GLOBALISATION OF THE FINANCE AND CAPITAL MARKETS

Latest Developments in the London Financial Markets

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INTRODUCTION

This paper will describe some of the developments in the law and practice of international banking out of the London international wholesale market with particular emphasis on the documentary and practical consequences which have flowed from these developments.

NEGATIVE PLEDGE LENDING

There have recently been numerous collisions between traditional negative pledge lending and the need of banks to seek asset protection for their credits. Negative pledge lending was notably a US domestic banking development which sprang from the fact that in the United States syndicate lending was common, partly because of the large number of smaller banks. By contrast in England, the tradition earlier in this century was for a single clearing bank to monopolise the lending to a particular enterprise and to take universal fixed and floating charges over all of the assets so that effectively the enterprise looked to one bank only.

A negative pledge is an undertaking by a borrower not to create or permit to exist any security over any of its assets and is intended to ensure that the unsecured lender is not subordinated by security granted to the other creditors. The protection is particularly potent when the borrower is in financial difficulties and only able to borrow secured, so that the effect is that, in a work-out, all of the banks must be secured, including those who originally lent unsecured.

In practice, borrowers in the international banking markets have to decide whether they are going to borrow secured or unsecured since it is not possible to combine both: once they borrow unsecured then the negative pledge is a fundamental term which cannot be avoided so this means that they have to continue borrowing unsecured.

The first major erosion of the negative pledge occurred in the 1980s when international bank lending switched from sovereign lending to ordinary corporate lending on a large scale and it was found that corporates had to carve out numerous exceptions to the negative pledge. Some were technical, such as liens arising by operation of law. Others grew more and more expansive, ranging from the ordinary pledges of goods, insurance policies and the like in relation to letter of credit trade transactions through to carve-outs for project finance. One has seen carve-outs running to more than two dozen exceptions of varying degrees of importance.

In the 1990s, negative pledge lending received a further blow when a large number of privatised state entities came to the market and found that banks were not willing to grant medium term credits except with asset backing, particularly privatised entities in emerging markets. In some cases these privatised companies at first borrowed unsecured and gave a negative pledge, perhaps without quite realising the future consequences.

Finally, much recent finance has been on a project basis in which case security is invariably required over as many assets as are available under the local legal regime. So there is much potential for conflict between the two philosophies.

SECURITY

These factors have led to a greater emphasis upon secured lending or one of its variants such as title finance and hence a corresponding emphasis upon effective security.

It came as some surprise to banks that the jurisdictions of the world show a fundamentally different attitude to security, with one group permitting universal corporate security which is easily and immediately enforceable by the appointment of a receiver without any form of judicial protection on the basis that the receiver is effectively a possessory manager: he does not have to sell but can run the business in the interests of the holder of the security.

Another group of states rejects this approach. They allow security over land but make it difficult to take security over goods, receivables and contracts. The more extreme jurisdictions inhibit security by prohibiting non-possessory security by imposing onerous initial formalities and unrealistic stamp taxes, by excluding security for future debt or revolving credits, by insisting on a maximum amount, by downgrading the security on insolvency below unsecured priority creditors so that no-one knows what it is worth and by placing obstacles in the way of enforcement, such as judicial public auction, compulsory grace periods and freezes on enforcement, particularly in connection with corporate rehabilitation proceedings.

A good example of a country which recently decided to support security in the ladder of payments is **Poland**. The new Pledge Law, in force on 1 January 1998, provides for a registered enterprise security over all assets, present and future, except real estate (governed by a separate system) and administrative decisions. The law allows for an administrator of the pledge similar to a security trustee. Registered negative pledge and anti-disposal clauses are effective against a third party. There are important exceptions from judicial enforcement proceedings including management via an administrator in some cases. Three months wages and personal injury claims rank ahead but not usually taxes. Similar legislation in **Hungary** followed the EBRD model law in many respects.

Russia's Pledge Law of 1992 has allowed a very wide universal corporate security but this was downgraded somewhat by the 1994 Civil Code. Developments elsewhere have been very tentative, eg in **Bulgaria** and **Romania**, with some rather inconclusive steps towards universal security in **China**. **Italy** has adopted a special privilege which is however also quite limited in effect.

