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FINANCIAL MARKETS LAW COMMITTEE

ISSUE 3 – PROPERTY INTERESTS IN INVESTMENT SECURITIES

The Six Classic Priority Scenarios

Background paper to FMLC paper entitled, “Analysis of the need for and nature of legislation relating to property interests in indirectly held investment securities, with a statement of principles for an investment securities statute”

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FINANCIAL MARKETS LAW COMMITTEE

ISSUE 3 - PROPERTY INTERESTS IN INVESTMENT SECURITIES WORKING GROUP

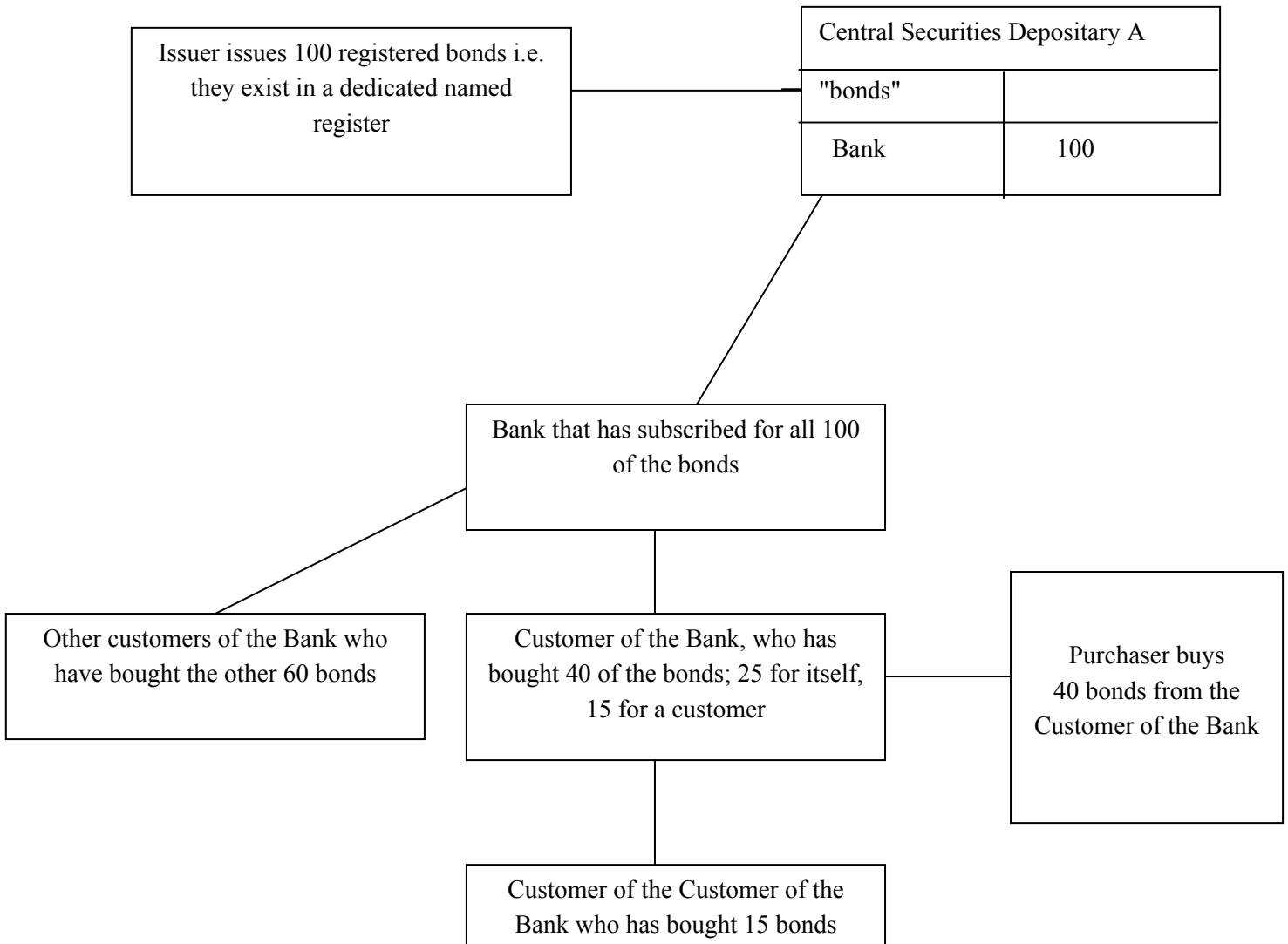
The FMLC paper entitled, “Analysis of the need for and nature of legislation relating to property interests in indirectly held investment securities, with a statement of principles for an investment securities statute” deals with the law, present and future, relating to ownership of certain securities.

