Financial Markets Law Committee ("FMLC")

Securities Markets Scoping Forum

Date: Wednesday 11 September 2019

Time: 9.00am to 10.30am

Location: Bank of England, Threadneedle Street, London, EC2R 8AH

In Attendance:

Sanjev Warna-kula-suriya (Chair)	Latham & Watkins LLP
Andrew Bryan	Clifford Chance LLP
James Grand	Simmons & Simmons LLP
Carolyn H. Jackson	Katten Muchin Rosenman UK LLP
Matthias Lehmann	University of Bonn
Eleanor Ley	Allen & Overy LLP
Ferdisha Snagg	Cleary Gottlieb Steen & Hamilton LLP
Madeleine Wanner	Linklaters LLP
Venessa Parekh	FMLC Secretariat

Guest Speaker:

Antony Beaves	Bank of England

Regrets:

Carter Brod	Morgan Lewis & Bockius UK LLP
Mark Chalmers	Davis Polk & Wardwell LLP
Paul Deakins	Clifford Chance LLP
Leland Goss	ICMA (International Capital Market Association)
Selmin Hakki	Slaughter and May
David Howe	Sidley Austin LLP
Stephanie Lincoln	Deutsche Bank AG
Kristina Locmele	Slaughter and May
Tim Morris	Ashurst LLP
Raj Panesar	Cleary Gottlieb Steen & Hamilton LLP
Alasdair Steele	CMS Cameron McKenna Nabarro Olswang LLP

Amanda Thomas Allen & Overy LLP

Minutes:

1. Introductions

1.1. Mr Warna-kula-suriya opened the meeting. Attendees introduced themselves.

2. The FMLC's Public Education Function: Speeches (Venessa Parekh)

2.1. Ms Parekh delivered a short presentation on the FMLC's Public Education Function, a key aspect of the FMLC's mission as a charity.[1] She encouraged Forum members to get in touch with the Secretariat should they wish to arrange a talk by a member of the Secretariat at their offices.

3. The role of trustees in capital markets transactions (James Grand)

3.1. Mr Grand began by reminding attendees that the trust was a creation of the common law. In the context of the financial markets, trustees needed to negotiate a balance between rights and obligations. He stated that an issue which had occupied his time recently concerned the ability of investors to instruct trustees to enforce their rights. This had originally emerged as a problem in the context of the collapse of Lehman Brothers where investors who had valid claims on collectables were unable to recover the value of their investments because of inefficiencies in the mechanisms of the deal. The issue had resurfaced recently owing to a number of small defaults and in the context of recent activism in the market. Mr Grand explained that in respect of a capital market instrument where there is a trustee involved, a requisite number of aligned investors are necessary to instruct the trustee to enforce the rights given via the structure of the trust. Often, this process is very slow and hampered by statutory requirements on trustees, which are perceived to have little utility in the context of capital markets transactions. For example, the trustee is not required to take action until it is indemnified to satisfaction, which serves a purpose in a commercial context. It is, however, in a capital markets context, accompanied by section 750 of the Companies Act 2006, which says that nobody may have any indemnity for any type of breach of their duty of care or diligence as a trustee of a debenture. Any such indemnity would render the duty void.

[1] Please see Appendix I below.

3.2. This has meant that, despite evolution in the market, the behaviour of trustees has remained the same. Should investors look to replace the trustee, they must comply with a number of regulations including the provisions of the Trustee Act 1925. In certain types of capital markets transactions, changing the trustee is a convoluted process. As a result, most participants in such a situation choose to undertake a complicated novation process, which takes time, requires negotiation and is costly. Should that fail too, the investors are left with little alternative as they may not have enough of a majority. Mr Grand noted that the situation was less than satisfactory, albeit accepted by the market in its current formulation. He thought that it would helpful if the scope of indemnities under section 750 of the Companies Act were amended to allow service providers to protect themselves against a majority of investors by recommending that the trustee is appointed by investors rather than the issuers, so that the trustee can be fired by the people whose interest he is acting in. Finally, Mr Grand referred to changes in companies' law and the rights under section 261 to derivative action where the directors have failed to enforce interests against other parties and recommended that similar derivative action rights be offered to investors in fixed income markets.