No civil law countries, so far as I am aware, have adopted the common law receiver as a possessory manager. The common law justification for this extraordinary procedure – which is like a foreclosure in substance – is that receivership is an effective rescue procedure which enables businesses to be saved by virtue of the fact that the receiver can be appointed within the hour and then can continue to run the business so that the assets are not broken up and so that there is no interrognum. While there may be much special pleading, UK statistics tend to show that receivership has in fact been a much more effective rescue method than the corporate rehabilitation proceedings based on the US Chapter 11 which have been so popular in recent years.

Nothing shows so dramatically the continuing dispute between the rights of secured and unsecured creditors than these corporate rehabilitations and their impact upon security. The theory is that the corporate rehabilitation may be thwarted if a particular secured lender could remove the factory or an essential computer, thereby wrecking the process, and hence many of these laws put a freeze upon the enforcement rights of the secured lender and give the administrator of the debtor a right to use the secured assets. The precursor of legislation of this kind was Chapter 11 of the US Bankruptcy Code of 1978 and it has been emulated in one form or another by many other countries, eg **Finland, France, Sweden, Belgium, Britain, Australia** and **Germany**. The impact on creditor rights of the British, Australian and German law is mild compared to the US and French versions. In countries like Britain the effect of the freeze has to some extent been neutered by judicial decisions which require justification for an administrator's refusal to permit enforcement and most creditors can live with that situation. The essential question is whether the legislation or case law offers the secured creditor adequate protection in the sense that the administrator cannot block enforcement or else must top-up if there are depreciations in value and that the administrator must compensate the secured creditor for lost interest (this is not a requirement in the United States). Where there are adequate protection rules, it is usually risky for an administrator to freeze an enforcement, especially in the case of volatile assets such as investment securities.

The purpose of security is to protect a creditor against the insolvency of the debtor and hence anything which hinders the exercise of the security on insolvency is an attack on the creation of the security itself. It is not easy to have it both ways, but a carefully drafted adequate protection regime seems the best way out. It is interesting to note that security freezes have been proposed or enacted in both **Thailand** and **Indonesia** as part of the recent bankruptcy reform programme suggested by the IMF.

Singapore has remained firmly in the camp of protecting secured creditors' rights; for example a recent case decided that in the commercial context an option by a secured creditor to purchase the securities covered by the charge was not a clog on the equity of redemption.

CHARGE-BACKS

In 1997 the House of Lords in obiter remarks – which, however, are considered to be an accurate statement of the law of England – decided in *Morris v Agrichemicals* that it is possible for a creditor to create a charge over a debt owed to him back to the debtor obliged on the debt. For example, it is now possible for a depositor to create a charge over his deposit back to the bank. This had probably been the case in English law in any event until the celebrated decision in 1986 in *Re Charge Card Services Ltd* where a court held, as an aside, that a charge-back was "a conceptual impossibility". This observation judicially converted most lawyers into geniuses because not only could they conceive of the transaction, they also did it. A number of Australian decisions were to the same effect but it seems that these were primarily driven by the desire to avoid stamp duty.

The "conceptual impossibility" remark generated considerable controversy and dismay, not because the point meant the end of civilisation as we know it, but rather because in England at the time there was some (unjustified) suspicion of the efficacy of set-off, because set-off was extremely important in international financial markets, because in some countries insolvency set-off was not available so the charge-back was the only means of protection, and because banks and lawyers could not understand why they were not allowed to do something when there seemed no good reason other than some abstract theory which they could not comprehend.

At any rate Lord Hoffman said in his judgment "where there was no threat to the consistency of the law or objection of public policy, the courts should not declare a practice of the commercial community to be conceptually impossible". This was therefore reassertion of a legitimate business need.

Where set-off is available in the jurisdiction concerned – as in most common law jurisdictions and the majority of others, eg Scandinavia, Japan, Korea, Panama, but not in many Napoleonic jurisdictions – set-off should always be used. The situations where set-off may be doubtful are where the debtor is located in a jurisdiction with no insolvency set-off, or where set-off is not available against interveners such as attaching creditors, and where the set-off is cash cover for a reimbursement liability – although it is usually possible by fancy foot-work to get the latter set-off.

If a charge back must be used and it is available – not apparently in Australia – then one must consider registration (unlikely in common law jurisdictions in the case of bank deposits), negative pledges, freezes on the enforcement of security, floating charge problems and the dramatically prejudicial effect that the charge-back will have if the creditor receiving the charge becomes insolvent – as demonstrated in the BCCI cases.

