

3 March 2004

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**Aide-mémoire of the  
13th meeting of the European Financial Markets Lawyers Group,  
held on Wednesday, 18 February 2004**

**1. Approval of the agenda and of the aide-mémoire of the last meeting**

The aide-mémoire of the 12<sup>th</sup> meeting and the draft agenda were approved by the group. Mr Michael Holmgaard Mortensen has newly joined the group.

**2. Enforceability of insolvency close-out netting arrangements under EU legislation**

The work undertaken by the sub-group on netting issues since the last EFMLG meeting was presented, alongside a tentative mark-up to the draft ISDA position paper regarding the interpretation of the term 'set-off' as used in Article 6 of the EU Insolvency Regulation. In particular, the jurist-linguistic analysis of the terms 'set-off' and 'netting' used in the authentic language versions of various Community legal acts was highlighted, alongside some additional citations to relevant case-law of the Court of Justice and to the Virgos-Schmit report supporting a broad interpretation of the term 'set-off' as encompassing close-out netting. However, it was also highlighted that law firms in a number of EU Member States have issued legal opinions for market standard master agreements endorsing a narrower interpretation of the term 'set-off' than that used in the draft ISDA position paper presented at the previous meeting.

One member thought that it was important to consider whether the term 'set-off' as used in the Insolvency Regulation referred to contractual or legal set-off, as these were different concepts in many EU Member States.

Two members questioned the feasibility of arguing that the term 'set-off' as used Article 6 of the Insolvency Regulation covers close-out netting since 'set-off' and 'netting agreements' enjoy separate protection under Articles 23 and 25 of the Winding-up Directive, and since close-out (as distinct from set-off) may itself be vulnerable to challenge under the insolvency laws of some EU Member States.

Some members, however, considered that the broader interpretation of Article 6 of the Insolvency Regulation could still be defended based on a purposive interpretation, taking account of the evidence in the recitals to the Insolvency Regulation and the Virgos/Schmit report indicating that set-off was intended to acquire a kind of guarantee function and was intended to cover contingent or future obligations documented under contractual set-off arrangements. Some members also highlighted that the Insolvency Regulation had been drafted before the Winding-up Directive, and before the term 'netting' had become widely used in financial markets.

Members agreed that a more comprehensive EFMLG position paper would need to be developed, taking into account underlying national insolvency and netting legislation in EU Member States. All EMFLG members would contribute to the preparation of this paper.

Members also agreed that there is a need for a legislative clarification of the concept of close-out netting on the Community level, for instance in the context of a future revision of the Collateral Directive. Substantive rules recognising close-out netting would provide a higher degree of legal certainty than recognising close-out netting by way of conflicts of law provisions, such as those contained in the Insolvency Regulation and the Winding-up Directive. This would also have a considerable impact on the legal opinions commissioned regarding master agreements. It was agreed that the EFMLG's position paper should conclude by addressing the need for legislative clarification at the Community level.

Finally, it was agreed that a continued co-ordination of the EFMLG's activities on this project with ISDA should be maintained.

#### Follow-up:

The sub-group will develop a more comprehensive analysis of Article 6 of the EU Insolvency Regulation, taking account of underlying national insolvency and netting legislation, and as part of this paper develop a proposal for an amendment to the netting provisions of the Collateral Directive.

### **3. Netting arrangements in the acceding countries**

The contributions by EFMLG members regarding the validity and judicial treatment of close-out netting agreements in the acceding countries were presented by Otto Heinz. On the basis of these contributions the draft EFMLG report on netting was updated.

The members discussed the findings and a possible follow-up. It was felt the mechanism and the benefits of close-out netting should be communicated in a clear manner to interested parties in the accession countries, with special regard to the ongoing legislative changes. In this context it should also be considered approaching certain governments. The existence and content of netting opinions in the accession countries should be closely monitored.

#### Follow-up:

Following the meeting, the draft EFMLG report on netting will be finalised and circulated to the full group for approval in a written procedure. The report will subsequently be published and could be circulated widely. Further ideas about the use of the report and its follow-up are welcome. The EFMLG will monitor further developments and may decide on regular up-dates of the content of the report.