3.3. Mr Grand accepted that the law as it was written was quite understandable but reiterated that legal uncertainty arose because the law's application was far from clear and prevented investors with legitimate rights from enforcing them. Mr Warna-kula-suriya observed that this was likely an unintended consequence of an old law put into place to deal with a maverick bondholder but said that he would question whether it amounted to a legal uncertainty only because an investor was not able to enforce the rights, which he expected to be able to. He noted that the capital markets had involved to include a number of new types of transactions, including multi-tranche securitisations and leveraged finance transactions with a number of formulations of trustee-investor relationships. He questioned whether Mr Grand's proposed amendments to the rules governing the behaviour of trustees would apply across the range of transactions. Mr Grand stated that this would depend on any Working Group's finding and recommendations.

3.4. An attendee wondered whether the issue might be raised with the Law Commission as a response to its Consultation on intermediated securities, even though the role of trustees was not within the scope of the Consultation. Another attendee noted that such large-scale changes in the roles of participants in large transactions—such as the introduction of collective action clauses in sovereign debt restructuring—had been the result of industry-wide action. He thought that industry associations might be able to raise the issue more effectively with HM Government. Forum members discussed whether this was a legal

uncertainty or inefficiency. An attendee asked whether this situation could arise in other jurisdictions.

3.5. Forum members agreed that the question was interesting but were unconvinced as to the merit of any action. Even if the FMLC was unconvinced that legal uncertainties arose, rather than simply disadvantages to a certain class of investors, Mr Grand suggested that the Forum recommend to the FMLC that a letter be sent, identifying the inefficiencies in the law.

4. Conflicts of laws rules for intermediated securities (Antony Beaves)

4.1. Mr Beaves presented a timeline of action taken to regulate intermediated securities over past two decades. The latest development was that the Law Commission had issued a Call for Evidence on the topic (the "**Consultation**").[2] Mr Beaves noted, however, that the Consultation does not address conflict of laws issues and focuses largely on the shareholders' rights and governance aspects of intermediation.

4.2. Mr Beaves began describing international discussions about rules governing intermediated securities which were begun in the 1990s. These discussions had scrutinised the many governing law and jurisdiction questions which could arise in a globalised world and coalesced in the form of the proposal for what would eventually become the Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary (the "**Hague Securities Convention**"). Around the same time, the E.U. proposed and adopted Directive 98/26/EC on settlement finality in payment and securities settlement systems (the "**Settlement Finality Directive**" or the "**SFD**"), which would bring into scope firms involved in settlement and payment systems that had a cross-border presence. The SFD settled on the Place of the Relevant Intermediary ("**PRIMA**")/"location" of account principle which was grounded in concerns about collateral in settlement systems and central banks operations and only referred to the law of the Member State in which the account was located.

4.3. In 2002, Directive 2002/47/EC on financial collateral arrangements (the "**Financial Collateral Arrangements Directive**" or the "**FCAD**" came in force. This adopted the law of the jurisdiction where the account was "maintained". It also elaborated upon a specific description of the book entry system of recording securities transactions. The FCAD also focused on collateral, but expanded scope to include all collateral takers. Mr Beaves briefly

[2] Law Commission, *Intermediated Securities: Call for Evidence,* (August 2019), available at: https://www.lawcom.gov.uk/project/intermediated-securities/.

considered the interaction of the SFD and the FCAD. He also examined the focus on "location" of account rather than on the governing law, which has led to several complexities.

