

THE CHAIRMAN

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## **Tenth Meeting of the European Financial Market Lawyers Group**

**5 November 2002**

### **Aide-Memoire**

#### **1. Approval of the Agenda and of the Aide-Memoire of the last meeting.**

The Members of the Group approved both documents. The Chairman welcomed Mr Antonio Maladorno and Ms Natalia Butragueño as new members of the group. Ms Helen Moran, Mr Mark Armstrong-Cerfontaine and Mr Stephan Aubel were participating on behalf of Mr Brian Sheridan, Ms Marie-Paule Gillen and Mr Jürgen Than respectively.

Moreover, the Chairman greeted Mr Gavin Bingham from the BIS and Mr Martin Thomas from the Bank of England's Financial Market Law Committee, who were attending the meeting as guests.

#### **2. Collective action clauses and sovereign debt**

The group considered the impact of recent sovereign debt crises, such as the Argentine crisis, and its legal effects in Europe, and in particular initiatives taken by the international community to counter such financial crises.

In this respect, particular focus was given to the work on collective action clauses (CACs), currently undertaken by a working group of the G-10. Mr Bingham, the secretary of this working group, gave a general introduction to the background and the basic philosophy behind this initiative. He mentioned that the working group was established in order to find ways for an orderly workout of sovereign debt in crisis

situations. He emphasised the need to find acceptable solutions, whilst maintaining a dialogue with both issuers and investors. The result could be a set of clauses to be inserted in future issues of sovereign bonds.

Mr. Bingham's presentation was complemented by presentations made by Mr Elderson (De Nederlandsche Bank), Mr Keller (Bundesbank), Mr Lenihan (ECB) and Mr Perassi (Banca d'Italia), all members of the same G-10 working group. It was shown that existing differences in the contractual framework exist with respect to majority amendment/restructuring and enforcement clauses in the major jurisdictions involved (England, Germany, Japan, and New York). It was mentioned that the practical implications for an orderly work-out could be considerable, as some civil courts (e.g., the Italian courts in Rome as recently as July) have already issued rulings in cases involving investors holding Argentine government bonds. Reference was also made to case law in Belgium and the US showing that vulture funds purchasing sovereign debt at distressed prices might be able to assert their legal rights in the future at the expense of an orderly sovereign debt work-out. As a result of these and other considerations the G-10 working group had elaborated proposals for inclusion in sovereign bond contracts. The group was invited to comment on the Report of the G-10 Working Group on Contractual Clauses, 26 September 2002 (*please note that this document has not been published by the G-10 Ministers and Governors, and is made available to EFMLG members on an informal basis only*).

The members of the EFMLG had a general discussion of the issue.

One member highlighted a number of relevant factors, including (a) the problem of transparency and the need to enhance information covenants provided by issuers, (b) the need to ensure an orderly restructuring so that investors share equally in the proceeds of a sovereign restructuring, while at the same time allowing individual creditors to enforce their rights in certain circumstances, (c) the importance of avoiding the 'rogue creditor'/'free rider' problem and (d) the possibility of increasing the usage of negative pledge clauses in the sovereign context.

Another member expressed some sympathy for the G-10 initiative as a means of promoting more transparency and a more orderly restructuring process, but questioned the significance of the 'rogue creditor' problem, noting that some of the US litigation involved both rogue issuers as well as rogue creditors. This member noted that the US market has to make the biggest changes of any market in order to switch over to CACs.

Another member stated that in principle he could agree with the G-10 proposals, but he also highlighted a number of problems, including (a) the 'first mover' problem, (b) the aggregation problem (will banks participating in a syndicated loan be in a better position to negotiate a better deal than bondholders?) and (c) the problem of bondholders' meetings (how will these work, with investors scattered all over the world?). This member questioned whether the drive towards CACs might be worth so much effort until the sovereign debt restructuring process becomes more transparent.

Another member stated that it would be difficult to find a 'one-size-fits-all' approach for the global financial markets, noting for example that the German market contains many retail investors, while the

US market is dominated by institutional investors. This member expressed broad support for the G10 project, and also the initiative to obtain legislative clarification to support CACs under German law. He expressed some caution regarding the low second or reduced threshold/quorum permissible in some bonds (e.g., English law bonds) which could allow a potentially low percentage of bondholders to change the payment terms, noting that there had been precedents in practice where the higher initial threshold/quorum had not been met.

**Follow-up:**

It was agreed that a lot of detailed issues need to be considered before the EMFLG can cast any judgement on this matter. It was also noted that this issue must be considered from both the credit and the legal perspectives. It was mentioned that there are some specific EU dimensions to this project (e.g., the plan by EU Member States to ‘lead-by-example’ by introducing CACs into their international bond offerings, the possible need for clarification from the Commission regarding the proper interpretation of the EU unfair contract terms directive in the context of CACs affecting retail investors).

The group decided that there might be room for an opinion or recommendation by the EFMLG. The matter is first to be assessed further by a sub-group comprising Mr Mark Armstrong-Cerfontaine, Mr Antonio Maladorno and Mr Ulrich Parche, as well as Mr Frank Elderson and Mr Niall Lenihan representing the public sector perspective on this issue. The subgroup will report its findings to the next meeting of the EFMLG.

