

# Financial Markets Law Committee

*"Tackling issues of legal uncertainty, domestic, pan-European and international, present and future, in the wholesale financial markets"*



THE BANK OF ENGLAND

## FMLC PROSPECTUS

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## 1. INTRODUCTION TO THE FMLC

### Who we are

- The Financial Markets Law Committee (the “FMLC” or the “Committee”) is a vitally important institution, whose work in tackling issues of legal uncertainty in the wholesale financial markets is actively supported by the Bank of England, HM Treasury and the FSA.
- The Committee participates actively in various international fora of significance and interacts with similar groups in other jurisdictions. It has achieved much of practical benefit to the UK and international wholesale financial markets.

### Contacting the FMLC

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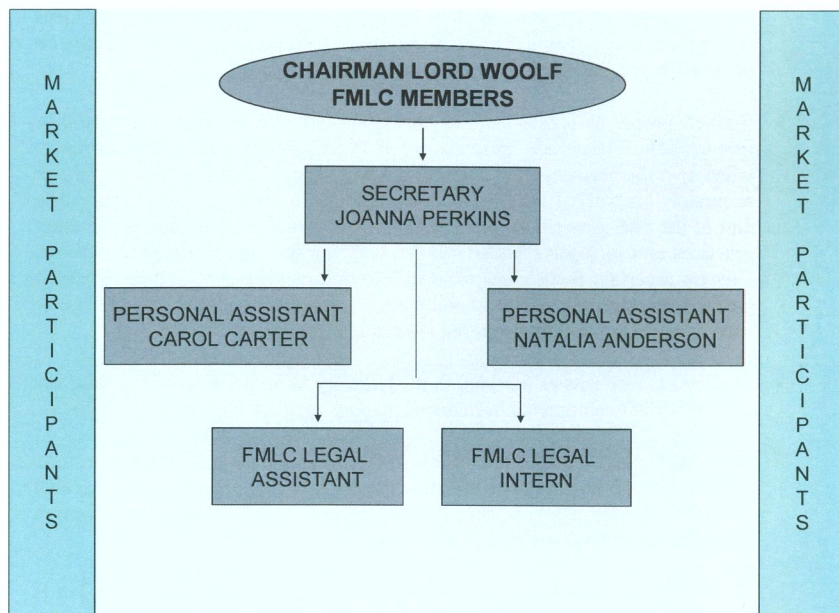
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### What we do

- The role of the FMLC is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.
- An element of legal uncertainty is inevitable in wholesale financial markets that are international, competitive and innovative. Although the UK framework of law for these markets is highly developed and robust, new ideas or practices can sometimes raise uncertainties as to how the law will apply, on occasion based on misunderstandings about existing law.
- Further, proposals for new law or regulation (whether as part of domestic or international initiatives) can give rise to uncertainties or misunderstandings, when specific features of wholesale markets practice have not been fully or accurately considered or reflected by a legislator or other public authority. The aim of the FMLC is to prevent inconsistencies between such laws and market practices and to resolve uncertainties. It fulfils this aim by liaising with the City (to ascertain those areas of legal uncertainty which are troubling market participants and their advisers) and the Government (in order to clarify and/or seek changes to the laws/proposed laws in question).
- The FMLC also acts as a bridge to the judiciary to help UK courts remain up-to-date with developments in financial markets practice (see section 4 below).
- The FMLC plays a useful role in relation to international and European efforts to identify legal uncertainties affecting the cross-border operation of the global financial markets and to resolve such uncertainties through the harmonisation of international law (see section 6 below).
- The FMLC is housed and partially sponsored by the Bank of England, but is entirely independent. Any views it expresses are its own, and not those of the Bank or any other interested party.
- The FMLC only addresses in depth those issues raised with it which are material, which have an appreciable impact on the markets and for which the FMLC is better placed than any other relevant organisation or group. The FMLC currently has 142 files in its archive (representing issues which it has sought or is seeking to address) of which some 30 or more are under active consideration.
- The value of the FMLC as perceived by market participants is reflected in the degree to which City law firms have seen fit to contribute (in terms of time spent on a *pro bono publico* basis) to the Committee’s work. This, in turn, ensures that the FMLC’s work product is consistently of the highest quality, with the result that the Committee’s value to the financial markets is maintained. This virtuous circle would be very difficult to recreate in the absence of the FMLC, and the public sector imprimatur which it carries.