One of the methods lawyers use to analyse questions in this area is to hypothesise certain factual scenarios that are common in commercial practice. The six classic scenarios where rules of priorities come into play are illustrated in the following pages. These are intended to be helpful to all who need to study this area of the law, and the FMLC’s proposals about it, whether from an academic, practicing, or official perspective.

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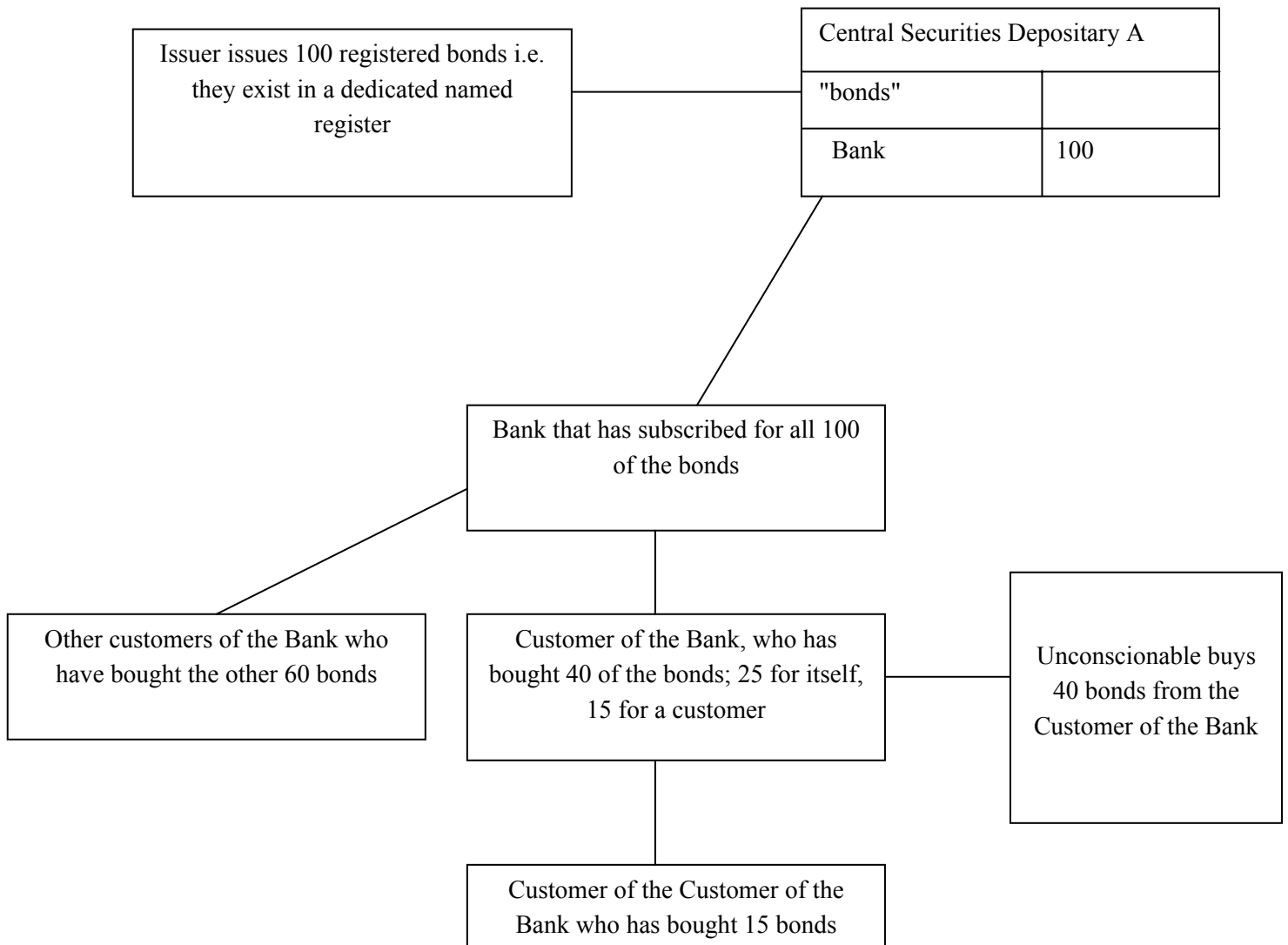
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1) The mischievous Intermediary



Q: If Customer of the Bank deliberately sells 40 bonds to Purchaser in contravention of its duties to the Customer of the Customer of the Bank, who owns them?

