

Mapping the international law of finance: a report on the

W G Hart Workshop 1998



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The three-day 1998 W G Hart Workshop received 45 papers from a broad range of speakers on Transnational Corporate Finance and the Challenge to the Law which were presented to an aggregate audience of about 120 people. The audience was largely academic with some practitioners of finance law from Europe, the USA, and South East Asia also present.

The law of finance is a distinct field which does not frequently receive a thorough academic examination by a large community of people working in the area away from the furnace of the practitioner marketplace. The distance from practice enables the lawyer, whether an academic or a practitioner, to think about potential problems and current challenges outside the straitjacket of market practice. Too often professional conferences are trapped by the momentum of incredibly powerful economic factors and are thus prevented from taking a long-term view of the subject matter. Only rarely do academic finance lawyers have the opportunity to spend a significant amount of time together to move the analysis forward. The 1998 W G Hart Workshop provided such an opportunity.

The legal context of global financial markets was introduced by Professor Barry Rider. At the outset of the workshop in plenary session he introduced the intricate problems of:

- regulating electronic, sophisticated, transnational markets;
- the challenge of adapting municipal private law to meet a global challenge; and
- the difficulties of synthesising economic priorities with legal models.

The academic community, in conjunction with those in practice, have a vital role to play in the analysis of market practice, the framing of substantive legal rules, and the development of suitable regulatory structures.

The four academic directors, Mads Andenas, Chizu Nakajima, Christos Hadjiemannuil and this author, set out the structure of the workshops. Three distinct areas were selected:

- the public law challenge of convergence in global marketplaces;
- the law affecting modern financial techniques (particularly derivatives); and
- developments in international securities law.

INTERNATIONAL FINANCIAL CONVERGENCE

The public law context of international financial convergence was introduced by Christos Hadjiemannuil. Francois Gianviti, General Counsel to the IMF, set out the approach of, and

challenges to, the IMF in dealing with developed economies in crisis, particularly in south-east Asia and in developing economies. The relationship between the IMF, the World Bank and the UN creates a particularly intricate public law context. The work of the IMF was explained as extending beyond simply macro-economic initiatives into micro-economic issues. The cultural questions of convergence were pursued, in particular the need for the creation of legal norms, especially bankruptcy laws, to put national economies on a more secure footing.

This issue was pursued by Professor J J Norton of the Centre for Commercial Law Studies, Queen Mary and Westfield College. In relation to a number of states in south-east Asia and Africa, many institutions were technically bankrupt but were continuing in operation because of a lack of insolvency law. Within this introduction of norms broader questions of cultural sensitivity, a desire for the promulgation of better democracy, and a need for thorough information-gathering to build appropriate models to meet the problems faced by particular states were identified.

The issue of convergence was therefore seen as a problem of attaining transnational legal norms. This is no less the case than in the area of private international law. Professor Jan Dalhuisen challenged the conception that conflicts of law in the analysis of financial products should be seen solely in terms of municipal priorities and policies. Rather, the private international law issues facing financial products should be seen as analogous to the cross-border norms established by the law merchant before the comparatively recent development of national commercial law. The generation of legal standards on this transnational level were seen as being symptomatic of greater convergence.

Two other contexts of convergence were pursued in the lively workshop sessions. The first was the issue of regulatory convergence and the second was that of financial liberalisation and institutional reform.

Regulatory convergence

Sol Picciotto and Jason Haines set out the need for a new approach to financial regulation which was not dependent on the uncontrolled self-regulation of market participants, but rather one which took into account the needs of a broader community. George Walker pursued a theme of convergence of regulation in relation to the activities of financial conglomerates. In particular,

the way in which international regulatory attitudes to multinational economic entities require them to coalesce around an identified range of supervisory principles. Campbell and Cartwright examined the importance of different models of deposit protection schemes and the particular problem of educating the public as to their availability. Charlotte Villiers and Laura McGregor analysed the thorny question, in the context of convergence of corporate supervision, of ensuring the independence of auditors in a context in which the market for accountancy services is shrinking. Their paper focused on the different approaches taken in Spain and in the UK, touching on issues of fiduciary responsibility and the scope of the tortious duty of care.

Financial liberation and institutional reform

The second area of convergence considered was financial liberalisation and institutional reform, a theme which enabled the speakers and the other participants to consider the growth in financial markets with a concomitant need for change in formal supervision of their activities. Rosa Maria Lastra examined the history of central banking and in particular the problem of ensuring the autonomy of such institutions in the face of other governmental and economic pressures. Lazaros Pangourias expounded a view of institutional anarchy in the regulation of finance which threatens the stability of the international banking system. Mark Armstrong looked at the way in which the critical problem of transfer pricing has been dealt with since the Second World War.

