



EUROPEAN CENTRAL BANK

**European Financial Market Lawyers Group
Aide-Memoire of the Meeting of 3 July 2001**

1. General

Mr Franc Tillian from Bank Austria, Ms Merja Viitala from Merita plc and Mr Pedro Ferrerra Malaquias from BCP Investimento have joined the group.

2. Force majeure

In contrast to the US markets, where force majeure is considered as a purely technical matter, in the European Union the diversity of jurisdictions is posing an additional layer of complexity. A possible initiative from the EFMLG in that area could take the form of a recommendation to the European Commission.

(a) Computer breakdowns and strikes

Mr Kerjean (ECB) presented the paper on this subject, listing applicable EC legislation and case law on the issue of force majeure:

- *Computer breakdowns*

The European Court of Justice has held that there is recognition of the concept of force majeure in all Member States, based on events being unforeseeable and beyond the reasonable control of the parties, whereby the circumstances have to create insurmountable obstacles even if all diligence has been respected.

- *Strikes*

In many Member States strikes are considered as a fundamental right, as evidenced both by the EU Charter of Human Rights and at a national level. Consequently, the ECJ is reluctant to accept strikes as an event triggering force majeure ('wild strikes' being an open issue).

(aa) Computer breakdowns

When discussing the note, the Group found that especially in relation to the protection of telecommunication services, a promotion of best practice and proposals to launch a discussion within the industry might be warranted. In this area, a possibility to give recommendations by the EFMLG was identified.

As to the content of any such recommendation, the Group agreed that the concept of force majeure directly affects the liability of counterparties and therefore the allocation of risks. The problem of consequences of force majeure would need to be tackled, i.e. whether it leads to an excuse of performance or only to a waiting (also known as 'grace') period during which solutions could be found. It was pointed out that, from a commercial perspective, computer breakdowns should never excuse performance. The question whether damages are due in case of a computer breakdown would depend on the actual circumstances. However, before terminating an agreement, a reasonable waiting period should be allowed for.

The question was raised whether this issue could be tackled by a market convention. Particular attention should be paid to the practise of securities settlement systems and alternative trading systems, which tend to limit their liability to a wide extent or to share losses between their participants.

Follow-up

The question will be further pursued by a sub-group, consisting of Mr Parche, Mr Fiset and Mr Tsibanoulis, with support from the ECB. The sub-group will try to formulate tentative recommendations to be presented in advance of the next meeting.

(bb) Strikes

Certain institutions, such as SWIFT, exclude liability in the case of strikes of their employees. This could have a potentially disastrous impact on the financial markets in general, if a small but central entity would be affected by strikes. However, the Group pointed out that, in practice, it might be very difficult to differentiate between internal and external strikes, thus giving leeway to uncertainties.

Follow-up

A short questionnaire, to assess the various national legal environments will be prepared by the ECB and circulated to the Members of the group in due course.

(b) Termination and close-out of trades under Master Agreements

Mr Bloom presented a discussion paper.

A number of issues for the consideration of the Group were identified, including the ongoing discussions within the Foreign Exchange Committee/the FMLG of the Federal Reserve Bank in New York, ISDA and the “Global” Documentation Steering Committee. The main problems that will have to be solved will be the scope of provisions to trigger force majeure events (change of law, illegality, etc.), the question whether it should be the same clause across different product types and finally, which effects such event should have.

Follow-up

A subgroup, consisting of Mr Bloom, Mr Firth, Mr Bosch, and supported by the ECB, will further address the topic by elaborating on the present issues note in order to present a tentative proposal to the Group in advance of the next meeting.

(c) Multi-branch issue

Mr Firth presented his note. In his view, the comparison of the situation in the US with the one in the EU could to a certain extent advocate for a legal act of the EU, the arguments in favour being a need for clarity and predictability, following a policy of prudent regulation, whereby the impact of modern technology should be taken into account. Against such legal act, it could be argued that the issue is part of the contractual allocation of risks between parties and might inadvertently affect the operation of the inter-bank wholesale deposit market.

Mr Firth recommended the preparation of a questionnaire, to obtain a snapshot of ‘ring-fencing’ provisions in the EU, and to clarify regulatory goals. In addition, Mr Bosch added to the presentation of Mr Firth, by referring in particular to the relevant US statutes in this field.

The group noted that, when assessing the situation, the impact of restrictions imposed by one Member State on institutions operating across the EU needs to be analysed. A further issue of attention might be the asymmetry of the rules on ring-fencing as regards branches of EU institutions in the US compared with the situation of branches of US institutions in the EU.

