EUROPEAN CENTRAL BANK

DIRECTORATE GENERAL – LEGAL SERVICES

DIRECTOR GENERAL

10 April 2000

MINUTES OF THE 3rd MEETING OF THE EUROPEAN FINANCIAL MARKET LAWYERS GROUP

on 28 March 2000

PARTICIPANTS: The list of attendants is attached (see Annex 1).

The third meeting of the European Financial Market Lawyers Group (EFMLG) was held in Frankfurt at the premises of the ECB on Tuesday, 28 March 2000. The meeting was chaired by Mr Antonio Sáinz de Vicuña (Director General, ECB Legal Services). Invited guests were Mr Peter Restelli-Nielsen of the European Commission's DG Internal Market, in his capacity as Secretary to the Commission's Forum Group on Collateral and Mr Edward Murray (Allen and Overy) as Chairman of the International Swaps and Derivatives Association (ISDA) Collateral Law Reform Group. In addition, representatives of several national central banks were present in an observer capacity.

1. Introduction and approval of the agenda

After an introduction and welcome of the guests by the Chairman, the Group approved the proposed agenda. The Chairman mentioned that contacts had been established with both the Financial Market Lawyers Group of the Federal Reserve Bank, New York, and the Financial Law Board sponsored by the Bank of Japan. He was also emphasising his gratitude towards the members of the Group who had contributed extensively to the ongoing projects. The Chairman expressed his wish that the Group could benefit from the increasing momentum of developments in the area of financial markets law which is also supported by a number of other initiatives, such as FESCO, the European Repo Council and others. Such a momentum might ultimately lead towards a consolidation of the financial industry in Europe, as it is presently already perceivable in the area of stock exchanges or securities settlement systems.

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2. Pledges and transfer of title

The Chairman invited Mr Restelli-Nielsen to present the work conducted by **the Commission's Forum Group on Collateral**. The Forum Group was established in 1999 by inviting market participants (both lawyers and operational experts) to give advice to the Commission on how best to achieve legal certainty as regards validity and enforceability of collateral in cross-border financial transactions. In doing so, the Forum Group forms part of the ongoing project of the Financial Services Action Plan that was adopted by the Commission in 1998 to set up a concrete work programme on how to promote further the development of financial services on a European scale. Amongst the issues that were given top priority was the issue of cross-border use of collateral. The Forum Group so far has analysed the existing legal situation in that area by building on work already conducted (Giovanini report, ISDA survey, IBA paper) and concluded that there is a need for an EC Directive: Although the Finality Directive has been a first step towards increasing legal certainty and validity of cross-border transactions, the Directive does not deal with bilateral transactions and does not touch the area of administrative burdens in respect of the establishment and perfection of collateral as well as a number of other issues. Thus there are still considerable obstacles with respect to the integration of a collateralised money market in Europe (legal, tax and accounting implications). The main issues to be focussed upon by the Forum Group have been perfection: requirements, location, protection against insolvency, close-out netting, top-up collateral and the re-use of pledge. The Group did not focus on issues such as real estate, consumer issues and a full harmonisation of securities law in the vein of Article 8 UCC. An outline report of the Forum Group is expected within the next few months.

The Commission's aim is to prepare a draft directive by the end of this year to have the directive adopted by 2003. Taking into account the deadlines required for implementation by Member States a European wide implementation might take place by 2005.

Both the Group and Mr Restelli-Nielsen agreed that the findings of the EFMLG in the area of pledge and title transfer so far are basically coming to the same conclusion.

Members of the Group mainly voiced their concern as regards the rather long timeframe, which might not give quick relief to the existing problems. In view of the urgency of the markets, perhaps a fast-track procedure would be justified. Mr Restelli-Nielsen responded that, compared to other legislative projects of the EC, a full implementation within four to five years would already be fast.