#### **4. ACI/EFMLG Report on the Information Memorandum for STEP**

Mikael Stenström informed the group of the latest developments with regard to the ACI project concerning short-term European paper (STEP). Since the last EFMLG meeting in October 2003, the written comments received from EFMLG members have been reflected in the ACI/EFMLG Report on the Information Memorandum for STEP (as circulated to the EFMLG members in December) and/or shared with the ACI. The Report on the Information Memorandum, and the additional reports of the other two working groups on statistics and settlement, respectively, were presented to the ACI Task Force on STEP at the ACI meeting in Berlin on 15 January 2004. As part of the outcome of this ACI meeting, some further amendments have been introduced to the ACI/FMLG Report as requested by the ACI Task Force.. The ACI appreciated very much the work conducted by the EFMLG and intends to publish shortly a main report prepared by the ACI Task Force, containing its overall recommendations, and the three reports by the working groups on information memorandum, statistics and settlement, respectively. In addition to the 2002 EFMLG Report on the legal aspects of short-term securities already posted on the EFMLG web-site, the EFMLG will make public on its web-site the ACI/EFMLG Report on information memorandum and the 2003 Up-date of the Report on the legal aspects of short-term securities. The placement of these reports on the EFMLG web-site will take place simultaneously with the ACI publication and include a reference (or link) to the ACI web-site. [The ACI Task Force has since decided that the publication should take place on Tuesday, 9 March 2004.] Following such publication, the ACI intends to consult the public authorities concerned, including the ECB, and the market associations and market participants involved in the project, with a view to prepare for the launch of STEP. The ACI will then consider the outcome of these consultations and the launch of STEP at its next ACI meeting in May 2004.

#### Follow-up:

The Chairman asked the EFMLG members to confirm again that the project is legally viable in all their respective jurisdictions and the members raised no objections in this respect. The final version of the ACI/EFMLG Report on the information memorandum for STEP, including the changes introduced in contact with the ACI Task Force on STEP, will be sent to the members of the EFMLG before publication.

## **5. Deposit netting**

Olof Myhrman gave a presentation of the issue of deposit netting. He focussed on the substantial gains to be made from this by capital relief in the countries where this is allowed.

The group discussed the topic and noted that in principle, deposit netting, being on-balance sheet netting is less complex than close-out netting. The contractual aspects are quite straightforward as can be seen from the current English law BBA document. However, the could also be integrated in a multi-product type master agreement such as the European Master Agreement.

However, there is only limited recognition by Member States of the resulting capital relief. EFMLG members reported on related national initiatives, such as a German standard interbank pledging agreement. To the extent that some Member States have specific netting legislation including deposit netting, the use is limited due to the lack of supervisory recognition. Only UK, the Netherlands, Luxembourg and Sweden seem to recognise deposit netting as of today. The group felt that the EFMLG should explore further the regulatory situation as regards deposit netting throughout the EU.

### Follow-up:

Olof Myhrman, with the support of the EFMLG secretariat, will liaise with both BBA and the FBE, to discuss the documentation aspects of deposit netting. Moreover, a short questionnaire will be sent to the EFMLG members to explore further the regulatory treatment in all EU countries. Depending on the results, it could be considered whether the issue could be brought to the attention of the newly established Committee of European Banking Supervisors.

## **6. Signing authorities and the enforceability of master agreements**

Helen Moran informed the members on the results of the survey that had been obtained by the EFMLG members in response to the questionnaire on the subject. The main aim of the questionnaire was to seek feed-back on the existing national procedures and to explore whether the group could establish acceptable procedures. In this respect, the need for certainty and speed was stressed.

The group discussed the possible use of the Internet under a market convention, in addition to commercial registers. Two problems were identified: it was felt that a wide distribution of signature books through internet might give raise to fraud, and that inevitable inconsistencies between WebPages and commercial registers could create uncertainty.

Possible avenues for the further work of the EFMLG might include providing an overview on existing procedures, and possible explore the merits of proposing a market convention or even legislative reforms. It was pointed out the in this respect, the ACI Code of Conduct and the FMLG best practices document might merit further analysis.

Follow-up:

Those members of the group which have not yet provided answers to the questionnaire are asked to do so at their earliest convenience.

In addition, the sub-group on signing authorities will meet to analyse the results and assess the work of ACI and FMLG in this field.