Christos Hadjiemannuil, in closing the first day, expounded a potential role for currency boards in enhancing greater monetary stability. That is that given the focus on the need for price stability, a combination of macroeconomic, infrastructural and political concerns created a climate in which sound and incentive-compatible monetary institutions are required.

MODERN FINANCIAL TECHNIQUES: DERIVATIVE PROBLEMS

The second day, directed by this author, sought to tease out the markets' innovative developments in two contexts:

- (1) in respect of the challenge to private law; and
- (2) for regulators. Evidently the development of financial techniques to enhance speculation or to meet the challenges of financial risk, poses a vital challenge to the legal system.

At the start of a bristling morning's plenary sessions, Professor Philip Wood expounded the particular role of set-off clauses as a common financial technique. As an opening presentation it explained precisely the dilemma posed by global marketplaces for hundreds of distinct legal jurisdictions across the world. The focus of this day was often a miserabilist concern as to the termination of transactions, as much as the promulgation of economic activity through supportive legal models. Set-off was such an example. In the context of insolvency (close-out netting), set-off is enforceable or not enforceable, mandatory or precluded, or simply an unknown question, from country to country, jurisdiction to jurisdiction. The potential problems for financial markets in this uncertainty over the legal efficacy of standard methods of terminating transactions is a major problem for financial markets.

The remaining plenary sessions dwelt on the derivatives markets. Schuyler Henderson explained the latest addition to

the derivatives firmament, the credit derivative. At a fundamental level it was important to place the credit derivative, whether in the form of total return swaps or credit options, within the definition of a derivative as an 'unbundling of financial obligations' rather than simply as a kind of funded participation in a loan issue. The role of the reference entity, the particular problems of conceiving of documentation to establish credit-worth, and legal proximity to insurance contracts were among the specific issues discussed.

Jeff Golden explained the EMU Protocol initiative propounded by the International Swaps and Derivatives Association (ISDA) seeking to smooth away the potentially grievous impact on the efficacy of derivatives documentation of the replacement of many European currencies with a single currency. The particular risks are:

- the frustration of contracts which depended on an arbitrage between different currencies for their commercial validity;
- the need to be able to calculate a price;
- the continuation of price indices;
- the failure of the denomination of bonds; and
- the disruption of payment netting mechanisms.

The current European legislation does not deal with these particular contexts which are potentially critical to a number of types of financial product. While the legislation does provide for the replacement of one currency with another, it does not provide for issues surrounding frustrated commercial purpose and the systemic pressure introduced by the cancellation of such transactions. Anna Morner examined a similar issue surrounding the problems of treating derivatives markets within European and international regulatory structures.

Ned Swan advanced the proposition that over-the-counter derivatives markets were lacking in transparency, certainty and international credibility. In particular he asserted that derivatives contracts meant the buyer was acquiring a promise not an asset. This proposition was pursued enthusiastically by the regulatory hawks in the workshop sessions, and disputed by private lawyers who pointed to the collateralisation and set-off typical in over-the-counter transactions refuting the suggestion of a lack of recourse to a substantive asset in derivatives transactions.

The workshop sessions took the morning's discussion into more specific battlegrounds. David Campbell and Sol Picciotto examined the particular context of futures traded on exchanges and the manner in which exchanges supervised trading. They asserted a new model based on the need for a greater public role in the regulation of new markets. In particular it was emphasised that there is a need to focus more on welfare economics rather than the market-driven preoccupations of regulators in the current climate.

VITAL ROLE

The academic community, in conjunction with those in practice, has a vital role to play in the analysis of market practice, the forming of substantive legal rules, and the development of suitable regulatory structures.

Janet Dine addressed the need for a different means of regulating financial derivatives which moved away from the characteristic division in financial regulation between prudential regulation and conduct of business regulation. In its place a model based on the object of controlling systemic risk by

offering a service to the regulated entity based on external prescriptive rules. Bill Rees considered the possibilities for using alternative means of dispute resolution to relieve litigation risks in financial markets. This last paper contrasted with the first two in that it seemed to facilitate a commercially useful means of resolving conflict whereas the new regulatory approaches emphasised a need to move away from the derivative markets' characteristic secrecy.

