the case of registered certificated securities a secured party has control either if registered with the issuer or if in possession of the certificate.[37] Possession of a certificate relating to a registered security does not, of course, have the same effect as possession of a certificate relating to a bearer security. Legal title to a bearer security is transferable by delivery, whereas delivery to the secured party of a certificate to a registered investment security merely gives the secured party an equitable interest which, where accompanied by a transfer instrument, entitles him to be registered with the issuer, thus acquiring legal title.

30 Under art 3(4) a secured party has control of a securities account maintained by an intermediary if—

(a) the securities account is transferred into the name of the secured party with the written agreement of the grantor and of the intermediary;

(b) the grantor, the secured party and the intermediary have agreed in writing that the intermediary will comply with instructions from the secured party directing the disposition of investment securities credited to the securities account; or

(c) the secured party is the intermediary.

31 Case (b) covers both positive control and negative control. Positive control depends on intervention by the secured creditor to give instructions to the intermediary. Until such instructions are given the grantor remains free to dispose of the securities as he chooses. This is to be contrasted with negative control, where the security agreement precludes the grantor from dealing with the collateral without the secured party's consent.

Perfection of security interest in intermediated securities

32 Over the years there has been a sharp move away from direct holdings of investment securities to holdings through an account with a bank, broker or other securities intermediary. Usually there are several tiers of intermediary. For example, an issuer issues a global note which is deposited with a CSD or ICSD. Euroclear UK and Ireland is the UK CSD and the first-tier intermediary. Participants

[37] Article 3(5).

holding accounts with Euroclear will in turn, as second-tier intermediaries, hold accounts for customers of their own, who in turn may hold for their own customers. Each account holder's relationship is solely with its own intermediary, with no look-through to a higher-tier intermediary or the issuer. Typically, all securities of a particular issue are held by an intermediary in a pooled, or omnibus, account with its own higher-tier intermediary for all its customers without designation of particular customers in the books of the higher-tier intermediary. The pooling system reduces administration and allows transfers from one customer of an intermediary to another to be effected in-house through the books of that intermediary without involving the higher-tier intermediary.

33 It has been noted that in SIJL 1 a directly held investment security is labelled simply "investment security". By contrast the subject-matter of a security interest in an intermediated security is described as a "securities account", reflecting the fact that the root of title is the account itself, as opposed to a direct interest in the underlying security. In other words each account holder has a proportionate interest in whatever is held on its behalf by its own intermediary. Unless otherwise agreed a security interest in a securities account covers all securities from time to time credited to that account.

34 A security interest in a securities account cannot, of course, be perfected by possession because the account is not a documentary intangible. Instead, the security interest is generally to be perfected either by registration or by control. Article 3(4) prescribes three alternative methods of control of a securities account maintained by an intermediary: transfer of the securities account into the name of the secured party with the written agreement of the grantor and the intermediary; an agreement in writing by the grantor, the secured party and the intermediary that the intermediary will comply with instructions from the secured party directing the disposition of investment securities credited to the securities account; and automatic control where the secured party is the intermediary. The opening of a new account in the name of the secured party creates a new root of title which in principle is unaffected by defects in the grantor's title to the original account.[38] The tripartite agreement to act on the instructions of the secured party is effective as a method of control even if, prior to such instructions, the grantor remains free to deal with the account. Under English law the security interest under such an agreement would be characterised as a floating charge. The third method is a special case. Where a securities intermediary buys

[38] See below.

investments for a customer and credits the customer's account before being put in funds a security interest in favour of the intermediary to secure reimbursement automatically attaches and is perfected without the need for any further act.[39] In effect this amounts to a statutory lien in favour of the intermediary.