4.4. Next, Mr Beaves turned to the Hague Securities Convention which was agreed in the early 2000s and signed in 2006 but which had been ratified only recently, coming into force in April 2017. Although the Hague Securities Convention was originally conceived with a PRIMA approach in mind, over the negotiations process, this was discarded in lieu of an approach which allowed the account holder and relevant intermediary to choose in the agreement the law to govern the issues as long as the intermediary has an office involved in the maintenance of securities accounts in that place. In 2003, the European Commission proposed a Council Decision that it would adopt the approach in the Hague Securities Convention. Certain E.U. Member States expressed opposition and the proposal was withdrawn.

4.5. Meanwhile focus shifted to the Unidroit convention on substantive rules for intermediated securities (the "**Geneva Securities Convention**") which complemented the Hague Securities Convention and proposed rules to determine the rights of investors and obligations of intermediaries. No consensus could be created amongst Member States to support its adoption. Proposals emerged in the context of the Capital Markets Union to look at conflicts of laws issues in this area. In 2018, the European Commission looked at simultaneously the assignment of claims for receivables and the conflicts of laws aspects of intermediated securities. Although the project had quite a wide scope, the resulting proposals had focused on the rules applicable to claims.

4.6. Mr Beaves referred to musings that Brexit might impact development in this area. He stated that it may be possible that Brexit provides an opportunity to clarify this area of law in the U.K. because it will no longer be an area of E.U. competence. Questions remain about whether, given the importance of Third Countries (the U.S. and Switzerland) which have ratified The Hague Convention, it would still be useful to reconsider issues which continue to arise in its application.

4.7. Attendees discussed work which the FMLC might consider in regards the conflicts of laws issues with respect of intermediated securities. Although the Law Commission's Consultation does not deal with conflicts of laws questions, a research paper examining these aspects of the financial markets infrastructure around securities. Forum members also considered the E.U.'s recent study of the law pertaining to conflicts of laws in respect of

claims and securities, and referred to the FMLC's recent letter on the proposal to amend the conflicts of laws rules applicable to claims.[3]

4.8. An attendee raised an issue she had come across in the context of the PRIMA test where the location of the relevant account is considered. This test functions in situations where the relevant account has a custodian who has an omnibus account with an intermediary. Certain legislation, such as Directive 2011/61/EU on Alternative Investment Fund Managers (the "**AIFMD**"), however, requires the custodian to segregate accounts along the chain for certain types of investment. If the custodian only has one client which falls within the scope of the AIFMD, it would still have to put the relevant assets in a segregated account. PRIMA doesn't work as neatly in such cases because the alternative investment fund might have multiple segregated accounts. Questions arise, in this context, about whether separate security must be held against all accounts, which might each be in different jurisdictions. Attendees discussed whether the PRIMA principle needed to be updated to reflect new realities owing to changes in law and technology.

4.9. Attendees agreed that it might be useful to refer the Law Commission to the FMLC's work in 2003 on custody issues, as that one issue could be separated from the rest of the Consultation. Forum members also agreed that it might be useful to highlight to the Law Commission that there remained issues outside the scope of the current call for evidence and urge it to broaden the scope in the next stage of its project. Attendees agreed, however, given the developments in the Brexit negotiations and the fact that the U.K. had opted out of recent legislative developments in this area, that it would not be the right time to engage with the E.U. on this.

5. Securitisation Regulation Update (jurisdiction scope, due diligence etc.) (Sanjev Warna-kula-suriya)

5.1. Members agreed to defer this discussion topic to the next meeting due to lack of time.

6. Brexit (onshoring legislation, jurisdiction and legal opinions) (Sanjev Warna-kula-suriya)

6.1. Members agreed to defer this discussion topic to the next meeting due to lack of time.

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[3] FMLC, *Letter to European Parliament: Proposal for a Regulation on the Law applicable to the Third-party Effects of Assignments of Claims*, (24 April 2019), available at http://fmlc.org/letter-to-european-parliament-proposal-for-a-regulation-on-the-law-applicable-to-the-third-party-effects-of-assignments-of-claims-24-april-2019/.

