COMMITTEE ON INTERNATIONAL MONETARY LAW

WORKING SESSION

Wednesday, 22 August 2018, 11.00AM

Chair: Professor August Reinisch (Austria)

The Chair, Professor August Reinisch (Austria) welcomed the MOCOMILA members and invited Sir William Blair to speak.

Sir William Blair (UK) noted the significant turnout at this session of MOCOMILA. Since the 2016 ILA Conference in Johannesburg, MOCOMILA has been hosted by the Bank of England and has also convened in Barcelona. Sir William Blair then invited members of the Committee to give self-introductions: Committee Vice-Chair **Mr Thomas Baxter, Jr (USA)**; Committee Vice-Chair **Professor Chiara Zilioli (Italy)**; **Mr Bernd Krauskopf (Germany)**; **Professor Engela Schlemmer (South Africa)**; **Professor Syue-ming Yu (Taiwan)**; **Mr Marcus Jewett, QC (Canada)**; and **Mr John L Taylor (Australia)**.

Sir William Blair noted the increasing use of soft force in international law. One specific example is the current US administration's decision to withdraw from the Iran nuclear deal and reinstate sanctions against Iran. While other State participants in the deal have expressed that they still consider themselves bound by the agreement, their decisions will most likely be impacted by the reinstated US sanctions.

Regime sanctions and international commerce depend on finance at their core. The two are interrelated. For instance, US regulators have imposed significant penalties on international banks for infringing the US sanctions regime against Iran. Public international law however does not always recognise the important role that is played by finance.

Sir William Blair invited Mr Krauskopf to speak.

Mr Krauskopf explained that he will provide an overview of issues arising in relation to control over ECB monetary policy. One major question is whether unconventional ECB monetary policy is subject to judicial control and, if so, the extent of that control.

In September 2012, the ECB announced an OMT programme in response to continuously rising interest rates on the sovereign bonds of certain member States. This programme provides for the outright purchase by the ECB of low-rated government bonds of selected member States in secondary markets without pre-announced quantitative limits.

From one perspective, the formulation and implementation of monetary policy requires a broad degree of discretion to be effective. Judges lack the necessary expertise to make determinations in respect of monetary policy and ought to leave this up to experts (that is, central banks). Mr Krauskopf noted, however, that nowadays most courts do have recourse to expert evidence in their decision-making.

From another perspective, monetary policy decisions are decisions of an administrative nature and therefore amenable in principle to scrutiny by the courts for the purposes of preventing abuses of discretionary power and ensuring that the law is properly applied.

Recent European court cases have demonstrated the relationship between national constitutional courts and the ECJ. German citizens lodged claims against the OMT programme in the German Constitutional Court (*Bundesverfassungsgericht* or BVerfG), claiming that the OMT programme is *ultra vires* as it failed to comply with the prohibition on monetary financing and lay outside the ECB's mandate, and that it impaired the budgetary autonomy of

the German Parliament which is part of German constitutional identity. As an EU instrumentality, the ECB can only act within the scope of competencies transferred to it by EU member States within the European Treaties.

As the ECJ is competent to interpret European Treaties, BVerfG referred the question of the OMT programme's legality to the ECJ for a preliminary ruling. The ECJ held that the OMT programme is compatible with EU law only if it contained safeguards ensuring that it did not contravene the prohibition on monetary financing. BVerfG then handed down a judgment based on the ECJ's decision, holding that the OMT programme is not *ultra vires* and will not impair the budgetary autonomy of the German Parliament if it acted within the limitations specified by the ECJ.

Although the ECJ is not bound by the judgment of any national court, the influence of the BVerfG's ruling can be seen in the ECJ's Public Sector Purchase Programme (PSPP), which contains safeguards specified by the ECJ and BVerfG. German citizens again lodged claims against the PSPP, which was launched in September 2015. BVerfG once again lodged the question of the PSPP's compatibility with EU law to the ECJ, and held that unlimited risk-sharing within the European system would amount to a violation of the budgetary autonomy of the German Parliament.

