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Thirty-third session

SUMMARY RECORD OF THE 682nd MEETING

Held at Headquarters, New York,  
on Thursday, 15 June 2000, at 10 a.m.

Chairman: Mr. Jeffrey CHAN (Singapore)

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The meeting was called to order at 10.10 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES (continued) (A/CN.9/466, 470 and 472 and Add.1-4; A/CN.9/XXXIII/CRP.4)

1. The CHAIRMAN recalled that an ad hoc group on exclusions had been set up to recast the United States proposal concerning article 6, contained in document A/CN.9/XXXIII/CRP.4, in the light of the previous day's discussions. He invited the representative of the United States to report on the group's work.

2. Mr. COHEN (United States of America) said that the ad hoc group, meeting informally, had been able to reach agreement on how many exclusions should be specified in the draft Convention. Before proceeding to the group's recommendations concerning draft article 6 (x) (ii) (A) to (D), he noted that each subparagraph would start with the word "receivables" or the words "rights to payment", depending on whether it was decided to list rights excluded from the definition of "receivable" or receivables the assignment of which was excluded from the scope of the draft Convention. For simplicity's sake he would, in reading out the draft amendments, use the word "receivables". Thus in

article 6 (x) (ii) the provision corresponding to subparagraph (A) should read: "Receivables arising from transactions on a regulated exchange". Subparagraph (B) should be deleted and the proposed exclusion in subparagraph (C), should be reworded in the following terms: "Receivables arising under financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions." In that context, he noted that the terms "financial contract" and "netting agreement" should be defined as proposed by the European Banking Federation (EBF) in document A/CN.9/472/Add.1. The recommendation based on subparagraph (D) aimed at distinguishing between bank deposit relationships and inter-bank payment systems and should read: "Receivables arising under bank deposit relationships," while the next exclusion concerned "Receivables arising under inter-bank payment systems or investment securities settlement systems." No text had been formulated in respect of the exclusions proposed in subparagraphs (F) to (I), in the absence of any guidance from the Commission.

3. With regard to receivables subject to netting agreements but not arising under financial contracts, the group had decided to recommend that assignments of such receivables should not be excluded. The Commission should, however, consider adding a short provision to draft article 20 to accommodate the need for set-off and mutuality in netting systems. Whereas draft article 20 gave debtors certain rights arising from the original contract, the group's proposed provision would enable the debtor, in the case of an assigned receivable subject to a netting agreement, to raise a defence arising from any other contract subject to the same netting agreement. That would preserve the integrity of the netting agreement, even in the event of an assignment of a receivable.

4. The CHAIRMAN suggested that, while delegations considered their positions on exclusions, the Commission should turn to the ad hoc group's suggestion that the netting of non-financial receivables should not be excluded but should be provided for in the set-off provisions of draft article 20. Consideration

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should also be given to a specific provision enabling a debtor to raise defences which under normal circumstances he would be entitled to raise.

5. Mr. IKEDA (Japan) wondered whether other delegations shared his view that, despite a day of discussion, little headway had been made on the United States proposal, which might yet be rejected in favour of variant A or B of draft article 5. The situation was complicated by the fact that no decision could be reached on the proposal until its effect on other articles could be ascertained. Its merits would have to be weighed against those of variants A and B of draft article 5 and assessed on how it and the two variants affected draft articles 11 and 12, as well as draft articles 6 and 4.

6. Mr. SCHNEIDER (Germany) welcomed the revised text recommended by the ad hoc group, which showed that a major step had been taken towards compromise, particularly if he understood correctly that there was to be no list of inclusions but merely exclusions from a general principle. The changes affecting netting agreements on trade receivables were particularly promising.

7. The CHAIRMAN suggested that, since non-financial receivables were not to be subject to exclusion but would be governed by a provision on debtor set-off and defences that could be raised by the debtor, any discussion of the issue should take place in the context of draft article 20.

8. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that few substantive changes had been made to the text of the United States proposal. In draft article 6 (x) (ii) (A) the only change was the deletion of the word "futures". That made it possible to delete subparagraphs (B) and (H) in their entirety, because subparagraph (A) would cover all regulated exchange transactions. With regard to the second recommendation, the language relating to netting agreements could be refined by the drafting group. The issue of industrial netting should be deferred until draft article 20 was discussed. The third recommendation merged the reference to inter-bank payment systems, as contained in subparagraph (D), with the provisions contained in subparagraph (I), in response to the submission of the European Banking Federation that such transactions should be listed together. That meant that only subparagraphs (F) and (G) remained to be discussed.