## 2. FMLC ORGANISATION CHART



### Who are the Members of the FMLC?

- The FMLC has 20 members and is chaired by Lord Woolf. Bill Tudor John (Nomura International plc) is the Deputy Chairman. Members are drawn from a selection of the main financial and legal institutions across the City, such as investment banks, law firms, trade associations, Government departments and barristers' chambers. Members are appointed to the Committee in a purely personal capacity and on a *pro bono publico* basis. (see p.16 for a list of current Members).
- The Committee meets every two months to discuss any issues raised with the FMLC since the last meeting and the progress of the Working Groups and working papers. It is not only at these meetings, however, that the Committee is briefed; it is regularly kept informed of new developments in the work of the Secretariat.

### Who are the full-time officers of the FMLC?

- The full-time staff is managed by the Secretary to the Committee, Joanna Perkins. Joanna joined the FMLC in November 2004. After completing a Doctorate in Law at Oxford University, where she worked as a college lecturer, Joanna qualified as a Barrister and currently holds a tenancy at 13 Old Square, Lincoln's Inn. She has lectured at Paris II (Panthéon-Assas), Université de Paris, and Birkbeck College, University of London. Previously Joanna worked at the Law Commission where she managed a law reform project on Unfair Contract Terms.



- Joanna is supported on a day to day basis by the FMLC Legal Assistant Louise Asbridge, seconded from Freshfields Bruckhaus Deringer LLP, and the FMLC Legal Interns, most recently Saira Arian, from the London School of Economics. Secretarial support is provided by Carol Carter and Natalia Anderson.



### 3. HISTORY AND ORIGINS OF THE FMLC

#### The Financial Law Panel – its origins and dissolution

- Confidence in the financial markets was badly affected by the decision in *Hazell v. Hammersmith & Fulham London Borough Council*<sup>1</sup> in which local authority swaps were held to be *ultra vires*. The decision had major implications for the practices of market participants since dealing in swaps by local authorities was wide spread (it was used as a way of making up for shortfalls in Government contributions). In the wake of this decision, in April 1991, the Bank of England decided to establish the Legal Risk Review Committee to consider what could be done to prevent a similar situation occurring again and a method by which legal uncertainties could be tackled in the future.
- The Financial Law Panel (“FLP”) was established in 1993 at the instigation of the Bank of England and the City Corporation in response to recommendations made by the Legal Risk Review Committee and in the belief that the wholesale financial markets were developing faster than the law regulating the activities of those markets, with potentially harmful consequences for financial stability. The prospect of conflict between the law and market practices could have produced considerable uncertainty which, in turn, could then have destabilised financial activity in the markets.
- It was hoped that the FLP would be the mouthpiece for the City’s concerns or rather, a conduit between the City and Westminster. However, by 2001, it was felt that the FLP had become too distant from the main concerns of practitioners and City institutions. Further, it was felt that the FLP was not sufficiently proactive in offering its views on future and existing legislation. These concerns, coupled with financial difficulties led to the FLP being disbanded in March 2002.

#### The origins of the FMLC

- Despite having decided to disband the FLP, the Bank of England concluded that there remained the need for an organisation tasked with identifying and analysing areas of legal uncertainty or misunderstanding affecting the wholesale financial markets. This conclusion was reached following the canvassing of a wide range of views.
- The general consensus was that such a body was necessary and that the Bank was well placed to support it. In response, the Bank decided to establish the FMLC. As stated above, however, the FMLC is independent of the Bank and its recommendations and views are entirely its own.

<sup>1</sup> [1992] 2 A.C. 1

### 4. FMLC ACTIVITIES

#### HOW WE TACKLE LEGAL UNCERTAINTY

##### The Radar Function

- An important aspect of the FMLC’s role is its “radar” function in contacting participants in the wholesale financial markets to identify any significant legal uncertainties of which they may be aware. To help achieve this “radar” function, the FMLC Secretariat conducts a systematic programme of meetings with market participants in order to collate issues that ought to be brought to the attention of the Committee. As part of the “radar” programme, the FMLC Secretariat visits the following City institutions:
  - Banks, securities firms and insurers in London;
  - Market infrastructure bodies in London;
  - Trade and professional associations;
  - Solicitors, accountants and auditors;
  - Barristers;
  - Judges;
  - UK public authorities;
  - Academics;
  - Legal and financial journalists;
  - Foreign public authorities and bodies; and
  - Foreign lawyers and academics.