Flawed assets are rather curious and are considered undeveloped. The best advice is to regard them with suspicion if neither set-off nor charge-back are available; for example one has to consider the law relating to forfeitures and transactions at an undervalue.

I recently jokingly referred to the dispute about charge-backs in a conversation with a leading English judge as equivalent to the mediaeval scholastic arguments about how many angels one can get on a pin head, to which the response was that in this case there were no angels and certainly no pin! We must never become so doctrinal as not to be able to take a larger and more generous view, but what was really at stake in this question was whether or not the law was prepared to treat invisible property as having come of age and able to be dealt with like any other property. The issue had a high symbolic value.

INTERNATIONAL NETTING

While we are on the question of whether creditors may be "secured" in the context of reciprocal debts, the main commercial jurisdictions in the world seem to have accepted the notion that something has to be done about netting, although in many states the result has been far from satisfactory.

At its simplest, netting is simply the set-off of reciprocal claims on the insolvency of the counterparty, but it is more complicated if executory contracts are involved such as contracts for the exchange of payments under derivatives transactions or foreign exchange contracts or contracts for the sale of securities such as repos. In the case of executory contracts, it is also necessary to be able to cancel the contract on the default of the counterparty, as well as the ability to set-off resulting losses and gains. The attention given to netting in the 1980s and 1990s resulted from the massive explosion in the size of markets with corresponding systemic risks. It was dramatically brought to the attention of the international financial community by the fact that the US Bankruptcy Code of 1978 put a stay both on contract cancellations and set-off, thereby bringing into question netting under US bankruptcy law. Many species of legal witchcraft were developed in order to get round this freeze, eg connexity of contracts and automatic termination clauses, all of which led to massive theorising but little credibility. The sense of unease was increased by the fact that in many countries the legal community could not make up its mind whether netting was available or not, eg **Italy**. Added to this unsatisfactory situation was the fad for corporate rehabilitation proceedings which in many cases imposed a freeze on set-off, eg **Canada, Finland, Ireland** and a number of others, but not **Britain** or **Singapore**.

Energetic lobbying by central banks, by other institutions and by associations such as ISDA, have now resulted in a complicated mosaic, though this is not their fault. Some countries such as **Britain, Germany, Italy** and **Switzerland** have reinforced their existing strong netting background by declaratory statutes for particular cases. This also seems to be the proposed route in **Australia**. A group of other countries which originally had netting, chose to freeze it by virtue of corporate rehabilitation proceedings, eg in **Finland, Canada** and **Ireland**, so they reintroduced carve-outs for netting, eg covering specific financial contracts. Another group of countries which have not absorbed insolvency set-off have also enacted a carve-out statute, eg **France, Spain, Portugal** and **Belgium**. These carve-outs lead to enormous international complexity, are usually restrictive and often quickly become out-of-date. They create a two or three tier system which is discriminatory since netting can be just as important for ordinary trading concerns as for banks and it is difficult to isolate one sector without distortion. Even for real experts it is extremely difficult to remember the precise conditions of national netting and to what institutions it applies and the fact that traders have to be aware of these problems in my view creates a systemic risk by itself.

It would have been better if the leading jurisdictions had made up their minds whether or not they were going to give a general grant of insolvency set-off and whether or not they were going to permit executory contracts to be cancelled on insolvency pursuant to express clauses. To decide in favour of the universal grant of netting does not seem to me to involve some great issue of policy or the abrupt demise of all sweetness and light in the world. But the present complication is a policy issue.

SETTLEMENT FINALITY

It was with great alarm that central bankers were advised with increasing insistence during the 1990s that settlement systems were threatened, not only because of the absence of netting, but also because of the absence of finality of payments, eg the zero-hour rule in many countries whereby an insolvency order made during the day is backdated to the first moment of that day so that any payments made before the order are upset and must be returned to the insolvent's estate. There were also other reasons why payments could be upset, eg preferences and tracing. Further, payment systems are often collateralised by participant banks. In view of the enormous exposures, considerable anguish was caused by the rules of various jurisdictions whereby collateral could be called into question, eg top-ups might be preferential and security deposited after the commencement of the insolvency was void. And many countries were busy installing these well-meaning freezes on enforcement in the case of corporate rehabilitation proceedings.