The ECJ judgment confirms that the acts of the ECB are subject to judicial review. These proceedings have led to further interpretation of the boundaries of the European Monetary Union.

Sir William Blair invited Professor Zilioli to provide an overview of regulatory developments in the European Banking Union.

Professor Zilioli explained that the regulatory developments commencing in 2016 found their genesis in 2012, when the EC advocated reforms in the wake of the GFC. These reforms have pursued different directions, but they have mainly centred around: institutional and structural changes including new powers conferred on EU instrumentalities; changes in the banking regulatory framework; and further innovation of the Monetary Union. EU member States transferred power over monetary policy to the ECB but retained competency over economic policy. The EU has sought further integration at the EU level.

Since MOCOMILA's draft report, more changes have occurred in respect of developments in the banking regulatory framework. The proposals to amend the CRR, CRD IV and BRRD have been further finetuned. Some proposals are still ongoing, but a few have been adopted. These amendments are based on the Basel III reforms. The legislative proposals mainly deal with the integration of the Financial Stability Board (FSB)'s total loss-absorbing capacity (TLAC) standards into general minimum requirements for own funds and eligible liabilities (MREL).

The second set of proposals are institutional changes which confer more powers to European instrumentalities that are responsible for the regulation of banking, funds, securities, and the like. There are two main streams to these proposals: first, measures to reduce risks in banks; and second, risk-sharing across the EU. There is pressure on the European legislature to devise ways to allow banks to easier rid themselves of non-performing bonds. The proposals also seek to distribute risk by allowing banks to invest in bonds that are not necessarily linked to one single country, that is, in sovereign bond-backed securities (SBBS), which are securities backed by a diversified portfolio of government bonds. Professor Zilioli noted that these reforms to create a new type of bond target private banks and therefore seek to reduce private risks. These SBBS are divided into senior and junior tranches (which are more high risk). Some European governments however are concerned that this type of instrument may contaminate their high

credit ratings. The second group of proposals on risk-sharing establish a European Deposit Insurance Scheme (EDIS), which is an insurance scheme for all bank deposits in Europe. Currently bank deposits are covered nationally under deposit guarantee schemes, however scheme requirements differ between member States and they are nationally financed. The EC seeks to further integrate the European market by providing a scheme that is available to all European institutions and is monitored by one supervisor.

The final set of proposals concern the further integration of the European Economic and Monetary Union. This includes a proposal to transfer the powers and responsibilities of the European Stability Mechanism (ESM) to a European Monetary Fund (EMF) which will be established under Article 352 of the TFEU. This provision allows the EU to do what is necessary to achieve EU objectives. However, there is debate on whether this is possible. In the alternative, the EC proposes to maintain the ESM (and its status as an intergovernmental treaty body established outside of EU law). However, this means that some proposals to integrate powers will not be possible because various competencies (including surveillance obligations) conferred on the EC cannot be transferred to the ESM. The European Council and the EC will convene in December of this year to further discuss the matter.

Furthermore, the Single Resolution Board (SRB)'s authority to carry out bank resolutions commenced in 2016. The SRB operates within the Single Resolution Mechanism (SRM) of the EU. Four cases have since been referred to the SRB. The first is the SRB's decision to take resolution action in respect of Banco Popular Español. In the second and third cases of Banca Popolare di Vicenza S.p.A. and Veneto Banca S.p.A., the SRB decided not to take resolution action. Similarly, it did not take resolution action in respect of the Latvian ABLV Bank and its Luxembourg subsidiary. The parent company entered into voluntary administration, and its Luxembourg subsidiary is currently paying off its debts. These cases show that having a single resolution Board does not mean the same outcome will occur in every crisis, and that different approaches will apply to different national contexts.

