



EUROPEAN CENTRAL BANK

DIRECTORATE GENERAL LEGAL SERVICES

To the Members of the
European Financial Market Lawyers Group

5 April 2001
Contact person: Klaus Löber
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European Financial Market Lawyers Group **Aide mémoire of the meeting of 14 March 2001 and follow-up work**

Dear Colleagues,

I would like to thank you for the lively discussions as well as your supportive input provided at our last meeting. I very much hope that by virtue of these discussions on the various subjects, the EFMLG will be able to provide added value to the developments towards a single European financial market.

1. General

Mr Richard Bennett of HSBC (represented by Mr David Bloom), Ms Nuria Alonso Jimenez of Banco Bilbao Vizcaya Argentaria (BBVA), Mr Ulrich Parche of HypoVereinsbank and Mr Klaus Poggemann of WestLB have joined the group.

2. Repurchase transactions in EU countries

In order to investigate whether the existing variances in the legal definitions of repurchase transactions are posing a problem to the integration of the EU financial markets, it was decided to gather information on the basis of a questionnaire prepared by Pierre Fiset. The proposed questionnaire is divided into four sections, referring respectively to background information, legal issues, regulatory issues and issues encountered in practice.

The group discussed, on the basis of the draft questionnaire, the various trends and focused on the history and economic goals of repos. It was discussed in particular whether or not a separation should be made between cash driven and securities driven transactions. It was suggested to make a comparison with securities lending transactions.

In the context of the legal issues, the group discussed i.a. the ownership concept (to be understood in a narrow sense or economic equivalent). It was also agreed to investigate further the treatment of coupon payments. In addition, the members of the EFMLG discussed whether there are specific issues related to multi-branch agreements, but concluded that this is more an issue for derivatives transactions. Finally, in the context of the issues encountered in practice, the group will be asked to state its views on whether the current definition in the EC draft Collateral Directive will be satisfactory from a practitioners point of view; and on whether any specific provision may be supported for consideration in the preparation of that Directive

Follow up

Based on this outcome, Pierre Fiset will revise the questionnaire and a new version will be forwarded to the members of the group within short delay. Members of the EFMLG are asked to provide answers (if possible, one set of answers per jurisdiction only) to the questions within five weeks on receipt of the new questionnaire.

3. Force majeure

The topic was presented by Ulrich Bosch on the basis of an issues paper that was sent to the group in advance of the meeting. According to Mr Bosch, three fields of relevance can be categorised.

First, the issue of force majeure becomes relevant in the context of the discharge or suspension of obligations based on statutory concepts or court doctrines of frustration and impossibility. A harmonisation of the statutory or court developed concepts of force majeure might prove as being too ambitious, with the group's aim mainly on the harmonisation of market standards. Moreover, it should be noted that these provisions often form part of the negotiation process between two parties.

The second issue of relevance related to force majeure are market related force majeure provisions in the underwriting business. In this context, it has to be noted that quite a remarkable harmonisation has already been achieved by the work of IPMA.

Thirdly, the issue of force majeure is relevant in relation to the termination and closeout in the context of trading master agreements. Here, force majeure has to be seen in a broader context, encompassing also cases of "impossibility" and "impracticality" in addition to illegality. The interest in that field can be underlined by recent events such as Malaysia. The group took also note of the work being conducted by the FMLG of the Federal Reserve Bank New York in the context of its foreign exchange master agreements. This issue has been considered also by members of market associations such as ISDA and the sponsoring organisations for the European Master Agreement. The group held the view that the developments within a number of master agreements could form a basis, which might ultimately lead to a recommendation for a best market practice by the EFMLG.

As a fourth issue that arose during the discussion of the group, it was discussed whether a party should be always responsible for performance (including through other branches) or whether a counterparty

which to choose to transact the specific branch of an institution should be bound by that previous decision. This issue is of relevance as regards the question of political ring fencing.

Finally, as a last issue not covered by the issues note, the group discussed the problem of computer breakdowns and strikes which are currently both regulated through contractual agreements but also a number by national (labour) law. In relation to this issue, the group identified the problem of defining a computer breakdown and discussed various ways to deal with this issue, e.g. by proposing standard language to the markets or even a market convention.

Follow-up

- a) In relation computer break downs and strikes, Ian Jameson, with the help of Ulrich Bosch, will investigate further on this issue and to prepare a short questionnaire to that respect.
- b) In relation to force majeure in the underwriting business, the group concluded that after substantial work had been done by IPMA in that field, there is no need to further pursue this issue.
- c) In relation to the issue of termination and close out of trading master agreements, the group concluded that a fair balance has to be found between (i) allowing for total discharge of obligations and (ii) an unlimited suspension and (iii) termination and netting. Current master agreements do often not contain any specific wording in relation to natural disasters, civil conflict or payment prohibitions. Thus, a general treatment of such an event as an event of default would apply. David Bloom will link up with Ulrich Bosch to set up an issues paper which will reflect on whether (based on the debate within the FMLG of the Fed of New York and the wording suggested by ISDA), a general recommendation could be elaborated.
- d) The multi-branch issue (political ring fencing) is covered in rare cases by special legislation such as in the US. There are differences under other national laws (Article VIII of the IMF Agreement is neutral on that aspect). The group concluded that further work needs to be done to assess the current state of legislation and whether there is a need for a legal act of the EC in that field. Alternatively, ring fencing could be achieved on a master agreement level or even a confirmation level. The work will be conducted by Richard Firth in collaboration with Ulrich Bosch.