As **general issues**, it was discussed whether a fully-fledged law reform along the lines of Article 8 UCC would have its merits. The majority of the members held the view that the existing duality of legal instruments (pledges and title transfer) is sufficiently clear to allow further elaboration and that there is already an ongoing trend to further specify the existing legal instruments (e.g. through the Finality Directive or legislative efforts such as in Belgium, France and the Netherlands as regards improving title transfer).

As regards an extension of the application of such new legislation to **consumers**, the Group felt that such an extension to consumers might be counterproductive as consumer issues are always sensitive when it comes to new legislation. To add a consumer element would bear the risk of inefficiency as the complexities of existing laws are too big.

Mr Ian Jameson then presented the two documents that had been prepared by him, namely a draft **proposal for European legislation** and a new version of the **report on pledges in the EU**.

Mr Jameson first presented his new **survey report** which had been updated with new material, especially as regards the status of the implementation of the Finality Directive and additional information on title transfer and securities lending. Mr Jameson indicated that he intended to set up schedules listing, in the form of tables, the areas of main relevance.

The survey shows the wide range of regimes in existence, from very favourable to non-favourable for *cross-border use of collateral*. Also, as regards *title transfer*, some countries provide for special legislation, while others prove problematic. All in all, the situation clearly shows a lack of clarity on how to establish collateral and thus hampers the efficiency of the markets. Mr Jameson asked the members of the Group to review again the respective national entries.

The draft **proposal for an EU legislation** takes up the issues stemming from the survey. Its proposed scope of application covers both pledge and title transfer whilst concluding that a new form of securities interest would prove too ambitious as running counter to national traditions. A special focus of attention should be on the definition of securities to be included in the scope of application as well as on the types of exposures.

The proposal is to be separated in a group of *core elements*, comprising minimum form requirements, perfection requirements, validation of title transfer, amendments to insolvency law and the recognition of top-up collateral, substitution and netting; and *supplemental elements* like the re-use of pledge collateral and tax and accounting as well as conflict of law aspects.

The Group felt that a clarification on the scope of application as regards the covered *entities* would be merited (e.g. excluding consumers). There was no final conclusion on whether the new directive should apply beyond inter-bank transactions by requiring at least one of the parties to be a financial institution or at least a professional investor.

On the issue of *good faith protection*, Mr Restelli-Nielsen made clear that the existing national rules to that respect should not be altered by new legislation.

As regards the issue of *transparency*, which directly relates to the registration requirements in some countries, the Group felt that such transparency could be ensured by requiring pledged collateral to be booked on special accounts or marked in a security settlement system.

On the issue of the *re-use of pledged securities*, the Group was divided. A number of members felt that this idea collides with traditional concepts of pledges in some Member States. Nevertheless the Group acknowledged that this possibility would correspond to market needs and, to a certain extent, already to

market practice. Some members felt that the possibility to re-use pledge collateral should only be given if expressly mandated by the collateral-giver. It was also pointed out that for those entities wishing to make use of collateral the parties concerned may make recourse to title transfer structures. There was a general feeling that the intention to introduce the use of pledge collateral might create opposition by Ministries of Justice.

A further issue was the *credit risk* inherent to both pledges and title transfer transactions. In relation thereto, some members of the Group felt that an automatic first priority pledge over assets to which title is transferred or over their identifiable proceeds to the extent of the over collateralisation might go far. There might be a market need to maintain a certain difference between the two regimes (i.e. being either more favourable for the collateral-giver or the collateral-taker (and this might also decrease re-characterisation issues).

The Secretary, Mr Klaus Löber, expressed the intent to deliver at least the final *proposal for EU legislation* to the Commission's Forum Group at its next meeting on 10 May 2000. The members of the Group were therefore asked to deliver their comments on the draft proposal by **15 April 2000** at the latest, in order to allow an incorporation into the proposal and a resubmission to the members of the Group for approval in advance of that date.