Sir William Blair said that the next topics will be the IMF's approach to corruption, sovereign debt, and then technological developments. He referred to Mr Edouard Fernandez-Bollo's chapter on Basel III rules in the draft report and invited those interested to read it. Sir William Blair then invited Mr Taylor to report on corruption.

Mr Taylor explained that this section of the draft report concerns recent efforts by the IMF to address corruption in IMF member States, and it was prepared by Mr Sean Hagan, the outgoing general counsel of the IMF. The IMF's policy to address corruption is motivated by the understanding that corruption harms GDP growth, reduces the possibility of sustainable investment, discourages foreign direct investment, and leads to higher inequality. These factors all culminate in a loss of trust from the populace, which has disastrous consequences, as has been demonstrated in Australia.

According to the IMF, a proper strategy to combat corruption must contain four main elements: (1) transparency; (2) rule of law, meaning that individuals who engage in bribery or corruption should be promptly prosecuted; (3) economic reform; and (4) institutional reform, meaning that officials ought to be rewarded for professionalism and punished for impropriety, leading to independent and competent administration.

In 2017, the IMF undertook a review of its existing anti-corruption programme, which was introduced twenty years ago. The IMF concluded that this programme required improvement and adopted a Framework for Enhanced Fund Engagement. This framework requires that, when the IMF undertakes its day-to-day work of assessing a country or determining the conditions of lending, it will: (1) assess governance vulnerabilities in the country; (2) assess

the economic impact of those vulnerabilities; (3) have regard to those vulnerabilities when formulating IMF policy recommendations; and (4) assess governmental measures to prevent private actors from offering bribes or providing services which will allow corrupt activities to remain secret. The IMF has invited all Fund member States to volunteer to be assessed. The G7, Austria, and the Czech Republic have all since volunteered.

Mr Hagan's report also recognises that implementation will be a challenge. Mr Taylor noted that it is unfortunate that the IMF will not be publishing rankings for its country assessments. Much of the discussion for these assessments will take place behind closed doors, however the final report will be available to IMF member States. The IMF's programme will be reviewed in three years.

Sir William Blair invited questions from the floor.

Mr Peter Willis asked clarification on why the country assessments will not be published. For instance, under the OECD Anti-Bribery Convention, reports on implementation of the Convention by Member countries are made publicly available. These reports cover civil society as well as public officials. Mr Willis asked whether the IMF's decision not to publish reports is an inevitable result of the political nature of the Fund.

Mr Taylor responded in the affirmative to the second point. He added that the Fund will be consulting with many other international organisations such as the Financial Action Task Force (FATF), the World Bank, and other groups from civil society. The IMF's decision not to publish reports is consistent with the IMF's tradition of requiring Fund member approval. Mr Taylor expressed hope that international pressure may encourage the IMF to shift towards more publication.

Sir William Blair invited Mr Baxter to report on bank resolution.

Mr Baxter explained that he will give an overview of the draft report's section on cross-border resolution and the FSB's proposal of a new financial crisis resolution tool, which was authored by Dr Eva Hüpkes. He provided some context to the report. During the GFC, supervisory authorities frequently faced a choice between rescuing a financial institution or allowing it to declare bankruptcy. This was the case for the United States Federal Government with respect to AIG in September 2008. At the time, AIG was the world's largest insurance company, had consolidated assets of USD$1.2 trillion, and conducted operations in 120 countries. The Federal Government faced the prospect of not only causing massive loss to shareholders and creditors, but also to many innocent parties. For example, the retirement plans of thousands of US teachers would have been negatively impacted by a decision to file for bankruptcy as AIG provided credit protection to a number of stable value funds including teachers' retirement plans. Mr Baxter noted that his wife is one of these teachers. The Federal Government took the view that the negative consequences on such innocent parties were too substantial to allow AIG to file for bankruptcy. As a comparison measure, Lehman Brothers was half the size of AIG at the time it filed for bankruptcy.