**3. Short-term securities**

Mr Stenström reported on the activities after the finalisation of the EFMLG consultation report on short-term securities and the on-going public consultation. He was noting that the ECB has been asked to host the open consultation of ACI and EFMLG on its website.

The release of the EFMLG Consultation Report was well publicised and there have been some public references (e.g. by Mr Trichet and Mr Issing, or by institutions such as the European Repo Council) to the activities undertaken by the ACI and the EFMLG.

**Follow-up:**

The group suggested that there should be a direct consultation of certain institutions (e.g. national banking associations) to initiate in particular national discussions on the subject.

It was also suggested to address directly in-house councils from corporates (e.g. through the Treasurers Association or the In-house Council Association) to obtain their views as major issuers of short-term paper.

#### **4. Dematerialisation**

Mr de Vauplane and Mr Löber presented the work conducted by the EFMLG subgroup on dematerialisation of securities. It was mentioned in particular that the subgroup found it appropriate to focus on the modus of book-entry transfers of securities rather than the actual way securities are issued as the main obstacle to a single cross-border market for securities in Europe. This approach is not, however, excluding to promote a common way how securities are issued.

It was also highlighted how the work undertaken by the EFMLG could fit into the range of activities currently undertaken by the European Commission and the Giovannini Group in particular. The timeliness of the topic was stressed.

The group had a lively debate on the subject matter. The members noted that there has been an evolution of the existing concepts of securities, which will affect the nature of rights and the creation and disposition of securities in particular. Strong emphasis was given to the protection of investors in a future legal framework. It was felt by some members that there should not be a complete abolishment of existing legislation in respect of securities, but a new additional option to be chosen by issuers. In this context, the existing distinctions between bearer and registered securities might no longer be appropriate, also in view of possible tax implications. One further aspect of relevance was identified in the existing national divergences as regards the date of a transfer of rights.

#### **Follow-up:**

The following questions have been put to the members of the group, with the request to provide answers by **Friday, 10 January 2003** at the latest:

1. Should there be a single mandatory system for securities in book-entry form?
2. If not, should one leave open the possibility of converting financial instruments into paper form?
3. Would it be appropriate to establish a special regime defining the status of CSDs, SSSs and Custodians, or should this be left to other legal acts such as the ISD?

In addition, the members are asked to submit any further comment or suggestions on the draft report to the EFMLG secretariat.

On the basis of the answers received, the subgroup will prepare a revised draft to be submitted to the full group again before the next meeting. It could also be considered to already convey the preliminary findings of the EFMLG to the Giovannini Group for their consideration.

Finally, the members of the EFMLG are asked to review by **end of February 2003** the overview tables in respect of their domestic jurisdiction on whether the information given is still accurate and up-to-date.

## 5. Repurchase Transactions

The topic was postponed. The finalised draft report will be submitted to the members of the EFMLG, together with the complementary overview tables for review in due course.

## 6. Issues of relevance to the Financial Markets

- *Unidroit project on the harmonisation of rules relating to indirectly held securities*

Mr. Löber informed the group on the work undertaken by Unidroit on the global harmonisation of substantive securities laws.

- *European Commission's communication on clearing and settlement*

Mr Löber reported on the state of play in respect of the Commission's communication on clearing and settlement. It was suggested that the members might share their comments or the one's of their respective institutions with the group.

- *European Commission's consultation of interested parties on financial regulation, supervision and stability*

Mr Recine informed the group on the Commission's consultation and the related EFC report on financial regulation, supervision and stability of 9 October 2002. It was noted that the consultation is still on-going. Again, it was suggested that the members might share their comments or the one's of their respective institutions with the group.

- *US Sarbanes-Oxley Act and USA Patriot Act – Application to European banks*

Mr Lenihan gave a general overview on the aforementioned US legal acts. The EFMLG considered to what extent these acts are of an issue for European financial institutions.

In respect of the Sarbanes-Oxley Act, members noted that the practical application will depend on further implementing measures and guidance to be issued and provided by the SEC, so at this point no final conclusions could be drawn. However, some corporate governance issues are being considered carefully in the context of European corporate governance practices, such as the independence required of an audit committee, the requirement that auditors be appointed by an audit committee, the prohibition on loans to directors and executive officers with no exemption for non-U.S. depository institutions and the new requirements applicable to officers and directors.

As regards the USA Patriot Act, there was agreement that this legislation might force foreign governments and legislators to assimilate their respective regimes.

## **7. The Financial Markets Law Committee**

Mr Thomas reported on the creation of the Financial Markets Law Committee by the Bank of England in Spring 2002. He stressed the independence of the committee, whose aim is to identify and address legal issues of relevance to the wholesale financial market markets. The initial range of legal issues includes legal risk, property interests in investment securities, the draft Hague Convention on indirectly held securities and the future English implementation of the Collateral Directive.

It was considered useful to maintain a close contact and exchange of information between the new Committee and the EFMLG.

## **8. Other issues**

### a) New EFMLG website

Mr. Löber informed on the newly released EFMLG website ([www.efmlg.org](http://www.efmlg.org)). The website is currently hosting the consultation on short-term securities, as well as containing information on past and on-going EFMLG projects. Moreover, the EFMLG documentation on the issue of Force majeure will soon be made public on the website

### b) Date of next meeting

The date of the next meeting of the EFMLG will be communicated to the EFMLG members in due course.