Andrew Haynes detailed the developments which have taken place in the debt securitisation markets. The ability of market players to bundle up receivables and trade them as a single security has established itself as an important liquidity and cash flow tool for large institutions. The legal issues involved in the assignment and consolidation of contracts in this way are intricate unless carefully analysed. Stephen Petri detailed the experience of the European Bank for Reconstruction and Development in creating project finance initiatives in central and Eastern Europe.

In a final workshop session, the line between established notions of property rights failed to deal with all modern financial techniques. Joanna Benjamin presented an immaculate account of the intricate problems of taking collateral and margin as security. Whereas the market prefers to have assets provided under quasi-trusts structures to secure future payments, the use of bonds issued under global notes as the collateral property creates unresolved problems of taking title to property which it is impossible to identify separately from other property, and of enforcement by private international law norms. Robin Mackenzie set out the similar questions surrounding the enforcement of property rights in intellectual property where cultural and jurisprudential difference frequently paralysed the effectiveness of rights created in a different legal jurisdiction. As Philip Wood had said, the difficulty with treating intangibles as property is that they require two parties to create and enforce rights over the property, unlike tangible chattels and land.

This author closed the second day with an analysis of the potential role for private law remedies in achieving a number of the goals of regulation. Given the conspicuous failures of financial regulators to spot or supervise the numerous high-profile derivatives crises of recent years, other actors around the defaulting corporation, principally shareholders and fiduciary officers, must be empowered to supervise the corporation through private law. In the context of credit derivatives, as an exemplar of a complex market driven by seller pressure, it was possible to see the role of existing equitable and common law claims filling much of the vacuum by realigning them as claims based on either consent, wrongs or unjust enrichment. In particular, an understanding of undue influence and constructive trust institutions as a form of unjust enrichment would create greater liability for sellers of derivatives where their clients are not educated as to all of the risks involved in the products at issue.

INTERNATIONAL SECURITIES LAW

The legal treatment of securities is particularly complex in a transnational world. Mads Andenas delivered the first paper which delivered a thorough and insightful examination of EC law in the regulation of finance in the internal market. Chizu Nakajima analysed the policy and institutional development of financial regulation in Japan since the Second World War. Of particular pertinence was the reform of regulation in the shadow of the Japanese financial crisis and the huge cultural adaptations

which have proved necessary in Japanese corporate structures. Professor Norton explored, as mentioned above, the practical questions of reforming not only financial regulation, but also legal norms and economic institutions in emerging economies and economies in crisis. Pedro Teixeira considered the theoretical problems of a closed financial system generating its own legal norms and operating an effectively privatised legal system.

The workshop sessions analysed a series of parallel concerns:

- Mahmood Bagheri considered the contractual ramifications of securities regulation;
- Vasiliki Galanopoulou argued for the restructuring of securities regulation to ensure more prudential management;
- Olusoji Elias teased apart competition policy on transnational corporate finance in economic markets that are themselves in transition;
- Sandeep Savla focused on the English law dealing with international co-operation and the operation of financial intermediaries;
- Antonio Franchi took similar issues from the perspective of Italian law;
- Mattias Bjorkman examined the Second EC Banking Directive (Directive 89/646, OJ 1989 1386/1) and the development of the notion of the general good.

Douglas Arner delivered a paper on his examination of the provision of financial support for emerging economies in crisis with the unsettling conclusion that continued crises like those in Mexico and Thailand are likely without profound changes to emerging economies. Emiliios Avgouleas advanced a theory of a need for 'fairness' in the harmonisation of conduct of business rules in the EU.

The symposium closed with a paper by Gerald McCormack and Frédérique Dahan on the particular situation of Poland and the difficulties of enabling security and credit at a time of rapid transition. Of particular concern was the development of a Model Law by the EBRD to oversee the transition from a command-economy to a market-economy. Within that context a number of issues were analysed in the Polish context including securing proprietary rights in contractual agreements, taking charges, and insolvency law generally.

LOOKING BACK

In short, a burgeoning community of finance academics and practitioners were able to create some quiet space in which to explore some of the most vital questions facing the law of finance at a time of critical economic pressure and turbulence in the markets which currently drive the global economy. Access to the Hart fund offered this community a rare opportunity to spend a good amount of time dwelling on the challenges and dangers of these issues, and appear likely to have laid the ground for a large amount of future work. The papers delivered will be brought together in a three-volume analysis of the challenges posed to the global economic order by transnational finance. 🇬🇧

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