The FSB has proposed a new tool that is intended to provide an alternative to supervisory authorities who are facing the choice of rescuing a financial institution or allowing it to file for bankruptcy. This tool contains four elements: (1) the systematically important components of the failing financial institution will be transferred into a bridge vehicle, which will continue operating in order to minimise harm to innocent parties; (2) the financial institution must have means to recapitalise the components within the bridge vehicle; (3) the financial institution must have liquidity (for example, the Dodd-Frank Act imposes minimum liquidity requirements to ensure that important components continue to operate); and (4) coordination

of supervisory authorities in the relevant jurisdictions. Mr Baxter acknowledged, however, that authorities may not work cooperatively in order to prioritise their own jurisdictions.

In order to facilitate the adoption of this tool, the FSB has also taken a number of actions: (1) publishing a list of key attributes for effective resolution regimes, in which the FSB identifies a minimum standard of statutory resolution powers that is required in jurisdictions where financial institutions conduct their material operations; (2) emphasising the need for international cooperation and coordination in order to make cross-border resolutions more effective (for example, multinational financial institutions that are facing insolvency may encounter inconsistencies between regulators in different jurisdictions); and (3) introducing TLAC standards which will provide the financial resources necessary for implementing the new tool.

If successfully adopted, then supervisory authorities will have access to a third tool when facing financial crises. This new tool will also detract from the idea that some institutions are 'too big to fail' by providing a process whereby innocent parties are protected as the institution's critical operations are still preserved, but the rest of the institution may be allowed to fail.

Sir William Blair acknowledged the importance of this tool, especially in the US. He opened up the floor for questions.

Ms Ida Levine noted that the decision to use the tool and its constituent decisions will need to be made very quickly given the nature of market forces. She asked whether there is a structure to identifying what are the systematically important components of an institution.

Mr Baxter replied that the FSB has a list of Global Systemically Important Financial Institutions (G-SIFIs). Furthermore, many jurisdictions including the US already require such institutions to have some kind of resolution plan in place. In contrast, Lehman Brothers hired bankruptcy counsel on 11 September 2008, and filed for bankruptcy four days later on 15 September 2008. The significant change between the GFC and the present day, is that financial institutions and supervisory authorities are much more prepared for insolvency situations.

The Chair thanked Mr Baxter for his contribution, and invited Mr Jewett to discuss sovereign debt.

Mr Jewett stated he would be discussing two reports on sovereign debt, looking at recent cases for background on the area and also the ILA's Sovereign Insolvency Study Group. He noted MOCOMILA was fortunate enough to have Mr Lee Buchheit, who often represents debtor states and Mr Sean Hagan, who is responsible for structuring sovereign debt, from the United States Branch as two experts in this field. He also noted that he and Professor Régis Bismuth prepared these portions of the report.

In relation to the background of recent developments in sovereign debt restructuring, Mr Jewett reports that there have been two main approaches to addressing sovereign debt restructuring. The first is the "treaty approach" which addresses sovereign debt issues with international treaties, and is favoured by the International Monetary Fund. The other is the "contractual approach", which is exemplified by the development and evolution of collective action clauses (CACs). CACs have met with some success in facilitating sovereign debt restructuring and addressing issues arising from holdout creditors.

There have been many recent examples of sovereign debt crises, including Argentina and Greece. In relation to Argentina's sovereign debt crisis, the proceedings came to a halt in June 2014, when the US Supreme Court refused to hear Argentina's appeal of a lower court's decision issuing an injunction that prohibited Argentina from making payments on its

restructured bonds without first paying holdout creditors in full. This demonstrates not only the lasting and significant impact of sovereign debt issues on global markets, but also the inordinate power that may be wielded by a relatively small number of holdout creditors in a sovereign debt restructuring.

Greece may also illustrate the problem of holdout creditors. The 2012 Greek debt exchange was the largest ever debt restructure in the history of sovereign defaults, and ultimately allowed for €106 billion in debt relief. Venezuela and Ukraine also demonstrate the ongoing problem of sovereign debt crises.