Proceeds

35 Under art 24 a security interest in collateral that is dealt with or otherwise gives rise to proceeds continues in the collateral, unless the secured party expressly or impliedly authorised the dealing, and extends to such proceeds as are capable, according to Part 2 of the Law, of being the subject of a security interest to which the Law applies. Article 1 defines "proceeds" as identifiable or traceable property, being intangible movable property in which the grantor of a security interest acquires an interest and that is directly derived from a dealing with the collateral the subject of the security interest or from a dealing with the proceeds of such collateral. Accordingly "proceeds" covers proceeds of proceeds. Only intangible proceeds fall within the Law, tangible proceeds being excluded both by the definition and by arts 1A and 24. Proceeds include a right to an insurance payment as compensation for loss or reduction in value of collateral or its proceeds but do not include interest, dividends or other income derived from collateral. This exclusion may need to be reconsidered, being based on a formal concept of transfer of title rather than an economic concept that income from collateral reflects a reduction in the productive capacity of the collateral itself.[40] Under art 25 a security interest in proceeds is a continuously perfected security interest if (a) the financing statement contains a description of the proceeds that would be sufficient to perfect a security interest in collateral of the same kind,[41] (b) though the financing statement does not refer to proceeds, these are anyway covered by the description of

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[39] Article 20.

[40] This is well explained by Professor R Wilson Freyermuth in his illuminating article "Rethinking Proceeds: The History, Misinterpretation and Revision of U.C.C. Section 9–306" 69 Tul L Rev. 645 (1995).

[41] For example, if the financing statement covers investment securities and proceeds and the proceeds are investment securities. Article 4 of the Security Interests (Registration and Miscellaneous Provisions) (Jersey) Order 2013 provides that for the purposes of art 25(a) proceeds may be described in a financing statement as "all present and after-acquired intangible movable property that is proceeds". Accordingly all proceeds can be covered by ticking the proceeds box in a financing statement without the need to list them.

the original collateral,[42] (c) the proceeds are acquired before the expiration of 30 days after the security interest in the original collateral attached to them,[43] (d) the proceeds are cash proceeds, or (e) the proceeds consist of a right to an insurance payment or other payment as indemnity or compensation for loss or reduction in value of the collateral or proceeds.[44]

3. Investment securities: priority of competing claims

36 Article 30 of the Law contains a number of special priority rules governing competing interests in securities accounts and certificated investment securities. Where a case falls outside art 30[45] it is dealt with by the residual priority rules in art 29.[46] It is, however, necessary to distinguish a competition between creditors holding a security interest in the same account, governed primarily by art 30, from a competition between a creditor holding a security interest in an account and a transferee from that account into a new account with the same or a different intermediary, which is governed by art 38. The former case involves a rule of priority, the latter a question of the new account holder taking free of the security interest.

Negotiable and registered investment securities

37 A secured party having possession of a negotiable investment security has priority over one who does not.[47] Perfection of a later security interest can only be by registration because it is not possible to have control without possession of the certificate. The priority

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[42] For example, where the financing statement covers investment securities and the proceeds are investment securities.

[43] Under art 26 a security interest in proceeds is temporarily perfected for 30 days if not otherwise perfected under art 25. Within that time the security interest must be re-perfected in order to ensure continuity of perfection.

[44] Article 25. A continuously perfected security interest is treated as perfected by the method by which it was originally perfected (art 29(2))—in other words, perfection of the security interest in proceeds goes back to the time of perfection of the security interest in the original collateral.

[45] As in the case of uncertificated securities.

[46] In particular, a perfected security interest has priority over an unperfected security interest; priority among perfected security interests goes to the security interest in relation to which the earliest of (a) registration or a financing statement, (b) possession, or (c) temporary perfection (see below) first occurred; and priority as between unperfected security interests is determined by the order of attachment.

[47] Article 30(5).

reflects the general law that negotiation of a negotiable instrument or security takes priority over transfer by any other means, such as assignment or registration. However, this priority gives way to the special priority in favour of an intermediary.[48] As regards registered investment securities the drafting of art 5(6) is less than felicitous—

> "Conflicting security interests under which each secured party has possession or control of a certificated investment security, control of a securities account or control of a deposit account rank according to the order in which possession or control was acquired."