The result of this in Europe was a draft Finality Directive which applies to formal settlement systems which are designated and which are subject to a member state law. The measure states in four deft ribbon-cuts that transfer orders are effective, final and non-revocable unless after a known insolvency, that netting is effective, that a participant's insolvency is governed by the law of the system, and that a participant's collateral (including repos) are unaffected by insolvency and are realisable.

This is commendable and remarkably free of ifs and buts. But the question must be asked whether, if these bankruptcy rules are considered inappropriate in one case, the inadequacies should not be regarded as general, ie whether fairness on insolvency should not be a universal principle and not merely restricted to high value payments in settlement systems. One does of course appreciate that societies have set a priority on protecting themselves against financial melt-down by reason of bankruptcy, but the point must be made that financial melt-down can just as much hit a medium-sized business as a payment system and what is unreasonable for the large may also be unreasonable for the small. There are political realities about getting laws through, but ultimately societies ought to aim at a system of financial law which is simple and which does not have too many carve-outs. That does of course involve deciding which way to jump, but that is what the law is supposed to do.

CUSTODIANSHIP

The Finality Directive also had tacked on to it at the end another provision designed to clarify an extraordinarily esoteric point. Where a security is deposited with a custodian or settlement system such as a Euroclear or Cedel, or indeed any other custodian, and the depositor decides to create a charge over the security, then if one applied the lex situs rule that the charge must comply with the law of the place where the securities actually are, the whole system would disappear in a puff of smoke. This is because often the securities, such as bearer bonds, are physically located in other countries, eg in a sub-custodian's vault in the country of the currency. The actual situs may require a possessory pledge or registration in the name of the chargee of the actual security. This would be impossible because it would involve getting the security out of the settlement system.

Luckily the general consensus of opinion amongst knowledgeable lawyers in the main countries in Europe is that what is being charged is not the security but rather the entitlement to the security which is located for legal purposes where the custodian is located. Logically this must be the case with fungible securities (because otherwise it would not be possible to say which actual security had been charged). This point is clarified in the new Article 8A to the US Uniform Commercial Code. This is also considered to be the case under English law despite a troublesome tax case in the 1960s which seems to support the notion of a see-through to the location of the actual security in the case of trusts of specific securities, but not in the case of fungible custodianship.

In any event the Finality Device will, if it is enacted, state that collateral over investment securities deposited with custodians is governed by the law of the location of the system account. Therefore, if the securities are deposited with Euroclear in Brussels, pledges must comply with the law of Belgium, not the law of the country where the bonds are actually kept, eg in a bank vault in France. This will come as a relief to participants in the market by reason of the fact that charges over investment securities are extremely important and involve very large amounts and very large exposures. The lawyers too will be relieved because the lex situs point was one which most bankers felt was a piece of labyrinthine ideology which defied all efforts of understanding. This is therefore a good case where common-sense ought to win.

There is still an alarming international black hole arising by virtue of the fact that many countries still do not recognise the trust so there is a risk on the custodian. The position may not be as bad as all that in view of carve-outs whereby non-trust countries do in fact recognise trusts of securities effective upon the custodian's bankruptcy. It is therefore difficult to tell how serious an international problem this is.

REPOS

Because of the problems with obsolete or prejudicial mortgage laws – which are resurfacing in modern rehabilitations – markets have plumped for alternatives to security. The most notable is the repo. Repo stands for sale and repurchase; the original seller typically sells securities for cash on terms that the financing buyer will resell those assets or equivalent assets at a later date back to the original seller for a price equal to the original sale price plus an amount equal to interest on that price. The object is for the original seller to raise money, supported by assets, but without "borrowing" or creating security. These repos are used just as much by central banks as by commercial banks.

Typically the repo is used to avoid enforcement freezes on insolvency rehabilitation proceedings, delays in public auction enforcement, registration, the priority of unsecured preferential creditors on insolvency, subordination to reorganisation expenses, preference risks on valuation top-ups, negative pledges, borrowing limits and sometimes usury laws. In England there is another special reason. Typically, the chargor has a right of substitution in respect of the securities and in England case law seems to indicate – especially as a result of the unconvincing recent *Coslett* case (where a charge over washing plant was held to be a floating charge) – that a right of substitution converts the charge into a floating charge because the pledgor has a right to deal. Apart from the usual weaknesses of floaters, a floating charge is frozen and subordinated to losses of administration under the British Insolvency Act 1986. This makes floating charges over securities completely uncreditworthy from the point of view of credit committees and so repos are universally used. ISDA has developed a standard form of title transfer for ISDA contracts.