9. Mr. DUCAROIR (Observer for the European Banking Federation) welcomed the changes recommended by the ad hoc group, even though they were more editorial than fundamental. For example, the phrase "financial contracts governed by netting agreements" was a substantial improvement on the phrase "financial netting agreement". He wondered, however, what decision the Commission would reach concerning the list of inclusions, which had originally formed part of the United States proposal.

10. The CHAIRMAN took it that inclusions need no longer be considered, or at least not until a final decision on exclusions had been reached.

11. Mr. DESCHAMPS (Observer for Canada) said that the Commission needed to align the French text of subparagraph (ii) (A), as amended in the United States proposal, with the English text. The word "marché" did not correspond to the

word "exchange". There were many commercial transactions that were carried out in regulated markets.

12. The CHAIRMAN suggested that the Commission should request the drafting group to align the language versions.

13. Mr. STOUFFLET (France) requested clarification about subparagraph (ii) (A), as amended. It was not clear whether it referred to receivables left after the balance of an account had been settled, or receivables which were included in a netting agreement.

14. Mr. MORÁN BOVIO (Spain) agreed that there could be problems with the other language versions of the United States proposal. It might be better to specify whether subparagraph (ii) (A), as amended, referred to an exchange regulated at the international or national level. The Commission needed to know the precise extent of the exclusion in that subparagraph.

15. Mr. DOYLE (Observer for Ireland) recalled that consensus had been reached on the United States proposal in the ad hoc group. Questions of language should be left to the drafting group.

16. The CHAIRMAN said that there seemed to be concern among some delegations that the ambit of the exclusion might be broader than had been intended.

17. Mr. WHITELEY (United Kingdom) said that his delegation agreed that the key issue was regulation, a concept which was usually quite precisely defined in national law. It supported the suggestion made at the previous meeting by the representative of Cameroon that some points could be illustrated in the commentary.

18. Mr. DESCHAMPS (Observer for Canada) said that his delegation did not feel that the problem was merely one of language. The drafting group must be given guidance about what was meant by "exchange". There were regulated markets for farm products; it must be made clear that receivables arising from such transactions would not be covered under the amended subparagraph. The subparagraph should be more precise and refer specifically to the exchange of financial products.

19. The CHAIRMAN recalled that the consensus on the previous day had been that subparagraph (ii) (A) should not be confined to financial products, but should be limited to regulated exchanges.

20. Mr. MORÁN BOVIO (Spain) said that the Commission would probably wish to exclude markets which were regulated by national law; for example, the stock market was adequately regulated, at least in most European countries.

21. The CHAIRMAN said that the problem seemed to be the use of the equivalent of the word "market" in the other language versions. The idea of the English text was to exclude transactions carried out on a regulated exchange. There was concern that, because sale and purchase transactions in the regular market were regulated in some countries, all such transactions would be excluded from the

scope of the draft Convention. The drafting group needed guidance on that point.

22. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that there seemed to be a risk that the scope of the exclusions might be extended. The original intention had been to exclude futures, precious metals and currency exchange contracts; if the word "futures" was deleted, the subparagraph became broader and covered all exchange transactions. The Commission might find it necessary to provide clarification in a commentary, or to specify the exchange markets that were to be excluded from the scope of the draft Convention.

23. The CHAIRMAN said that the issue was whether the other languages had a term which would precisely capture the meaning of the English word "exchange". The Commission had already moved away from the idea of listing goods and services to be excluded, and had expressed support for the idea of specifying the nature rather than the content of the transaction. It certainly did not intend to exclude every transaction in a regulated market. The Commission could leave the issue to the drafting group and revert to it later.

24. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) suggested that the French word "bourse" might be closer to the meaning of the English word "exchange".

25. Mr. MORÁN BOVIO (Spain) said that, if the amended English text of subparagraph (ii) (A) was sufficiently clear, it could be left as it stood, with an explanation in the commentary.

26. Mr. DUCAROIR (Observer for the European Banking Federation) said that in France the bourse dealt not only with stocks and shares, but also with financial instruments. The amended subparagraph should refer to the regulated exchange of financial instruments.

27. The CHAIRMAN said that, if the Commission followed that suggestion, it would be moving away from its earlier decision that the exclusion would apply not only to financial instruments but also to all receivables arising from transactions on a regulated exchange.