There are currently more than 500 participants in the “radar” programme.

- The object of the “radar” programme is to enable the FMLC to stay close to market participants. This ensures that the issues it addresses are those which are of most concern to those participants. It also helps to ensure that the work that the FMLC undertakes and the solutions that it proposes are practical and market driven.
- Where the FMLC is agreed that it is the best placed institution to tackle an issue identified via the radar process, that issue will be adopted and the Committee will look at the best way to resolve the concern.

##### Forming Specialised Working Groups

- When adopted issues become particularly active the Committee may take the view that a Working Group needs to be established to examine the points of concern in more detail and to discuss potential solutions or propose action plans to resolve the problematic issues. Working Groups are made up of market contacts with the relevant legal know-how, technical expertise or practical experience in the field under discussion, with participants contributing from law firms, barristers’ chambers, banks, international and governmental bodies and academia.

## 5. FMLC SUCCESS STORIES AND CURRENT PROJECTS

### Devising Solutions

- Many issues will result in the production of a “solutions paper” that outlines the issue(s) identified and suggests how the relevant legal uncertainty might be eliminated or ameliorated. It is the task of the FMLC Secretariat to raise the profile of FMLC papers with those who are best-positioned to implement the recommended solutions. As set out in section 5, below, the FMLC has an outstanding record in achieving the amendments/improvements that it seeks.

### Roundtable Discussions

- In addition to its standard procedures as set out above, the FMLC has hosted a number of “Roundtable” discussions with stakeholders and the relevant UK Government and/or European Commission department/s. These events allow market participants to share their concerns and suggested amendments with the relevant Westminster and/or Brussels officials. Further, they allow HM Government and/or the European Commission to conduct informal impact assessments on proposed or existing legislation/regulation.

### Responding to Consultations

- The Committee is frequently asked to participate in European and UK government consultations regarding proposals for the creation of new legislation or to amend existing law, where such changes could impact on the financial markets. These opportunities are used to lobby for appropriate changes to benefit the financial markets and the FMLC provides an important voice for many market participants who are unable to engage in the consultation process themselves.

### Bridge to the Judiciary

- A secondary, but nonetheless important, function of the FMLC is to act as a “bridge to the judiciary”. This is intended to provide a link between commercial judges (who typically do not have financial markets backgrounds) and the City. The function is carried out primarily by organising seminars to brief members of the judiciary on aspects of wholesale financial markets practice of which they might not otherwise be aware. Whilst the FMLC convenes these seminars, the speakers are generally market practitioners drawn from outside the FMLC’s membership.
- Previous judicial seminars have dealt with issues such as the anti-money laundering regime, the intricacies of structured finance and offshore structures for investment in Russian oil and gas assets. The most recent judicial seminar took place in June 2008 on the subject of Structured Investment Vehicles. The seminar analysed some of the issues which were highlighted at the beginning of the market turbulence and the introduction of SIVs to the capital markets. The next seminar is planned for May 2009 and is set to look at hedge funds,

- Some recent examples of the FMLC’s achievements include:

- **Transparency Obligations Directive:** The FMLC became concerned that the Transparency Obligations Directive could have a negative impact upon securities issuance. Having originally produced a well-received paper on the subject, the FMLC wrote a second paper on the UK implementation which, the Committee has been given to understand, was instrumental in persuading HM Government to commission a public review of the liability issue by Professor Paul Davies.
- **Stock lending and recharacterisation:** The FMLC became aware that the forthcoming UNCITRAL Draft Legislative Guide on Secured Lending was likely to introduce recommendations which would be inconsistent with the legal forms relied on in the repo and secured lending markets, and with title transfer collateral arrangements in particular. These concerns were the subject of letters from the Bank of England’s Stock Lending and Repo Committee to both Westminster and Brussels. In response to these concerns, the FMLC Secretariat was asked to form part of the UK Government’s delegation to recent negotiations in Vienna. The delegation managed to secure a carve-out from the Draft Guide for “securities”, thus avoiding the potential disadvantages referred to above.
- **Rome I Regulation:** The EU Commission is to enact a new Regulation adopting the Convention of Rome 1980 as a Regulation under European Community law. While this was originally proposed as a transposition of the existing regime (under the Rome Convention) into EC law, it is in fact new law and, being a Regulation, will have direct effect in Member States. Furthermore while, under the Rome Convention, the UK has (and exercises) the right to opt out of specific provisions of the Convention, no such right will be available under the proposed Regulation (although it will be possible for the UK to opt out of the entire instrument if it so desires). The FMLC Secretariat, at the request of the UK Government, became involved to elucidate specific aspects of the negotiation process to dictate the UK’s position in relation to certain financial markets issues arising under the Regulation, as well as representing the UK in foreign negotiations relating to it. A stakeholder forum to discuss the outcome of negotiations indicated that both market participants and the Government were pleased with the final draft Regulation and the contributions of the FMLC towards achieving this outcome have been widely acknowledged.
- **Building Society and Friendly Society Set-off:** Insolvency set-off in relation to companies is governed by the Insolvency Rules 1986. Those rules, however, do not extend to societies, with the result that the mandatory insolvency set-off rules contained within the Insolvency Rules do not apply in situations where societies collapse. The absence of set-off provisions in relation to societies is not deliberate and the FMLC is of the view that this lacuna needs addressing. A working group paper was