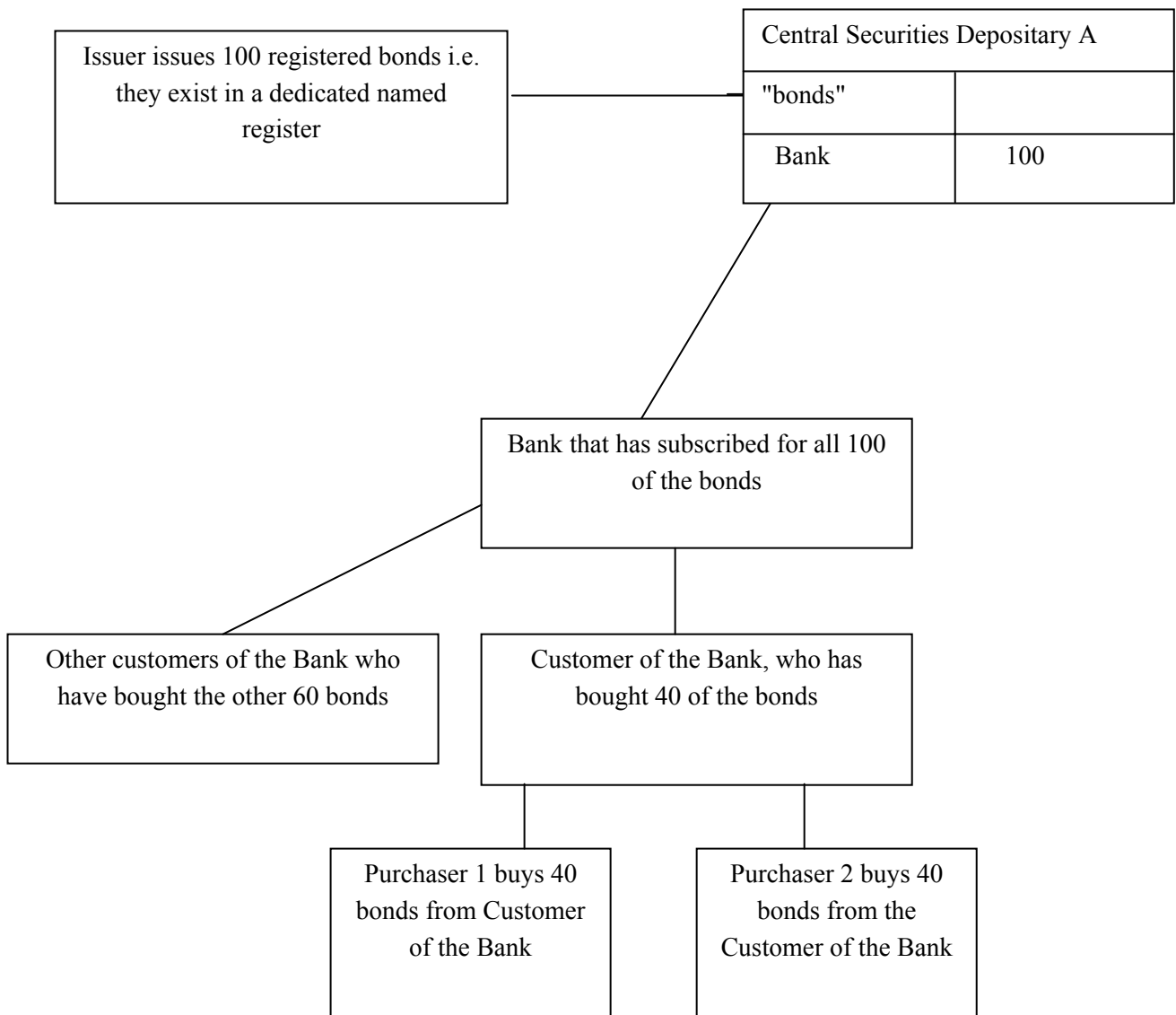
2) The bad faith purchaser



Q: If Customer of the Bank sells 40 bonds to Unconscionable (being someone who knows that 15 of the bonds were bought for a customer of the Customer of the Bank), who owns them?