For repos to be successful, there must be a developed and well seasoned sympathetic regime in relation to tax, netting, capital adequacy, stamp duty and accounting treatment. A repo must not be recharacterised as a pledge for the purposes of charge registration and insolvency law, but must be recharacterised as a pledge for the purposes of tax, documentary taxes, capital adequacy and accounting. This requires much ingenuity by the legal system.

There are many other forms of title finance, eg retention of title, financial leasing, hire purchase, sale and leaseback, factoring and discounting, etc. It is perfectly true that many of these transactions have a similar effect to security and indeed are intended to provide asset-backing for the raising of money. As a result, there have been many cries for the recharacterisation of title finance as security so as to bring it back within the net of security law. There is a very large variation in jurisdictions between those, such as the **United States** (under Article 9 of the UCC, subject to carve-outs) which do recharacterise, and those which do not, eg **England** and **Germany**.

It seems to me that the real question is not whether title finance is similar to security (which it often is), but whether the law relating to security interests ought not to be reformed so that the market does not have to resort to magic and illusions. Choices have to be made and, as often as not, the issue gets caught up in the ancient politics of debtors and creditors.

DERIVATIVES

After an initial flurry of adverse cases in the United States, decisions have now been coming out of courts in the leading jurisdictions which tend to uphold the notion that, where a punter places a bet that a particular horse will win the race but the horse does not win the race, then the punter cannot sue the bookie. The leading English case on this proposition – applying of course to sophisticated customers – was the *Dharmala/Bankers Trust* case, but there have been others, eg *Ata v American Express Bank Ltd* (Commercial Court, unreported, 7 October 1996).

In addition, many jurisdictions have enacted legislation to negative the notion that derivatives are basically gambling and are therefore ineffective, including margin FX trading. Thus there is **UK** legislation of 1986, **French** legislation of 1993, **German** legislation of 1989 and **Dutch** legislation of 1986. A **Singapore** case obligingly held in a 1997 case that though a Las Vegas loan at the Hilton Hotel was a gambling loan and therefore ineffective under Singapore law, it was governed by the law of Nevada, and, as the issue was a matter for the governing law, the Singapore courts would uphold it.

Still there are occasional surprises. An **Abu Dhabi** court recently held that FX margin trading is gambling even if for hedging purposes. The **Austrian** Supreme Court held in 1996 that foreign exchange margin trading is also gambling if off-exchange – a doubtful case because "economic justification" was not pleaded. Gambling laws are really consumer protection and ought to be ring-fenced: they continue to mystify the international markets. Nevertheless, all the old arguments about speculation continue to be made with the old stridency.

SECURITISATIONS

A great many countries have resolved to enhance the regime for securitisations in one way or another, eg the **Netherlands**, **Germany**, **Argentina**, **Spain**, **France** and others. One basic problem still remains and has not been faced in numerous countries. This is that an assignment of a debt must mandatorily be notified to the debtor and, if it is not, then the assignment is void on the insolvency of the assignor. In many securitisations it is not commercially feasible to give notice to the debtors, particularly where it is desired that the originator of the receivables will continue to collect them as agent of the securitisation vehicle. In all countries notice to the debtor is *desirable*, eg in order to preserve priorities, but this is very different from making the notice *mandatory* and expropriating the assignee if the notice is not given.

The countries which insist upon notice include most of the **Napoleonic** group, including most countries in **Latin America**, except where there is a securitisation carve out (and the doctrine has been much eroded by case law in France) and also including such countries as **Japan**, **Korea** and the **Scandinavian** countries, as well as the **Netherlands** in some cases. The rule does not apply in most **English-based** countries, except sometimes (not England) in relation to assignments by individual debtors (by reason of the "reputed ownership" clause on individual bankruptcies) and it does not apply in **Germany**, **Austria** or **Switzerland**. I believe it does apply in **Scotland**.