38 The reference to possession is a slip, because only one person can have possession at a time and, as stated above, if one person has possession the other cannot have control. Accordingly art 5(6) should be read as limited to cases on which two or more parties have control. This rule will rarely apply in the case of a registered security because it is extremely unlikely that a situation will arise where one party is on the register and the other is in possession of the certificate. So in practice art 5(6) will usually be relevant only to priorities arising from multiple control of a securities account, to which we now turn.

Securities accounts

39 The priority rules governing competing security interests in securities accounts are a little more complex because of the range of possibilities to consider.

Case 1

40 With the written agreement of the grantor and the intermediary, the securities account is transferred into the name of the secured party, whose security interest then has priority over a security interest in favour of the intermediary itself. [49] This is logical because the securities intermediary has assented to the transfer. The transfer also gives the secured party priority over other secured parties, who no longer have control, this having passed to the transferee. So another secured creditor, even one perfecting by registration, will be subordinate to the transferee.[50] The new account constitutes an independent root of title. Of course, the secured party's interest is limited to a security interest and upon the debt being repaid the securities must be retransferred to the grantor's original account,

[48] See below.
[49] Article 30(4).
[50] Article 30(5).

which will be subject to any junior security interest or interests given over the account prior to the transfer.

Case 2

41 The securities are retained in an account in the name of the grantor but the secured party acquires control because of a tripartite agreement that the intermediary will act in accordance with the secured party's instructions. No control agreement is entered into with any other party. In this case the secured party is the sole person having control and he will therefore have priority over a secured creditor who has perfected by registration.[51]

Case 3

42 The securities are retained in an account in the name of the grantor and the intermediary enters into two control agreements, first with SP1, then with SP2. Priority is determined by the order of control and therefore goes to SP1.[52]

Case 4

43 Securities are held by the grantor in a securities account with an intermediary, I, and the account agreement with I provides that I is to have a security interest in all securities held in the account to secure the grantor's obligations to I. Subsequently I enters into a written agreement with the grantor and SP to act in accordance with SP's instructions. I's security interest has priority under the special priority rule in art 30(8). This may seem to follow anyway because as intermediary I is the first to have control,[53] but the rule is useful to avoid any suggestion that I, by entering into the agreement with SP1, is impliedly subordinating its own security interest.

Case 5

44 Securities are held by G in an account with intermediary I, who advances the price for the purchase of additional securities which it credits to G's account. Subsequent G enters into a security agreement with SP, who takes a security interest over the account. I has priority over SP under arts 20 and 30(8).

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[51] *Ibid*.
[52] Article 30(6).
[53] Article 3(4)(c).

Case 6

45 Securities are held by the grantor in a securities account with I. The grantor grants security interests first to SP1, then to SP2. Both parties perfect by registration. This case is routed by art 30(9) to the residual rules in art 29, so that priority goes to the first to register a financing statement.[54]

Case 7

46 The facts are as in Case 6 except that only SP2 perfects its security interest. Though SP2's interest was later in time it has priority over SP1's unperfected security interest.[55]

Case 8

47 The facts are as in Case 6 except that neither secured party perfects its security interest. Here priority is determined by the order of attachment, so that SP1 wins.[56]

Case 9

48 In order to secure finance a securities intermediary grants security interests to SP1 and SP2 over securities accounts. These may be accounts recording securities held for customers in respect of which the intermediary has been granted rights of use or rehypothecation or the intermediary's own proprietary, or house, accounts. Neither secured party is given control. SP1 and SP2 rank equally, regardless of the order in which the security interests were granted.[57]

49 Article 30 does not currently provide a rule dealing with priority between account holders and a third party taking a security interest from the intermediary in the securities credited to their accounts, a matter of some consequence if the intermediary becomes insolvent. Article 20 of the 2009 Geneva Convention,[58] which is not yet in force, gives priority to the third party except where he actually knows or