7. Any other business[4]

7.1. No further business was raised at the meeting.

[4] The next meeting of the Securities Markets Scoping Forum will be held on Wednesday 11 December between 9.00am and 10.30am.

The FMLC's Public Education Function: Speeches

Venessa Parekh

Research and Communications Manager

The FMLC's charitable remit

According to the charitable remit, the FMLC has a tripartite mission:

- to *identify* relevant issues (the **radar** function);
- to *consider* such issues (the **research** function); and
- to *address* such issues (the **public education** function).

Reduced legal uncertainty and risk is in the public good; the ***radar*** and ***research*** functions are somewhat self-explanatory in this regard. The ***public education*** function is a key aspect of the FMLC's status as a charity, and is addressed in the following ways:

- All FMLC papers, presentations/speeches and correspondence are freely available via the FMLC website.
- The FMLC seeks to raise the profile of its research with those who are best positioned to implement solutions. This is achieved primarily through correspondence: the FMLC maintains active correspondence with regulatory and legislative groups around the world, particularly HM Treasury and the European Commission.
- Most FMLC events (with the exception of Patrons' events) are free to attend by members of the public.
- The FMLC also acts as a bridge to the judiciary, a task it carries out primarily by organising seminars to brief senior members of the judiciary on aspects of wholesale financial markets practice.

The Public Education Function

- Along with publications and events, the FMLC Secretariat furthers the Committee's education function by giving speeches about legal developments and issues of legal uncertainty in the financial markets.
- These speaking engagements may be at high-profile events or at a smaller gathering of an interested audience at a stakeholder firm.
- Members of the Secretariat have presented to audiences, within law firms for example, which are interested in learning about current issues facing the financial markets.
- The FMLC used to be CPD-qualified and such talks presented excellent training opportunities.
- Example of topics on which the Secretariat has presented are set out in slides below.

Brexit, FinTech and FinTech Regulation After Brexit

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Transitional Period: "Fourth" Cou

- Another uncertainty arising in the context of a trans
be a result of the U.K.'s status during the period as
Member State.
- While the U.K. will continue to be considered
for the purposes of intra-E.U. business, such a
not legally continue to be party to the E.U.'s
states.
- For example, U.K. CCPs may not autom
substituted compliance concessions awa
the CFTC.
- It will be necessary to start from scra
authorities to negotiate bilateral m
each Third Country jurisdiction in e

FinTech Today

- At the end of 2018, Bloo
cryptocurrency use
- According to a K
over 2000 types of
- In March 2019, the
a trial of cross-border
central bank digital cur
- On 28 June 2019, Facebo
"stable global cryptocurre
fiat currencies.
- Blockchain venture capital fu

Post-Brexit U.K. Fintech Regulation

- **HMT Consultation on Transposition of 5th Money Laundering Directive**
  - Expands regulatory perimeter to include virtual currencies and custodian wallet providers
- **FCA Cryptoassets Taskforce Report**
  - Sets out measures that the U.K. authorities intend to take regarding cryptoassets, including regulating financial instruments that reference cryptoassets and consulting on extending the regulatory perimeter for ICOs
- **FCA's Feedback Statement (FS17/4) on its Discussion Paper (DP17/3) on DLT**
  - Suggests current rules are flexible enough to accommodate use of DLT and that the FCA will continue to monitor DLT-related market developments
- **FCA granting e-money licences**
  - The FCA granted its first e-money licence to Coinbase in March 2018
- **FCA Guidance (FG16/5) for firms outsourcing to the "cloud"**
  - Lists areas of guidance that firms should consider when outsourcing to the cloud and other third-party IT services, including legal and regulatory concerns and effective access to date.

IBOR Transition (at the P.R.I.M.E Finance Conference 2019)

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SONIA (O

The definition of SONIA has two elements:

- (i) Statement of underlying interest
  SONIA is a measure of the rate at which int
  wholesale funds in circumstances where cre
- (ii) Statement of methodology
  On each London business day, SONIA is meas
  four decimal places, of interest rates paid on elig
  transactions.

