CITY OF LONDON LAW SOCIETY

FINANCIAL LAW COMMITTEE

Minutes of a meeting held at the office of Ashurst, Broadwalk House,

5 Appold Street, London EC2A 2HA

on 21 May 2014 at 1.00pm

Present: Dorothy Livingston (Herbert Smith Freehills LLP – Chairman)
Simon Roberts (Allen & Overy LLP)
Nigel Ward (Ashurst LLP)
Simon Johnston (CMS Cameron McKenna LLP – alternate for John Naccarato)
Charles Cochrane (Clifford Chance LLP)
Nick Swiss (Eversheds LLP)
Alan Newton (Freshfields Bruckhaus Deringer LLP)
Penny Angell (Hogan Lovells LLP)
David Ereira (Linklaters LLP)
Richard Calnan (Norton Rose Fulbright LLP)
Matthew Dening (Sidley Austin LLP)
John Davies (Simmons & Simmons LLP)
Tom Vickers (Slaughter and May – alternate for Andrew McClean)

In attendance: Megan Rutherford (Herbert Smith Freehills LLP – alternate for Rachael MacKay - taking minutes)

1. **MINUTES OF LAST MEETING, MATTERS ARISING**

It was noted that the minutes of the last meeting which took place on 26 February 2014 had been circulated and approved in advance. No new matters were reported. Apologies received from Mark Evans and Presley Warner. The Chairman announced that John Naccarato was retiring from practice and would be leaving the Committee at the end of the month. The vacancy would be advertised by CLLS. She thanked John for his considerable contribution to the Committee.

2. **SECURED TRANSACTION REFORM**

2.1 **Fixed and floating charges**

The chairman of the working party, Richard Calnan, reminded the meeting that the Committee's Discussion Paper 2 "Fixed and Floating Charges on Insolvency" (dated February 2014) had been circulated to a number of interested people who were invited to provide comments. The Committee was informed that a meeting to discuss views and further steps will take place on 15 July 2014.

2.2 **Restrictions on transfer/assignment**

It was reported that a meeting of the working party took place a month ago and that a note is currently being prepared for the next meeting which will cover the paradigm cases where people do and do not wish to limit transfer/assignment. It was noted that the aim is not to change the law, but to make sense of clauses limiting transfer/assignment and encourage people to give more thought to the commercial outcomes they are trying to achieve.

The Committee's attention was drawn to a seminar to explore and discuss the merits of an online register for all security interests, including outright assignments of receivables, which took place at Freshfields Bruckhaus Deringer on 8 May 2014. It was reported that an interesting debate took place between Professor Hugh Beale (who was in favour of overriding prohibitions on assignment) and Sarah Paterson (who defended the use of anti-assignment

clauses) and that Professor Louise Gullifer led a discussion on proposals for an online registration of interests in receivables. The slides to these presentations are available on the Secured Transactions Law Reform Project website.

3. **CASE ON MEANING OF "DEBENTURE": FONS HF (IN LIQUIDATION) V CORPORAL LTD AND PILLAR SECURITISATION LIMITED [2014] EWCA CIV 04**

It was noted that in *Fons HF (In Liquidation) v Corporal Ltd* [2014] EWCA Civ 304 a charge over the shares in a company, which defined "shares" widely as including "debentures", was held to capture inter-company shareholder loans. Debenture was given an extension of its ordinary meaning of a document which creates or acknowledges debt.

The judgment was thought to be surprising, as it had previously been thought that loan agreements under which loans are to be made in the future, and subject to the satisfaction of conditions precedent, neither "create" or "acknowledge" debt (in this case, only one of the two loans had already been advanced when the agreements were entered into). The Committee was informed that the case is not going to appeal. It was noted that it may be possible to confine the case to its facts, but this was not certain given the terms of the main judgment.

The Committee discussed a draft letter it had been asked to endorse from the CLLS (Regulatory and Financial Law Committees) to HM Treasury. The letter highlights the regulatory implication of the *Fons* decision, namely, that loan agreements could be regulated investments for Financial Services and Markets Act 2000 (FSMA) purposes. The Committee was awaiting a further draft which had been expected last week. The Committee was of the view that, in order to take the letter (as currently drafted) forward, amendments should be made to clarify what the Regulatory Committee is asking HM Treasury to do.

Afternote: The revised draft has been approved and sent and will appear on the CLLS website. The Committee will be represented at a meeting with the Treasury organised by the LMA in order to discuss this issue.

4. **CAPITAL REQUIREMENTS REGULATION (575/2013) ARTICLE 194(1) AND LEGAL OPINONS**

It was noted that of Article 194(1) of the Capital Requirements Regulation 575/2013, which requires institutions to undertake due diligence measures to ensure that their credit risk mitigation techniques are effective and legally enforceable in all relevant jurisdictions, could potentially mean that, on all secured loans, banks would need to procure external legal opinion.

It was noted that the European Banking Authority (EBA) has provided a helpful response to this issue: an internal opinion may be sufficient (provided that it is "independent, written and reasoned") and it may be possible to rely on a generic opinion (Single Rulebook Q&A, question ID: 2013_23).