produced and brought to the attention of HM Treasury and the Insolvency Service, with the purpose of highlighting the potentially disastrous affects of this oversight and suggesting how it may be remedied.

- **Brussels Regulation on Jurisdiction:** Recent case law of the European Court of Justice has thrown doubt on the efficacy of exclusive jurisdiction clauses in contracts concluded between counterparties in European Member States. The FMLC prepared a solutions paper setting out a number of proposals designed to re-establish a position whereby parties can rely upon the timely enforcement of such clauses.
  - **Administration – Set-off and expenses:** On 15 September 2003, a number of important changes were made to the administration regime, the new rules include set-off provisions and provisions relating to administration expenses which the FMLC believe could give rise to potential legal uncertainties. The Committee formed a working group to address these issues of uncertainty and a paper has been produced which sets out a number of proposals which the FMLC believe would help to resolve some of the identified problems. This paper was brought to the attention of the Insolvency Service and HM Treasury and it is hoped that it will be instrumental in raising the profile of the uncertainties identified and in bringing about an appropriate resolution.
- The FMLC has regularly produced papers that have been received with widespread approbation, both by industry and by public sector bodies, both domestically and in Brussels. Examples include its paper on the Consumer Credit Bill (which criticised the UK government's proposals to allow consumers to challenge credit arrangements under the concept of an "unfair credit relationship") and its paper on the Hague Securities Convention (which provided solutions to various uncertainties in the Convention and which was ultimately fed into the Commission's official legal assessment).
- Issues that the FMLC is currently addressing include:
- **Emissions Allowances:** Uncertainties regarding the legal nature of emissions allowances are apparently causing greater concern to market participants as market conditions harden. One area of particular uncertainty in this field is the treatment of emissions allowances on insolvency. The FMLC has been involved in discussions with both DG Markt and DG Environment on this issue and the FMLC Working Group has been asked by the European Commission to identify the relevant issues on paper and to propose a plan of action to address the issues at a European level.
  - **Banking Reform – Depositor Protection:** On 30 January 2008, the Bank of England, the FSA and HM Treasury published a joint consultation document entitled "Financial stability and depositor protection" as a response to recent market turbulence and instability. The FMLC published a response which looked at the issues of concern in detail. A copy was submitted to the Tripartite banking reform team on 23 April 2008. Three further consultation papers have been published by the Tripartite

Authorities. One of these consultation documents focused on the proposal to introduce a pre-insolvency "Special Resolution Regime" for struggling banks and the latest (published in November 2008) introduced proposed safeguards for partial property transfers. The FMLC has produced responses to each of these consultations and a written submission for the Banking Bill 2008 Committee. The FMLC was invited to nominate one of its members to appear on the Expert Liaison Group (the "ELG") which is working with the Government to help prepare new secondary legislation for the Special Resolution Regime.