Eligible transactions are:

- reported to the Bank's Sterling Money Market daily dat
  the effective version of the 'Reporting Instructions for Fo
- unsecured and of one business day maturity;
- executed between 00:00 hours and 18:00 hours UK time a
  and
- greater than or equal to £25 million in value.

Euro Rates

- EURIBOR is the rate at which Euro interbank term deposits are offered by one prime bank to another prime bank within the EMU zone, and is calculated at 11:00 a.m. (CET) for spot value (T+2).
- EONIA is a rate which represents the rates at which banks of sound financial standing in the European Union and European Free Trade Area (EFTA) lend funds in the overnight interbank money markets in Euro.
- ESTER is a rate which reflects the wholesale euro unsecured overnight borrowing costs of euro area banks. The rate is published for each TARGET2 business day based on transactions conducted and settled on the previous day (reporting date T) with a maturity date of T+1 and which are deemed to be executed at arm's length.

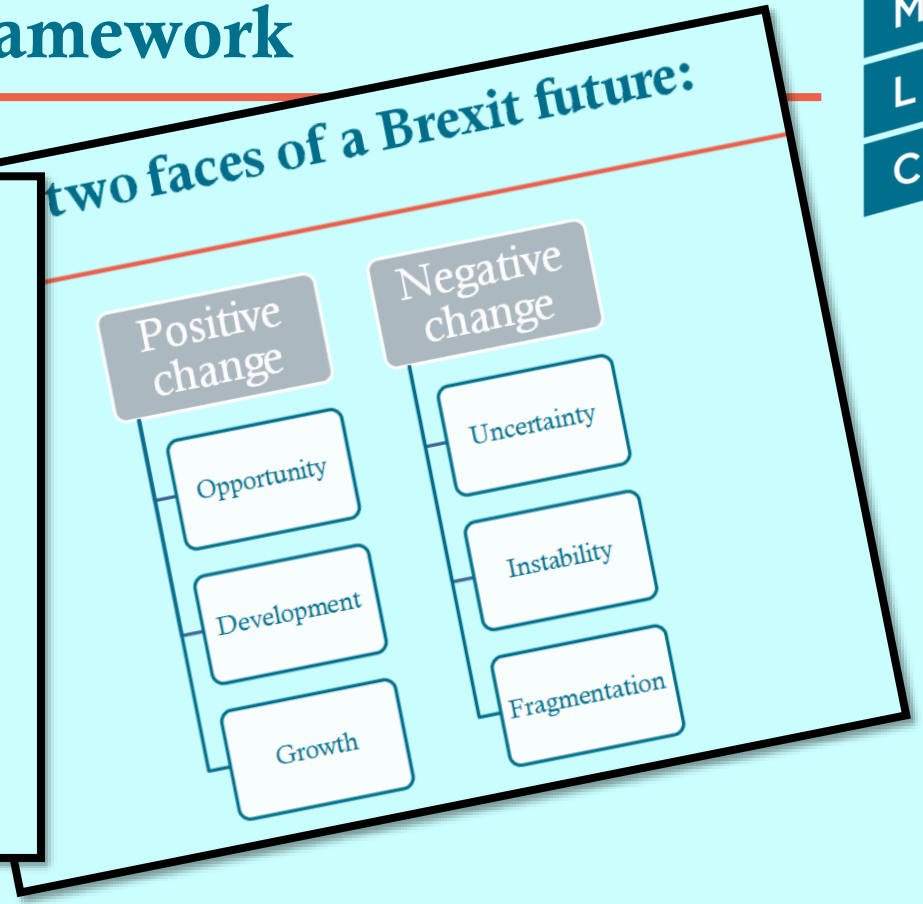
Brexit and finance: the legal framework

Covering note on the Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018

5 Following this model will mean that EU 'Level 1' legislation (which was developed by the European Commission and negotiated through the Council and European Parliament) and 'Level 2' legislation (apart from BTS and certain other technical elements of Level 2), will become the responsibility of the UK Parliament. This body of EU legislation includes provisions which set the policy direction for financial services, so it is appropriate that responsibility for deciding how deficiencies are fixed in this legislation should rest with Parliament. HM Treasury will propose amendments to this legislation, using the powers under the EUWB, ensuring that Parliament is able to scrutinise all of the changes. It is expected that the majority of the statutory instruments needed to correct deficiencies in this legislation will be laid under the affirmative procedure.