Follow-up

A questionnaire will be prepared by Mr Firth, to be sent out to the Members in advance of the next meeting, with the aim of obtaining a comparison between the US and the EU situation.

3. Repurchase transactions in EU countries

Mr Fiset presented an overview of the answers to the questionnaire received so far. Those Members who have not yet replied were urged to send in their answers at their earliest convenience.

It was pointed out that the answers received vary as to the extent of detail they provide. As a first general conclusion, it may be noted that the differences are not very significant, with the possible exception of Spain and Italy. There seem to be only a few differences with regard to the formalities. However, the tax and the accounting situation might need more analysis.

Concerns were raised as to whether all elements of repurchase transactions will be properly covered by the proposed EC Directive on financial collateral arrangements.

Follow-up

The draft overview on the national situations will be completed and the some aspects of the answers will be further elaborated with the help of the Members and in connection with other entities. A tentative list of the main findings will be prepared by Mr Fiset with the support of the ECB.

4. Dematerialisation

Mr Nizard presented a tentative table comparing the national situations in three EU countries: France, Germany and the UK. The aim of the dematerialisation questionnaire was inter alia to obtain a critical analysis of national law. In general, all forms of holding and transferring assets by way of book entries should be covered by the responses.

The Group pointed out that specific attention may be paid to questions of transfer of ownership on a trans-national level, in particular in multinational entities such as Euronext. As an ultimate goal, multinational placing of issues should be possible. It was also pointed out that an optional dematerialisation may be preferable to a mandatory solution.

Follow-up

A sub-group consisting of Mr Fiset , Mr Thomas, Mr van Besouw, Mr de Vauplane and Mr Jansson, supported by the ECB, will finalise the overview on the national regimes and start to analyse whether there is room for a recommendation of the Group.

5. The use of the European Master Agreement

Mr Lenihan (ECB) introduced the topic and reported on an exchange of views with the FMLG, at whose last meeting a presentation was given on the EMA.

The Group exchanged views on the question whether the EMA provides for an appropriate vehicle for conducting financial transactions throughout the EU. Whilst the general feeling was that the EMA is a very well drafted document, the participants noted the slow progress of its introduction. The inclusion of derivative transactions, which could be achieved i. a. by a 'bridge clause' with the ISDA documentation, was discussed. It was noted that, also from a legal perspective, the combination of various products poses an advantage, but that at the same time the operational framework needed by the respective back offices might not yet be in place in many institutions. This also holds true for facilities to enable day-to-day margining. In any case, cross-product netting has clear benefits as regards insolvency close-out and regulatory purposes. A few members also pointed out that they expect the continued use of national documentation on a domestic basis.

Follow-up

No immediate follow-up, but further developments will be monitored by the Group.

6. E-trading

A presentation of the subject was given by Ms Papathanassiou (ECB), on the basis of a paper prepared on legal issues and Community activities in this field.

It was noted by the Group that there seems to be already a quite advanced legal framework in place within the EU. Open issues might still pertain as regards the mutual recognition, especially of ATs operating on a cross-border basis and with regard to global harmonisation. However, this might be more likely an issue to be tackled by FESCO.

Follow-up

No need for immediate action by the Group.

7. Organisation of the EFMLG

The Chairman asked members for their view on the structuring of the work conducted by the EFMLG so far. He stressed that membership is based on a personal status, not on being a representative of a bank. It was pointed out that the EFMLG should not try to mimic the FMLG in New York, as it operates in a different environment, which is multi-jurisdictional and decentralised.

The EFMLG approved the establishment of sub-groups, to work on specific items, whereby the final result of the sub-groups would then be submitted for approval to the full Group. It was also agreed that in respect of the participation in sub-groups, there should be a certain degree of flexibility as regards the persons involved, i.e. allowing to involve persons with a specific expertise outside of the members of the Group.

Finally, some members of the Group expressed the desire to have a secured area for an exchange of views within the future EFMLG website.

8. Other topics

a) External ratings

The Chairman pointed out that there might be a degree of uncertainty in the financial markets, stemming from the non-regulation of the regime applying to rating agencies across Europe. Contrary to the situation in the US, where there is strong regulation in place, there is no comparable situation in the EU.

The group agreed that this topic might be suitable for further assessment.

Follow-up

An issues note will be prepared by the ECB Legal Services.

b) Assessment of legal risk

Mr Thomas presented the issue, which will become of particular relevance in view of the current revision of the Basel Accord. Mr Thomas asked the group to help to identify what legal risks need to be assessed in the context of operational risk. Some group members mentioned that their institutions are already working on this subject.

Follow-up

The Group will monitor further developments.

9. Date of the next meeting

The next meeting of the group will take place on 15 November 2001.