In relation to the status of current efforts to address sovereign debt, Mr Jewett highlighted that the ILA has a Sovereign Insolvency Study Group, initially formed in 2008. After a couple of iterations, the Study Group was reconstituted under the Chairmanship of Professor Michael Waibel of Cambridge University, as the Study Group on Sovereign Bankruptcy. In September 2017, the Study Group held a workshop at the Lauterpacht Centre for International Law at Cambridge University.

Further, the United Nations General Assembly, recognising the seriousness and intractability of sovereign debt issues following the Argentine example, established the Ad Hoc Committee on Sovereign Debt Restructuring Processes in 2014. A proposal of basic principles on solvent debt restructuring emerged, spearheaded by Argentina. These principals encouraged adherence to principles such as good faith and impartiality. The Principles were endorsed by the General Assembly. However, these principles may still be too contentious, as they were opposed by the United States and the European Union, among others.

On the contractual approach, the shortcomings in CACs have been addressed in a so-called "second wave" of CACs. "Aggregated" CACs improve voting procedures, requiring a majority of all "aggregated" bondholders, as well as a slightly lower-threshold majority within each series of bonds, to consent to a restructuring. Within the EU, these new CACs are mandated by the EU in accordance with the ESM Treaty.

The IMF has also been particularly active in revising their lending into arrears policy. The most recent revisions have occurred in 2015.

In response to issues in the treaty and contractual approaches, a Model Law has been posited. This is a half way point between a treaty and contractual approach. It has been promoted by the Centre for International Governance Innovation (CIGI) and is currently being pursued with two governments. The Model Law could be enacted through a domestic statute, and apply to the issue of bonds under domestic law. It incorporates and adapts many features of the sovereign debt restructuring mechanism (SDRM) to take advantage of the significant knowledge and expertise arising out of the SDRM.

Professor Reinisch (Austria) noted that ~~treaty and contractual~~SDRM approaches are based on the willingness of nations to accept that some kind of customary international law will apply in the absence of treaty, or that contractual clauses will be accepted. Under the contractual approach, conflict of laws issues arise as it is not always clear which jurisdiction should hear the dispute.

However, the Model Law is put forth as a third option. Under this approach, national legal systems voluntarily adopt something that would otherwise be the basis of a treaty. Professor Reinisch asked Mr Jewett the extent to which this is feasible, and whether there is a first mover problem involved. He also asked whether jurisdictions would be willing to adopt the Model Law, given that this may mean their bond markets are less attractive.

Mr Jewett agreed that there is a first mover problem. The host state should have a reputable legal system and a competent judiciary. The first mover problem will apply to issuing countries, that is, to their decision to issue not under English or New York law but under the Model Law. However, in the debt and insolvency area, the first mover problem is not a new phenomenon. This also applied to the new CACs. Mexico was the first jurisdiction to adopt the new CACs for an issue of bonds in the US. However, there is definitely a problem.

Mr Willis asked whether it was essential for the Model Law proposal that the governing law of the debt issue be that of the Model Law jurisdiction. He inquired whether the approach would still work where the law of the forum adopts the Model Law, with the governing law remaining the dominant jurisdiction (e.g. English law or New York law).

Mr Jewett responded that there are a number of possibilities. The idea is that the governing law will be the domestic law. This is a work in progress.

Mr Willis said that the utility of the Model Law approach will be limited if the market chooses to issue bonds under jurisdictions that do not adopt the Model Law. Singapore would be a good jurisdiction given its centrality in international arbitration. However, the efficacy of the Model Law will be constrained if it were only adopted by lesser known issuing jurisdictions. For example, it is difficult to see many bonds issues occurring under Ontarian law.

Mr Jewett mentioned that he is Canadian, and he has met with representatives from Singapore's central bank (the Monetary Authority of Singapore) and the Singapore Ministry of Law who seem to invite the Model Law.