- **Unsettled OTC Cash-Equity Trades in Euroclear UK & Ireland:** In the wake of Lehman's collapse, a large number of OTC trades remained unsettled and suspended within the EUI system. These trades had been matched and entered the system for settlement when Lehman's account was suspended and no funds were made available for settlement. Euroclear UK and Ireland suspended the trades for 9 weeks in these circumstances before directing the parties involved to agree a mutual deletion of their settlement instructions. During the 9 weeks in question, non-defaulting counterparties experienced considerable operational uncertainty arising from their vulnerability to settlement and the consequent risk of exposure to trades which they had, by then, already replicated in the market for contractual and regulatory reasons. The high volume of trades involved and the very considerable exposure of the non-defaulting parties caused considerable market uncertainty and could have had significant adverse consequences for the financial system. A working group has been set up to consider this issue and is proposing to draft several papers which will address how to prevent similar problems occurring in the future.
- **Landsbanki Freezing Order:** This order caused concern in relation to the ordinary processes on which banks rely to close out their positions against a defaulting counterparty under market standard derivatives trades - by imposing criminal penalties on those attempting to do so. After the Freezing Order came into force, the Treasury swiftly issued a licence to allow close-out in this situation. The use of a licence, however, - rather than an amendment to the legislation - implies at law that the original intention of this legislation was to prevent exactly the actions covered by the Licence and raises questions for those who acted prudently and in good faith to close out their positions ahead of the Licence coming in to force. A working group has been set up and is currently considering this issue.

## 6. FMLC ON THE INTERNATIONAL SCENE

### Global Financial Markets Groups

- The FMLC has very strong relationships with the European Financial Markets Lawyers Group (“EFMLG”) at the European Central Bank, the Financial Markets Law Group (“FMLG”) at the New York Federal Reserve and the Financial Law Board (“FLB”) at the Bank of Japan. It is a member of the Quadrilateral group (comprising the FMLC, the EFMLG, the FMLG and the FLB) which discusses areas of global concern to the financial markets. Further, the FMLC Secretariat attends occasional EFMLG meetings and participates in the FMLG’s regular conference calls; both of which offer the FMLC the opportunity to discuss and raise issues of a cross-border nature or international application.

### Central Banks Legal Units

- The FMLC also participates in regular video conference discussions with the legal units of other Central Banks to discuss current issues (including the Central Banks of New York, Singapore, Switzerland, Frankfurt, and Tokyo). With so many issues affecting the wholesale financial markets having European, if not global application this contact enables the FMLC to compare and discuss international issues of legal uncertainty.

### International Conventions

- Furthermore, the FMLC Secretariat regularly forms part of UK delegations charged with negotiating (on behalf of the British government) international conventions relating, for example, to conflicts of laws. Examples of instruments that the Secretariat has been involved in negotiating include the draft UNIDROIT Convention on Intermediated Securities and the UNCITRAL Draft Legislative Guide on Secured Lending. In relation to the latter, important concessions were won by the UK delegation, particularly in respect of securities, financial contracts supported by netting agreements, and foreign exchange transactions.

## 7. CONCLUSION

- The FMLC is uniquely placed to identify legal uncertainty in relation to the wholesale financial markets due to its ability to maintain close contact with those markets at the highest level. At the same time, it is also uniquely placed to address the issues thus identified, as a result of its strong links with legislators, both in the UK and abroad. It can (and has) brought about tangible legal reforms, to the benefit of the efficient functioning of the financial markets and, therefore, to the economy and the public at large. In addition, the breadth and depth of financial markets expertise at the FMLC’s disposal enables it to provide an invaluable link between those markets and the judiciary.

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*Should you have any queries in relation to the contents of this Prospectus or require further information regarding the FMLC please contact the FMLC Legal Assistant at: [fmlc.legalassistant@bankofengland.co.uk](mailto:fmlc.legalassistant@bankofengland.co.uk)*



## CURRENT MEMBERS OF THE FMLC<sup>2</sup>

Lord Woolf (Chairman)

Bill Tudor John, Nomura International plc (Deputy-Chairman)

Peter Beales, LIBA

Sir William Blair

Michael Brindle QC, Fountain Court

Simon Dodds, Deutsche Bank

Sir Terence Etherton, The Law Commission

Ruth Fox, Slaughter and May

Ed Greene, Cleary Gottlieb Steen & Hamilton LLP

David Greenwald, Goldman Sachs International

Mark Harding, Barclays

David Lawton, Financial Services Authority

Clive Maxwell, HM Treasury

Gabriel Moss QC, 3-4 South Square

Habib Motani, Clifford Chance LLP

Ed Murray, Allen & Overy LLP

Steve Smart, AIG Europe (UK) Ltd

Paul Tucker, Bank of England

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<sup>2</sup> Note that Members act in a purely personal capacity. The names of the institutions that they ordinarily represent are given for information purposes only.