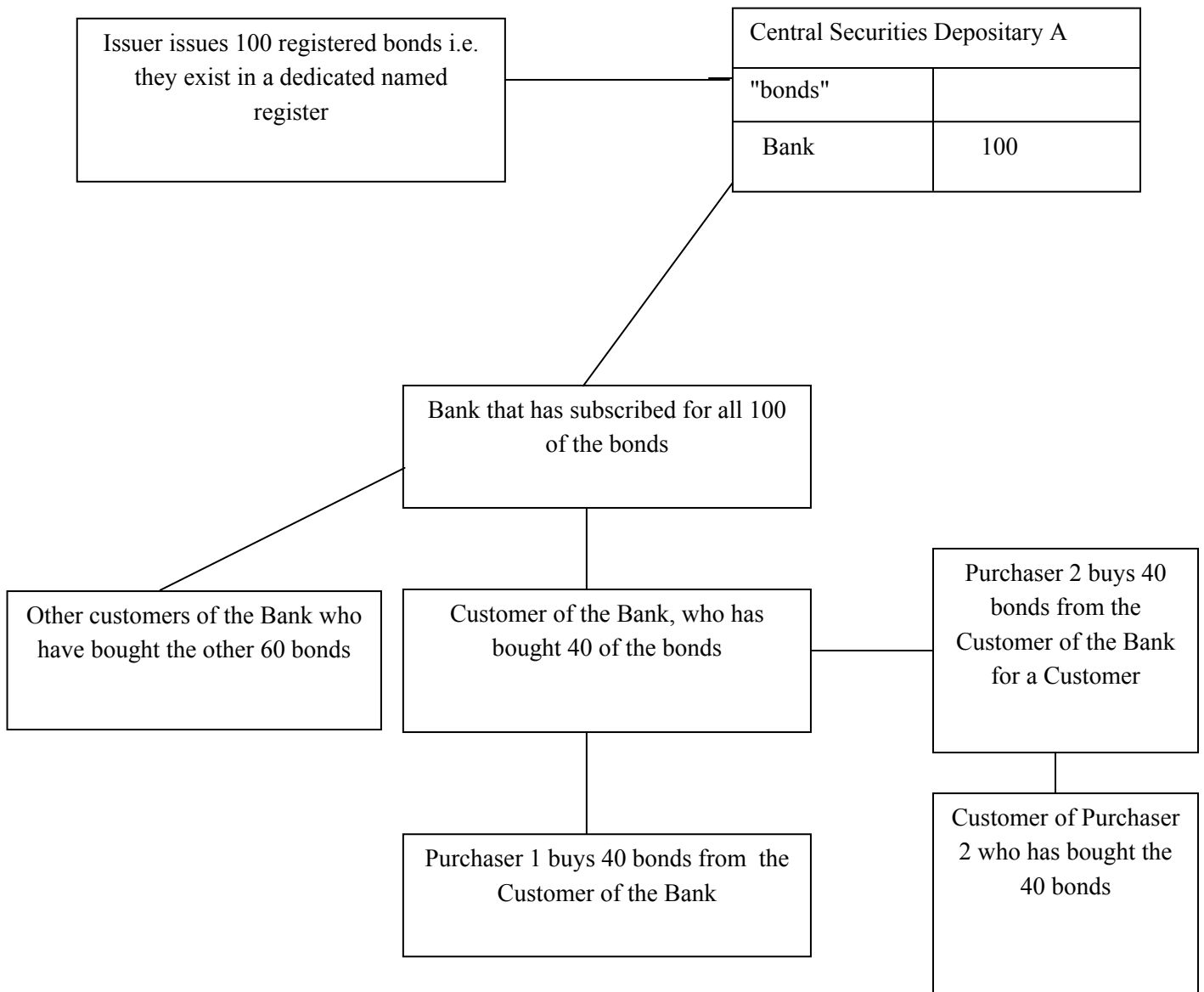
3) The double-dealing Intermediary

i) Purchasers hold through the same Intermediary



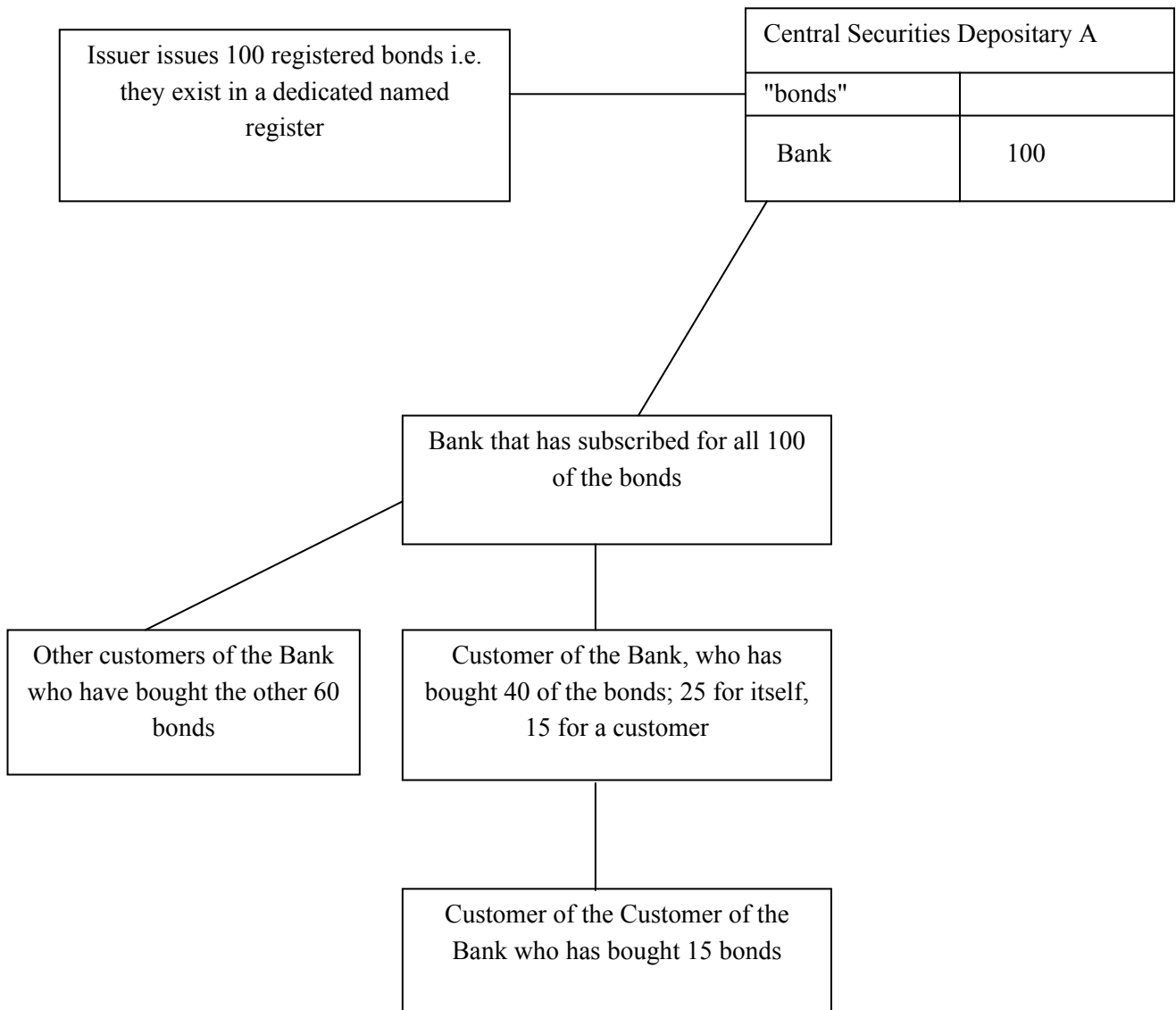
Q: If Customer of the Bank sells 40 bonds to Purchaser 1 but continues to hold these bonds on behalf of Purchaser 1 and then sells the same 40 bonds to Purchaser 2, who owns them?

ii) Purchasers hold through different intermediaries



Q: If Customer of the Bank sells 40 bonds to Purchaser 1 but continues to hold those bonds on behalf of Purchaser 1 and then sells the same 40 bonds to Purchaser 2 who hold them on behalf of a Customer, who owns them?