Sir William Blair referred back to the sovereign debt debate. Page 20 of the MOCOMILA report refers to a well-known case in which Ukraine was sued for 3 billion dollar note issue. The unusual feature in this case was that all of the notes were held by Russian Federation. The case was decided under English law by Sir William Blair. He gave judgment for the creditor. That case is now proceeding through the appellate system in England, and the appellate court will hand down a judgment quite soon.

Sir William Blair then explained that he will cover the remaining sections of the report on technological advancements in finance. He acknowledged the work of Ms Sonya Branch, General Counsel of the Bank of England, on the section of the report concerning the "'Direct Delivery' Model for the UK's High Value Payment System".

Sir William Blair said that the chapter on 'Central Bank Digital Currencies (CBDC) Tokenized Schemes – An Overview' was written by Professor Benjamin Geva, who is a leading authority on payment systems. Bitcoin is an extremely well-known digital currency. Now, central banks are considering whether to issue their own digital currencies. A number of proposals exist, including in the US and China. These digital coins would be centrally issued on a blockchain-style decentralised ledger, however the central bank would remain in full control of the timing and quantity of coins issued, and also fix the value of the currency. This is the crucial difference between a central bank digital currency and Bitcoin.

There has been a great deal of research into central bank digital currency, but not much has happened in practice. There are currently two projects dealing with this: the Bank of Canada's Jasper Project, and the Monetary Authority of Singapore's Ubin Project. Both of these projects utilise a DLT payment system which is based on the central bank using a blockchain to settle interbank transactions. However, the success rate of these projects has thus far been modest.

Critical financial market infrastructures like wholesale payment systems are not sufficiently catered to by current versions of DLT technology. Transfers in the DLT system are low

compared to transfers in conventional payment systems. Furthermore, these DLT systems as a whole are still in a state of development and cannot yet be utilised effectively by central banks. DLT-based payment systems may bring benefits to the financial system through their interaction with a larger DLT ecosystem of financial market infrastructures, including cross-border transactions.

The best judgment to defer to in this respect is Mr Jamie Dimon, the CEO of JP Morgan. Mr Dimon believes that Bitcoin itself is simply a speculative vehicle. But the underlying technology will play an important role.

Sir William Blair then explained that the section on 'Update on the Current Regulatory State of Fintech in the EU' is written by Dr Klaus Peter Follak. Financial technology is currently at the cutting edge of the present IT revolution. For example, blockchain is being explored, artificial intelligence is being utilised for AML/CFT purposes, and facial recognition technology is being used for bank accounts. Established banking institutions have also experienced the side-effects of disintermediation, especially in respect of payment systems. Highly sophisticated payment systems are arriving, and within that system, financial services are being provided. In China, an extremely sophisticated, licenced, payment system is being developed.

Sir William Blair referred to the useful summary of the Basel Committee's sound practices with respect to FinTech provided by Dr Follak.

There is a huge amount of interest in FinTech in the European Union – certainly from the European Central Bank, the European Securities and Markets Authority, and the European Banking Authority (EBA).

Sir William Blair invited Dr Gardella, of the EBA, to speak.

Dr Anna Gardella (Italy) said that the EBA is dedicated to developing FinTech. The EBA has published a FinTech Roadmap setting out its priorities. In 2018, the EBA will be analysing banking and regulatory sandboxes. They will also be hosting an industry workshop within two weeks of the ILA Conference to better understand industry needs and regulator expectations. This workshop will occur in the context of a knowledge hub that the EBA has established to promote exchanges between supervisors and industry. The EBA will also be focusing on the anti-money laundering aspect to preserve the integrity of the financial system, and aspects relating to the Payment Services Directive, Part 2 (PSD2).

Sir William Blair invited Professor Reinisch to speak.

Professor Reinisch thanked members for their contribution and declared the session closed.

Reporters: Nina Mao and Shannon Peters