28. Mr. SCHNEIDER (Germany) said that subparagraph (B), as amended, referred to netting agreements and subparagraph (D), as amended, to inter-bank payment systems; however, inter-bank payment systems were largely covered by netting agreements. Moreover, it was not clear whether the exclusion of receivables owed on the termination of all outstanding transactions in amended subparagraph (B) also applied to subparagraph (D), as amended.

29. Mr. COHEN (United States of America) said that the ad hoc group had prepared formulations on the basis of the Commission's tentative decisions of the previous day. Many inter-bank payment systems might well fall under the definition of netting agreements; however, there was a variety of inter-bank payment systems at the current time, and there were likely to be more in the future, which did not fall under that definition. The intention had been to have a specific exclusion for receivables arising under inter-bank payment

systems so as to be sure that they were excluded, whether or not they were governed by netting agreements.

30. On the question of the exception for close-out receivables, he said that inter-bank payment systems and investment security settlement systems were both ongoing relationships, and therefore there was no need for a close-out exception.

31. While inter-bank payment systems and investment securities settlement systems were often netting agreements, that was not always the case, and his delegation felt that it was important to exclude those two sources of receivables regardless of whether they qualified as netting agreements. Moreover, the future development of those systems was likely to take unpredictable forms that would not necessarily qualify as financial contracts governed by netting agreements. In either case, his delegation felt that they should be excluded from the scope of the draft Convention.

32. Since there was no market in financing close-out payments owed under inter-bank payment systems or investment securities settlement systems, the exclusion of receivables from those two sources could be a complete exclusion, and there was no need for the exclusion specified in subparagraph (B), as amended.

33. The CHAIRMAN said that the exclusion in subparagraph (B), as amended, was based on the substance of the transaction, while the exclusion in subparagraph (D), as amended, was based on the label of the transaction. There seemed to be a concern that, if an inter-bank payment system was actually a netting agreement, the exclusion in subparagraph (B), as amended, would apply; if it was not, that exclusion would not apply.

34. Mr. SCHNEIDER (Germany) said that the Commission must avoid inconsistencies. If the intention of subparagraph (D), as amended, was to exclude only inter-bank payment systems and investment securities settlement systems which were not covered by netting agreements, that should be specifically stated. Then subparagraph (B), as amended, would set out the general rule and subparagraph (D), as amended, would set out the rule for inter-bank payment systems and investment securities settlement systems not covered by netting agreements.

35. Mr. MORÁN BOVIO (Spain) said that his delegation had no difficulty with the two subparagraphs. Subparagraph (B), as amended, referred to all netting agreements and subparagraph (D), as amended, was specifically concerned with inter-bank payment systems, with which the Commission did not wish to be involved.

The meeting was suspended at 11.30 a.m. and resumed at 12.05 p.m.

36. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) noted that the ad hoc group endorsed the EBF definitions of "financial contract" and "netting agreement" contained in document A/CN.9/472/Add.1. With regard to a possible overlap between subparagraphs (B) and (D), it was helpful to keep in mind that the term "financial contract" in

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the EBF proposal referred to "any spot, forward, future, option or swap transaction", and that such transactions were distinct in nature from the payment systems and settlement systems referred to in subparagraph (D).

37. The words "any deposit transaction" could be deleted from the definition of the term "financial contract", assuming that the bank transaction exclusion was accepted.

38. Mr. BERNER (Observer for the Association of the Bar of the City of New York) noted that the Commission was dealing with two definitions that limited the general concept of "netting agreement" and excluded many types of bank settlement arrangements, for instance inter-bank settlement arrangements. A settlement between a London bank and a New York bank might or might not be organized along the concept of same currency. There might be a means of set-off based on the day's rates of exchange. According to the definitions, therefore, there was far less overlap than might seem at first sight.

39. Mr. FRANKEN (Germany) said that, even though the financial contracts governed by netting agreements might cover part of the inter-bank payment systems, such systems might not be governed by netting agreements. They should in any case be excluded, because the banks were heavily controlled by the authorities and the Convention could not interfere in those regulated parts of the market.

40. In addition, investment securities settlement systems might or might not be governed by netting agreements. In order to clarify the situation, he proposed the addition to subparagraph (D) of the words "regardless of whether or not governed by netting agreements".

41. Ms. WALSH (Observer for Canada) and Mr. DUCAROIR (Observer for the European Banking Federation) supported the proposal made by the German delegation.