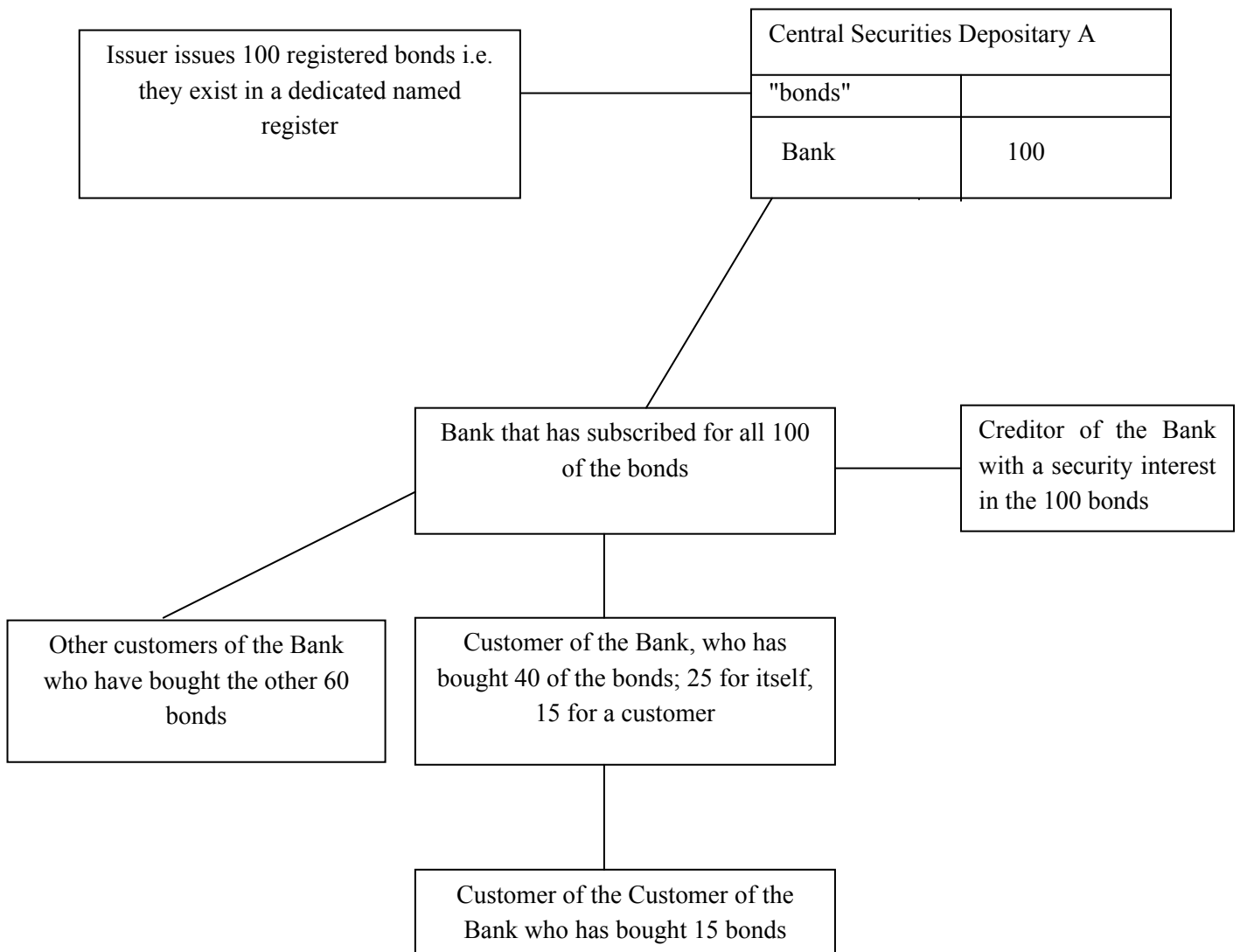
4) A shortfall in the Intermediary's securities



Q: If for any reason the Bank only in fact has 80 bonds on its books, who owns how many bonds?