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[54] Article 29(d)(i).
[55] Article 29(1)(a).
[56] Article 29(1)(g).
[57] Article 30(7).
[58] UNIDROIT Convention on Substantive Rules for Intermediated Securities. See for a comprehensive analysis see the Official Commentary by Hideki Kanda, Charles Mooney, Luc Thévenoz and Stéphanie Beraud, assisted by Thomas Keijser.

ought to know that the interest granted violates the rights of one or more account holders.[59]

Priority in intangible proceeds other than securities accounts or investment securities

50 Where proceeds consist of securities accounts or investment securities, cash or insurance or other compensation payments, the priority rules set out above apply to the proceeds, and if the security interest is covered by the continuous perfection rules described above priority follows that of the original collateral. Where the proceeds consist of other forms of intangible, for example, contract rights or intellectual property rights, the residual rules of art 29 apply.

4. Persons taking free

51 While art 29 and 30 deal with priorities, art 38 describes the circumstances in which a purchaser takes free of a security interest altogether. However, since "purchaser" includes a person taking security, art 38 operates as priority rule in relation to such a person, so that "taking free" is to be interpreted accordingly. The first case of taking free is where a person gives value for a certificated investment security and takes possession of the certificate. The second is where a person gives value for an investment security held with an intermediary where this is transferred into that person's name in a case outside art 30. The only case where a transfer falls within art 30 is where the competing security interest is in favour of the intermediary and is subordinated to the rights of the transferee under art 30(4). The taking free provisions do not apply if at the time the purchaser agrees to acquire the investment security he knows that the disposition to him would be in breach of the security agreement.[60]

5. Default and insolvency

Default remedies

52 SIJL 1 provides a battery of default remedies, including appropriation of the collateral or proceeds[61] and sale, and ancillary

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[59] *Ibid*, at 128 *et seq*.

[60] Article 38(2), (4).

[61] Appropriation means taking of the collateral in or towards satisfaction of the debt and its effect is to extinguish the debtor's right of redemption and junior security interests (art 47, which does not refer to extinguishment of the right of redemption, but this is implicit in the remedy). Appropriation is to be distinguished from the English law remedy of foreclosure, which entitles the

actions such as taking control or possession, exercising any rights of the grantor in relation to the collateral or proceeds, instructing any person who has an obligation in relation to the collateral or proceeds to perform that obligation for the benefit of the secured party. The secured party may also exercise any other remedy provided for by the security agreement so far as it does not conflict with the Law.[62]

Secured party's rights on debtor's insolvency

53 The secured party's powers of enforcement are not affected by the grantor's insolvency[63] and apart from avoidance of an unperfected security interest most of the provisions of the Bankruptcy (Désastre) (Jersey) Law 1990 and the Companies (Jersey) Law 1991 do not affect the operation of SIJL 1.[64]

54 Finally, close-out netting provisions by which agreements between the grantor and the secured party are terminated and netted to produce a single delivery obligation remain valid despite the advent of insolvency proceedings.[65]

Professor Sir Roy Goode QC is Emeritus Professor of Law in the University of Oxford and Emeritus Fellow of St John's College, Oxford. A leading authority in the field of commercial law and the law relating to secured transactions, on which he has published widely, he provided the blueprint for what is now the Security Interests (Jersey) Law 2012. As consultant to the Government of Jersey he worked closely with the then Law Draftsman and with Jersey banking lawyers. He has been asked to act in a similar capacity in the preparation of SIJL 2.

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secured party to keep the collateral without a duty to account for any surplus value while extinguishing the debt and is a rarely used remedy. By contrast, any surplus value held by the secured party exercising a right of appropriation must be held for any junior creditors and, if any remains, for the grantor (art 49).

[62] Article 43.

[63] Article 56.

[64] Articles 57–59.

[65] Bankruptcy (Netting, Contractual Subordination and Non-Petition Provisions) (Jersey) Law 2005, art 2.