4. Dematerialisation

The issue was presented by Frederic Nizard, who prepared a background note and two questionnaires specifying the scope of the problem. The two questionnaires deal with different issues relating to dematerialisation. The first questionnaire raises questions of the general structure established in the member states whereas the second one tries to point out the practical implications of the dematerialisation regimes. The first questionnaire deals with the theoretical aspects whereas the second tries to assess the practical aspects of dematerialisation. The main questions to focus on were (a) what is the nature of investor's right and (b) how are titles evidenced. Allusion was made to the Maxwell case.

The group agreed that the main aim of any legislation should be simplicity and effectiveness. It was acknowledged that a system of full dematerialisation depends on sufficiently modern technology. Especially the integrity of the person who runs the book entry systems must be ensured. The group discussed at length the advantages and differences between a fully dematerialised system and a system based on immobilisation, without coming to a final conclusion.

The members of the group identified three possible ways in which systems for the holding of securities are currently being structured: either they are mandatory paper based or they are mandatory dematerialised or they allow for both ways to issue securities. Whilst acknowledging traditional aspects related to the concepts of the issue and holding of securities, the group acknowledged that there have been recently a number of developments in relation to the cross-border aspects, in particular as regards the private international law side which would demand a review of existing regimes.

The need for the European financial markets to integrate further and the need for a cross-border recognition of the holding and transfer of securities urges for revising of the current legal regimes in Europe. One possible option could be to address the issue by Community legislation. To that extent, the group agreed that a good starting point would be to investigate fully on the current legal situations in the EU Member States on the basis of the questionnaires prepared by Frederic Nizard.

Follow-up

The group agreed to send any comments they might have on the current questionnaires within ten days after the meeting, subsequently a revised version of the draft questionnaires will be sent out to the members of the group.

Deadline for the submission of answers (again, if possible only one set of answers per jurisdiction) would be within six weeks within receipt of the questionnaire.

5. Dematerialisation in the UK/Operation Machete of the Financial Law Panel

Martin Thomas presented current developments as regards the dematerialisation of securities in the UK. He reported that the current partial dematerialisation system of Crest would be re-organised. In addition, he presented the project Operation Machete of the Financial Law Panel which aims at allowing for privately issued debt by means of complete dematerialisation). The group debated the scheme proposed by the Financial Law Panel.

6. Hague Convention on the Law applicable to cross-border dispositions of securities

Klaus Löber reported on the project currently being undertaken by the Hague Conference on Private International Law to set up a convention determining the law applicable to securities held through indirect holding systems. The aim of the project is to remove uncertainties as to which law applies to

collateral transactions on a cross-border basis, which is currently severely hampering the smooth functioning of cross-border collateralisation. The draft convention is intended to be restricted to the conflict of law rule relating to proprietary aspects of cross-border dispositions of indirectly held fungible securities and is not intended to interfere with insolvency law. The group noted that the draft convention is not yet in its final shape. As the convention will be discussed by a diplomatic conference of the Hague Conference in June, comments might still be channelled to the Hague Conference by the end of April 2001.

Follow-up

The members agreed to submit any comments they might have on the current draft of the Hague Convention within two weeks after the meeting. The group also agreed that a quick solution is desirable, in particular the goal of a consistency with the existing EC legislation (e.g. the Settlement Finality Directive and the Winding-up Directive for Credit Institutions) should be maintained. The group debated in particular on possibilities to locate a securities account. The group held the view that the determination should be based on objective criteria, although some members questioned whether a linkage to accounting rules is helpful as securities accounts normally do not form part of a bank's account. However, the members of the EFMLG held unanimously the view that any final solution should be as simple as possible in order to avoid any ex ante uncertainty on the applicable law.

Members agreed to provide feedback, if any, by mid of April 2001.

7. Issues of relevance to the European Securities Markets

a) *The final report of the Wise Men*

The group discussed the findings of the Wise Men in particular the proposals to establish comitology proceedings in the field of the securities markets. The chairman noted that the ECB will be involved in the further proceedings.

Follow-up

The members were encouraged to give any feedback on that issue they might deem helpful for the further debate.

b) *Collateral directive*

Klaus Löber reported on the state of affairs as regards the draft EC Collateral Directive. It was reported that the final proposal of the Commission is due to be released by the end of March 2001. The chairman mentioned that any feedback on reactions of national associations, such as the Banking Associations, might prove helpful for the further work in that area.

Follow-up

The members are requested to send in any national feed back on the collateral directive.

8. Other matters

a) *Financial Market Lawyers Group/Financial Law Board*

David Bloom and Niall Lenihan reported about current work being undertaken by the FMLG of the Fed in New York. Amongst the issues currently being discussed, a netting conference hosted for the Latin American and Caribbean states should be mentioned. Moreover, the FX Committee issued new guidelines for FX activities. Moreover, the FMLG and the FX Committee are currently considering best practices for the markets in case of an enactment of foreign exchange controls.

Pierre Lastenouse reported on activities of the Financial Law Board of the Bank of Japan which have been dealing with issues related to the modernisation of the national securities settlement systems, the registration system and aspects related to dematerialisation of Japanese securities.

b) *EFMLG website*

The chairman reported, that the establishment of an EFMLG website linked to the ECB's website has been approved by the Executive Board of the ECB. The technical preparations for the set up are currently being undertaken and a launch is expected in the second half of 2001.

c) *Date of next meeting*

As discussed at the end of the last meeting, we propose **Monday, 18 June 2001** as the date of the next meeting. In order to allow you to arrive in the morning of that day, the meeting will only start at 11 o'clock and will last until 18 o'clock.

Best regards,

Antonio Sáinz de Vicuña
General Counsel