The origin of the rule is the doctrine of false wealth whereby a debtor should not deceive his creditors into giving credit by the appearance of many possessions but no assets. Hence, so the theory goes, the transfer of an asset must be complete and public. Therefore, the assignor must give notice of the assignment of the debt to the debtor so that the assignor has completely divested himself. This justification is wholly without merit since creditors cannot see the debt in any case, let alone know whether notice has been given to the debtor.

Belgium abolished the rule in 1994. It is considered that the example of Belgium ought to be universally followed.

ARBITRATION

A striking feature of loan documentation for borrowers in emerging countries, notably in **Central and Eastern Europe**, has been the appearance of arbitration clauses.

Arbitration is generally considered to be wholly unsuitable for loan agreements, eg because there is nothing to arbitrate, because arbitration is a condition precedent to enforcement, and because the rules of evidence and procedure are (often intentionally) less developed than court procedures, because there can be jurisdictional disputes, because it is not necessarily the case that arbitration is speedier and less expensive than the process through commercially orientated courts (arbitrators have to be paid, unlike judges), and because the decision may be made without regard to strict law.

It is true that these arbitration clauses have generally been inserted as an option to the lenders in addition to the conventional jurisdiction clause – which generally gives jurisdiction to an external court so as to assist the insulation achieved by the external governing law.

The insertion of arbitration clauses has been motivated by the fear that judgments in external courts may not be enforceable within the country of the borrower. This does not seem an altogether practical view because court judgments are extremely rare in any event (either the borrower is put into liquidation or a private rescue is organised), because if there is no local problem, proceedings can be taken locally in the first instance and because if there *is* a local problem, due to an exchange control or moratorium or some other inhibition, that is likely to strike the local enforcement of the judgment in any event, notwithstanding the New York Arbitration Convention.

I view these arbitration clauses as just another clause cluttering up loan agreements, but I know that many others, including some of my colleagues, take a different view.

It is interesting to note that the number of countries which still decline to enforce proper foreign judgments for debt claims where there is agreed jurisdiction but without a treaty is substantially declining. The main outstanding countries appear to include **Indonesia**, **Thailand**, and theoretically at least, the **Netherlands**, **Sweden** and **Finland**. There are a few others, eg **Surinam**, and a larger group might theoretically re-examine the merits or require token reciprocity. **Russia** has recently introduced a statutory liberal regime.

I imagine that the arbitration clauses really appeared because of a sense of unease about the courts of the emerging countries which expressed itself in a desire to have as many alternatives as possible. It would be amazing if a lender in a major international syndicated loan ever chose to go to arbitration as a way of getting paid.

LOAN TRANSFERS

Following similar initiatives in the United States, the Loan Markets Association was formed by a number of internationally active banks in London in December 1996 with a view to facilitating the trading in loans. Until then, trading in loans had been dominated by the trade in defaulted sovereign debt, plus defaulted corporate debt, referred to as "distressed debt". The banks would now like to increase the liquidity of their loan portfolios (mainly because of capital adequacy and low returns) and the LMA was formed in order to standardise as many clauses as possible in loan agreements, to establish market standards for settlement procedures and codes of practice, to establish loan valuation mechanisms and generally to ensure that loan agreements contain provisions facilitating transfers, eg novation certificates, no prohibitions on assignments, no confidentiality clauses, and no inhibitions under tax and increased cost clauses excluding assignees from the benefit of the protections.

It obviously would be impossible to standardise entire loan agreements and the LMA has therefore opted for the less ambitious programme of standardising key clauses so far as possible.

The English courts have recently upheld (in the *Lenesta Sludge* case) the proposition that an assignment in contravention of a prohibition on assignments is void (and does not merely give rise to a right to damages), but even more recent case law (in the *Don King* case this year) has also confirmed that a prohibition on assignments does not prevent a trust of the contract or a trust of the proceeds – which almost amounts to the same thing. If there are doubts, subparticipations must be used, although these are much less satisfactory from the point of view of the participant, eg because of the double risk, ie a risk of the ultimate borrower and also a risk of the intermediary bank.

REGULATION

The leading jurisdictions have energetically pursued programmes to stamp out fraud in the banking sector, particular following the disgraceful BCCI episode. The campaign against money laundering continues to be vigorously pursued, notably by the United States.