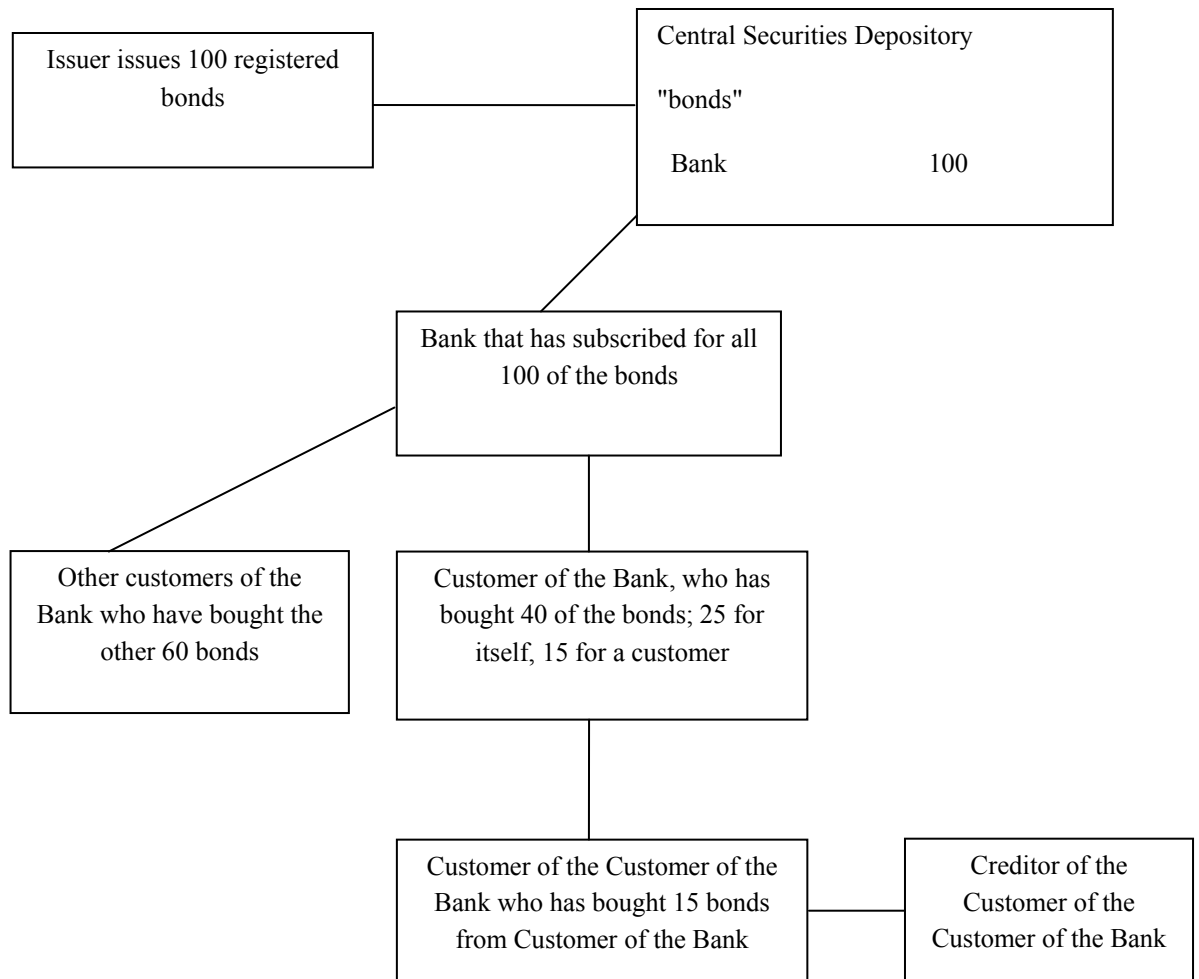
Does your answer differ depending on whether the shortfall arises as a result of the fault of either the Bank or of any identified customer?

5) The "Creditor versus Account Holders"



Q: If the Bank defaults under the terms of the loan granted to it by the Creditor, is the Creditor able to exercise its rights under the security agreement? What about the various customers?

6) **The "Upper Tier Attachment"**



Q: If the Customer of the Customer of the Bank defaults under the terms of the loan granted to it by the Creditor, can the Creditor go to Customer of the Bank, Bank or to Central Securities Depository directly and claim the 15 bonds?