6 For certain EU 'Level 2' technical rules, known as Binding Technical Standards (BTS), HM Treasury proposes to transfer ongoing responsibility from the European Supervisory Authorities to the UK financial regulators – the Bank of England, the PRA, the FCA and the Payment Systems Regulator (PSR). BTS, running to several thousand pages, do not set overall policy direction but fill out the technical detail of how the requirements set at Level 1 are to be met. Having played an important role in the EU to develop these standards, through their membership of the Boards and working groups of the European Supervisory Authorities, UK regulators have the necessary expertise and resource to maintain them after the UK's exit from the EU. This allocation of responsibility would be consistent with the general rule-making responsibilities already delegated to the FCA and PRA by Parliament under FSMA.

7 As HM Treasury proposes to transfer ongoing responsibility for BTS to the UK regulators, it also makes sense that the regulators perform the task of making corrections to deficiencies in existing BTS so that these rules operate effectively in the UK at exit. HM Treasury therefore proposes to delegate to UK financial regulators the power to correct deficiencies in BTS arising from EU withdrawal.



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Conflicts of laws on securities and claims: collateralisation

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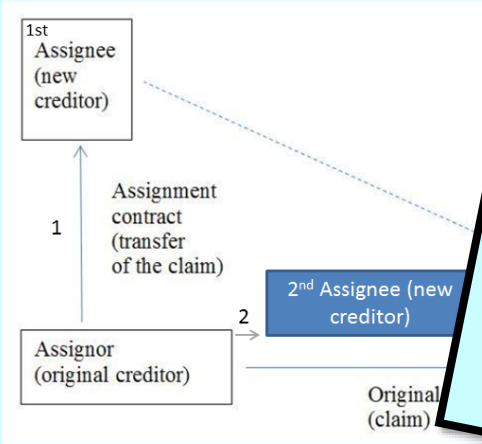
Collateralisation and the assignment of claims



Collateralisation and the assignment of claims

- The Commission proposal insures that retail deposits, whi
against banks by natural person depositors
the law of the underlying clai
- This is the correct rule: hig
by a natural person, who is
habitual residence.
- Situations in which individu
include the taking of security
relationship, the assigning of
association to a company on t
bank account from one spouse
matters are excluded from the p
lead to competing entitlements a
residence, it may be that only the
generate a legally certain result.

Collateralisation and the assignment of claims

- Further, with regard to bank accounts in general, it is often argued that banks should be able to take a charge over their own indebtedness *vis à vis* their clients under the law of the assigned claim and irrespective of any rule to the contrary in the law of the latter´s habitual residence.
- The question arose for consideration in the U.K. courts in two cases: *In re Charge Card Services Ltd* [1987] Ch 150, where it was held to be "conceptually impossible" that banks should take a charge in these circumstances, and *Re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214, where the House of Lords settled the question and upheld the charge. In between these case decisions, legislation was enacted in several jurisdictions with common law influence (including the Cayman Islands, Bermuda, Singapore and Hong Kong) providing for the validity and enforceability of charges of this kind, which were common at the time and continue to be prevalent as a means of taking security today.

Summary and Conclusion

- The Secretariat is happy to visit your organisation and introduce legal uncertainties in a relevant area of the financial markets.
- This helps us get reach a wider audience of stakeholders, learn about the questions occupying their time and fulfil our public education.
- If you are interested, get in touch with Debbie Hayes at: secretarial@fmlc.org or with Venessa Parekh at: research@fmlc.org