We are still no nearer solutions on the required degree of investor protection in investment transactions, eg drawing the line between consumer and wholesale transactions, and how prescriptive or formalistic the regime should be.

But the regulators continue to be defeated by the core problem of banks, ie how to make sure they stay solvent. In September 1997 the Basle Committee issued the Basle Core Principles for Effective Banking Supervision – 25 of them – which reaffirm basic principles as to licensing, approval of controllers, capital adequacy, financial supervision, management systems and controls, external validation by auditors, consolidated financial statements, global consolidated supervision and sharing of information. Much progress is being made, but banking systems, especially in emerging countries, still remain extremely vulnerable to capital flight. In many countries, banks have been effectively ruined by the politicisation of lending decisions and by the habit of governments in treating the banks as an easy source of cash to subsidise the national economy, ie taxation by another name. It is the tax payer who ultimately has to pay for failed banks.

In Europe the "single passport" regime giving a bank located in the European Union a single passport to transact business anywhere in the EU is well under way, despite some delays. The World Trade Organisation has made good progress in liberalising financial services by virtue of the protocol of December 1997, but there is still a long way to go. The programme was hit by Asian flu. The 1997 arrangements are not yet in force.

DOCTRINE OF SPECIFICITY

Real specialists will be interested in the recent English decision *Re Harvard Securities Ltd* that it is possible to transfer shares where the particular shares to be transferred are not identifiable. In this case a broker sold shares to clients, registered them in the name of a nominee without segregating them and then became bankrupt. The court held that each client had a beneficial interest in unidentified, unallocated shares, notwithstanding cases to the contrary dealing with the need to specifically identify goods which are transferred (now overridden by recent sale of goods legislation in Britain).

Although this decision may seem somewhat esoteric, in fact it was of fundamental import to dealings in intangible property which is so enormously important in modern economies. The original doctrine of specificity is now out-of-date in today's world because it expropriates a transferee on the insolvency of the transferor for no good reason. I was puzzled why the court was persuaded by the arguments of the liquidator's counsel that specificity still applies in such a case in the relevant Australian state: some of the shares were Australian having a situs in Australia and in those cases the clients got nothing. It is not feasible to set up clearing systems for securities – which are now usually dematerialised in the major jurisdictions – unless the doctrine of specificity is consigned to the dustbin. In any event, it has never been logically possible to label claims in the same way that one can label a packet of sweets or a washing machine.

THE EURO

Europe has now embarked on its big adventure of having a single currency. All the participating countries will switch as from 1 January, 1999 although the conversion proceeds in stages so that in the initial stages national currencies will continue to exist as legal denominations of the Euro in the same way as one can have pounds and pennies.

The lawyers have had a field day in discussing whether the change of currency could cause problems, eg on any entitlement of counterparties to base repudiations upon the doctrine of frustration, major change of circumstances or force majeure. Market research revealed that the number of situations where this might be a technical possibility is probably tiny, but nevertheless a directive has been passed to give effect to the "continuity of contracts" principle and there is independent legislation in such jurisdictions as New York. Switzerland and Japan are thinking about it.

Apart from this, multi-currency loan agreements have provisions whereby, when there are two currencies running side by side, the agent can dictate the currency in which payments are to be made. There has been much technical work on the definitions of interest rates, business days, place of payments, day count fractions and roundings.

DRAFTING

Lawyers often have the uneasy feeling that their draftsmanship, particularly drafting at the last moments in the small hours of the night, might not be completely up to scratch. Fortunately a 1997 decision of the House of Lords (*Investors Compensation Scheme v West Bromwich Building Society*) comes to the rescue. In this case the court decided that literal legalistic interpretation is now discarded and there may well be cases where the court must ascertain the meaning which a reasonable man would give to the document which is not necessarily the same thing as the meaning of the words used. The court might even conclude that the parties have used the wrong words or the wrong syntax. So all is not lost.

FINALLY

I may conclude with a case which shows a less tolerant attitude to human weakness. In the Privy Council decision from the Hong Kong court in *Union Eagle Ltd v Golden Achievement Ltd* ((1997) 2 All ER 215), a sale agreement for the sale of land provided for completion at 5:00 pm. Time was to be of the essence. The purchasers' lawyers were held up in the Hong Kong traffic and arrived at 5:10 pm. Held: too late.