**7. Corporate crisis: legal issues of interest for banks / corporate bonds issuance and conflict of interests**

Fabio Recine introduced the topic, by highlighting that recent insolvencies in the EU have revealed some legislative gaps that might call into question banks' legal liability. In addition, Emilio de Lillo presented a note concerning the problem of conflict of interests of a bank when lending and providing investment services to the same entity. It was pointed out that there seems to be a structural conflict of interests that put at stake the responsibility of a bank. Additionally, the banking secrecy could be at stake when conflicting with duty of disclosure related to the provision of investment services to the same entity. The application of insider trading rules may be also at stake.

The members of the EFMLG noted that considerable legal risks could emerge for banks. They discussed whether the issues might deserve further attention of the group. The legal risk of a bank acting as underwriter is an issue already addressed by a project of the FMLC. As regards current market practices, the group noted the IPMA guidelines for due diligence. As regards possible conflicts of interest, it was felt that the ISD, but also the draft FIM Directive deals with the issue in an ambiguous manner. The issue could be explored further and be brought to the attention of CESR. It was noted that there will be an open CESR consultation on this issue, to which the EFMLG might respond. Finally, in respect of possible conflicts of duties resulting from the conflicting application of confidentiality and disclosure requirements, the group felt that other fora might be more appropriate to address this issue.

Follow-up:

It was agreed to establish a sub-group on conflicts of interests which could prepare an EFMLG response to the forthcoming CESR consultation related to the prevention of conflict of interests. Members are asked to express their interest to participate in such sub-group by **Wednesday, 17 March 2004**.

## **8. Legal risk**

Klaus Löber presented an issues note regarding legal risk in the context of the revision of the Basel Capital Accord (Basel II). The group took note of the on-going attempts, for instance by a working party of the IBA, to provide for a definition of what constitutes legal risk.

The group felt that there are merits for a common understanding of what constitutes legal risk and how it should be assessed. In relation to the work undertaken in the context of Basel II on legal risk, members stated that a number of relevant aspects might not be appropriately reflected in on-going discussions. For example, currently regulatory risk is excluded from legal risk. Moreover, reputational risk might benefit from closer attention. Litigation risk could be broader than losses resulting from inadequate documentation. And finally, there could be a clear distinction between legal and documentation risk. Another aspect that might merit further analysis is the interrelation between legal risk and the compliance function inside of financial institutions.

The members gave preference to the development of an EFMLG paper containing the group's views as regards the definition of legal risk.

### Follow-up:

It was agreed to establish a sub-group on legal risk. Members are asked to express their interest to participate in such sub-group by **Wednesday, 17 March 2004**.

## **9. Joint meeting between the EFMLG, FMLC and FMLG in London.**

The Secretariats of the New York's FMLG and of London's FMLC have approached the EFMLG with the idea of organising a joint tripartite meeting hosted by the FMLC in London, to address issues of joint interest. The EFMLG members have been supportive to this initiative.

### Follow-up:

The tentative date for such meeting was said to be the **10 June 2004**. It was recalled that the European elections would comprise that date, which may affect attendance. The date of the meeting is to be confirmed. EFMLG members are requested to suggest agenda items of transatlantic interest. The resulting agenda will be circulated in due course.

## **10. Other matters**

### **a) General discussion on matters of relevance to the European Financial Markets**

As a possible topic for further consideration by the EFMLG, the issue of banking secrecy in the context of credit derivatives as well as ABS and CDS structures has been brought forward. The issue will be addressed in the next meeting of the group.

#### Follow-up:

Members are asked to express their interest to participate in the preparation of this topic by **Wednesday, 17 March 2004**.

### **b) Response of the EFMLG to the EU enlargement**

The group agreed that the representation of the acceding countries in the EFMLG will be dealt with in a step-by-step approach following the identification of suitable candidates. As a principle, EU banking groups operating also in the Acceding countries should be represented by their head offices only. Suggestions for possible future members are welcome.

### **c) EFMLG website – restricted member area**

The group was be informed about the access to the recently established closed member area within the EFMLG website.

### **d) Date and place of next meeting**

In view of the trilateral meeting tentatively scheduled for the **10 June 2004** in London, it is envisaged to hold a normal EFMLG meeting in the **afternoon of 9 June 2004** in London, at a venue still to be decided.

#### Follow-up:

Members are asked to express their availability for the suggested dates (**9 June 2004**, afternoon and **10 June 2004**).