It was also noted that the European Supervisory Authorities (ESAs) were consulting on important regulatory technical standards dealing with the use of uncleared margin in the European derivatives markets and the consultation was open until July 14th. The draft regulatory technical standards appeared to prescribe the form of legal opinions that would be required to be given in certain circumstances. There were various issues raised by the proposed language.

The Committee felt that the issues raised were not just City of London issues and that aspects would need discussing with ISDA and other international bodies.

5. **STATUTORY AUDIT SERVICES MARKET INVESTIGATION AND BAN ON "BIG FOUR" CLAUSES**

The Committee was reminded that the Competition Commission's (now the Competition and Markets Authority (CMA)) has revised its timetable to implement remedies following its final report (dated October 2013) in light of developments at the EU level and that the CMA is expected to issue further consultation in Q3 2014.

At the EU level, it was noted that the European Parliament and European Council have adopted the Commission's proposals to amend the Statutory Audit Directive and introduce a new Regulation on audit, which includes a prohibition on "big four" clauses.

The Committee was of the view that for many major companies there were, in practice, no alternatives to one of the big four. The prohibition might, however, add to costs for borrowers as lenders might instruct their own auditors at the borrower's expense, if dissatisfied with the quality of the borrower's auditor. The EU language was rigid, compared with that discussed with the Competition Commission and therefore increased the possibility that banks would find this was the only way to manage audit risk.

The Committee was of the view that the LMA will take the lead on this issue. However, it was noted that it might be worth seeking clarification from the EBA with respect to retroactive effect (there is no grandfathering) and extraterritoriality. The Chairman would take this forward in conjunction with other interested bodies.

6. UK CRIMINAL CARTEL OFFENCE

It was noted that the amended version of the cartel offence (which removes the dishonesty requirement) came into force on 1 April 2014 and that this could have implications (i) at an early stage in a transaction and (ii) for the loan agreement itself. (See the Competition Law Committee's submissions at the draft stage of the legislation on the CLLS website.)

Consultation within firms between Finance and Competition lawyers on this issue would be helpful to practitioners to the extent this has not already happened.

Afternote: The LMA has issued a notice to members on this issue.

http://www.lma.eu.com/uploads/files/LMA_Notice%20on%20the%20application%20of%20competition%20law%20to%20syndicated%20loan%20arrangements.pdf

7. FINANCIAL STABILITY

7.1 Banking Reform Act 2013, Bail-in, EU Recovery and Resolution Directive proposal and Liikanen Regulation

a. The Committee was informed that earlier today members of the Committee and the CLLS Insolvency Law Committee attended a meeting with HM Treasury regarding their response to the bail-in consultation (dated May 2014). It was reported that HM Treasury was relatively receptive to the issues raised and that it now appeared that progress will be slowed so that secondary legislation regarding bail-in powers will be implemented together with implementation of the Recovery and Resolution Directive (RRD). The Committee was informed that a further consultation is expected in July 2014, with legislation expected to come into force by 1 January 2015.

b. It was noted that the RRD has been approved by the European Council and European Parliament. It was noted that the deadline for transposition into national law is the end of 2014 and the deadline for applying the provisions on the bail-in tool is 1 January 2016, but the UK proposes to "front-run" the application by more than 12 months. The Committee was of the view that, in practice, bail-in would be restricted to "going concern loss absorbing capital" (GLAC) and would only be used in relation to holding and operating companies (not deposits and derivatives), but the law would allow greater flexibility and the RRD may sometimes require other creditors to be bailed in.

7.2 Non-bank Resolution Regimes

Nothing new to report.

7.3 Structural Reforms

The Committee was reminded that in January 2014 the EU Commission published a draft Regulation on the Structural Reform of Banks and that this, like Volcker, would require affected banking groups to dispose of their proprietary/own account operations completely, subject to discretionary exemption for individual banks subject to existing national solutions of equivalent value. It was noted that this is not expected to progress until 2015.

It was noted that the Regulation's possible terms complicate the UK's preparation of legislation for ring-fencing of key banks but, nevertheless, HM Treasury continues to work on

the statutory instruments on which they consulted last year. These are due to be laid before Parliament in the Autumn.

8. **EUROPEAN ACCOUNT PRESERVATION ORDER PROPOSAL**

The Committee noted that the final version of the proposal was adopted by the European Council in May 2014 and will come into force following publication in the Official Journal. It was noted that the UK remains opted out and that a further consultation on this issue is expected.

9. **SCOTTISH INDEPENDENCE REFERENDUM**

The Committee's attention was drawn to the debate to be held at the BBA "What Scottish Independence means for the City" on 1st July, sponsored by Tods Murray, the Edinburgh law firm.

10. **LAW COMMISSIONER FOR COMMERCIAL LAW**

It was noted that the Law Commission is looking for a practising solicitor to take over as the next Law Commissioner for commercial law.

11. **ANY OTHER BUSINESS AND CLOSE**

There being no further business, the meeting closed.

Nothing in these minutes should be considered as legal advice or relied upon as such.