3. Dematerialisaton

The rapporteur for this issue, Mr Philip Hanssens, presented the table that had been prepared on the basis of the answers given by the members of the Group. The main issues of concern are the lack of homogeneity and, resulting therefrom, possible national discrimination. Another issue that had been identified is the status of legal ownership to dematerialised securities.

Some members of the Group voiced their concern that, although important for the markets, dematerialisation is mainly an issue of corporate law, and only to a lesser extent to financial services law. Also, further clarification might be needed on who would be the addressee to a possible recommendation by the Group (e.g. the EC or FESCO).

The Group members were asked to revise again the entries to the table and to return corrections together with possible other remarks to the secretary of the Group. Such other remarks might comprise suggestions on whether the disharmonised legal treatment of securities raises issues for the cross-border use of securities that might warrant a solution at Community level. In that respect, the members of the Group are also asked to consider what initiatives could be taken by the Group.

4. Legal concepts of debt

The rapporteur, Mr Martin Thomas, presented his draft **survey on concepts of debt** in the EU. He noted that the survey so far is only half-ready, as only half of the countries are covered. It is intended to present a full survey to the members of the Group as soon as possible.

In the meantime, the members are asked to review the draft and to comment on which of the issues listed in the draft survey might merit a solution at community level due to the current lack of harmonisation as regards the legal treatment of securities in the context of cross-border securities transactions.

The Group is also asked to consider whether there is a scope for the harmonised structure of debt instruments and, if so, whether it would be beneficial for a fully integrated capital market.

5. Force majeure

The rapporteur, Mr Klaus Löber, presented the table on the existing situations with respect to **force majeure** in national environments. This draft table shows that there is still a wide range of diversity when analysing the coverage of force majeure either by statutory law, courts or provisions within standard agreements. Nevertheless, in particular, with a review on the case law that has been established by the European Court of Justice, the basic elements that define force majeure throughout the EU can be extrapolated. In addition, there is noticeable trend throughout the exiting standard market documentation to either introduce or to expand force majeure provisions within existing master agreements. This can be seen in particular in respect of the treatment of impossibility or illegality events.

Mr Niall Lenihan then presented the new force majeure provisions that had been adopted by the FMLG last December. He noted that the new provisions mainly deal with procedural issues (e.g. waiting periods) and only to a lesser extent with a clear definition of what constitutes force majeure.

The Group is asked to revise the national entries to the table on force majeure. They are also invited to express their views on whether the force majeure provisions in the EU are sufficiently similar to allow for a standard approach and, if so, in relation to what areas of financial market business. It is intended, on the basis of the feedback of the members, to draft an issues paper proposing further steps.

6. Market documentation update

A short presentation was given on new developments in the fields of market documentation by presenting the state of affairs as regards the European Master Agreement, the new cross-product master agreement published by various market associations in February 2000 and two ECB publications issued in November 1999 on cross-border payments in TARGET and the correspondent central banking model.

7. Other matters and follow-up

The members of the Group were asked to provide their input as soon as possible, possibly before **15 April 2000**. Preference should be given to the answers on the draft proposal on EU legislation and the draft survey on collateral. On the basis of the answers of the members, it is suggested to review the existing documents and, in particular as regards pledge and title transfer to present a finalised draft proposal to the Group for its approval. Pending the feedback of the Group, a **fourth meeting** of the EFMLG is proposed for **Friday, 5 May 2000** at the premises of the ECB in Frankfurt.

The Chairman also announced its intention to ask for permission of the ECB to set up an *EFMLG website* linked to the ECB homepage. The Group approved this intention.

Finally, as regards new issues to be dealt with by the EFMLG it was proposed to focus on a common definition of what constitutes a **repo transaction**. This proposal was taken up favourably by the Group. Unless objections will be raised by members of the Group, this issue will be taken up amongst the future projects to be followed by the EFMLG. If proven successful, this issue might even be extended to securities lending transactions in a second step.