42. Mr. KOBORI (Japan) requested clarification of the German proposal in relation to the exception for a close-out transaction.

43. Mr. FRANKEN (Germany) said that the exception from the exclusion under subparagraph (B) should not be valid for inter-bank payment systems and therefore had not been included in the German proposal concerning subparagraph (D). Receivables arising after termination would be excluded from the draft Convention.

44. The CHAIRMAN suggested that the Commission should move on to the definition of financial contracts. When the Commission had completed its consideration of the United States proposals, it would be testing them against the other provisions of the Convention, as well as weighing their relative merits in relation to variant B.

45. Mr. DUCAROIR (Observer for the European Banking Federation) said that, as the ad hoc group was proposing a special provision to exclude receivables from bank deposits, deletion of the words "any deposit transactions" from the definition of "financial contract" would avoid redundancy and make the text clearer.

46. The CHAIRMAN assumed that the Commission agreed with the view expressed and wished to refer the matter to the drafting group.

47. Mr. HERRMANN (Secretary of the Commission), referring to the decision to accept the German proposal, said that the text should indicate that a receivable would be considered in relation to each exclusion individually, irrespective of whether it was covered by another exclusion. If excluded under one provision, the receivable was excluded, regardless of whether it was covered by any other exclusions.

48. Mr. RENGER (Germany) asked whether the EBF definitions of "netting agreement" and "payments or securities settlement systems" had also been endorsed by the Commission.

49. Mr. COHEN (United States of America) said that the proposal from the ad hoc group had incorporated two definitions from the EBF proposal: the definitions of "financial contract" and of "netting agreement". The group had not addressed the issue of whether to include the definition of "payments or securities settlement systems" and it was therefore not part of the proposal.

50. The CHAIRMAN noted that there was no reason to include a definition of terms that did not appear in the text.

51. Mr. DUCAROIR (Observer for the European Banking Federation) pointed out that the EBF definition in question, which was based on a European directive, referred to "any contractual arrangement between three or more participants" and therefore excluded the case of two participants. However, in the case of inter-bank settlement systems, there might be only two participants.

52. Ms. WALSH (Observer for Canada), referring to the EBF definition of "financial contract", proposed the deletion of the words "and any collateral or credit support related to any transaction referred to above". A financial contract was a kind of transaction; those words did not fit within the definition and were unnecessary to complete it.

53. Mr. WHITELEY (United Kingdom) said that, in the current formulation of the proposal, only financial contracts that formed part of a netting agreement were covered by the exclusion. Collateral would be relevant only where it was part of the netting structure. Participants in the financial markets might take collateral in the form of a security interest, or there could be a transfer of assets with an obligation to redeliver equivalent assets at a future date. That obligation to redeliver provided priority because it could be netted against the exposure under the netting agreement. For that reason, it was important to retain the reference to collateral in the definition of "financial contract". The structure of that kind of contract was very similar to a repo, and it was clear from the text that the original intention had been for repos to be covered by the exclusions.

54. Mr. COHEN (United States of America) said that, while he appreciated the point made by the representative of the United Kingdom regarding the nature of the transactions, the term "financial contract" was used only to define the type of netting agreement in question. He therefore agreed with the observer for

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Canada that the final words should be deleted; they added no independent meaning, lengthened the definition and added a term, "collateral", which the Commission had carefully avoided using elsewhere in the draft Convention.

55. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) noted that, in transactions such as those governed by the Association's Master Agreement, credit support was typically provided as backup for the entire exposure under the netting agreement. It might therefore be more appropriate to refer to collateral or credit support in the definition of the term "netting agreement" rather than that of "financial contract". The words "(including any collateral or credit support arrangement with respect to such agreement)" could be inserted after the words "an agreement" in the EBF definition of "netting agreement".

56. Mr. MORÁN BOVIO said that that amendment would clarify the paragraph in the context of actual practice.

57. Mr. COHEN (United States of America) said that his delegation was in favour of a clearer definition of the term "netting agreement". However, it was important not to inadvertently exclude receivables that might be many layers deep in a collateral or credit support agreement; it was the netting agreement that produced the exclusion. He wondered whether the same objective could be achieved by stating that a netting agreement was an agreement as defined in the EBF proposal, whether or not there was a collateral or credit support arrangement with respect to such agreement. Indeed, those words could be included in the definition of "netting agreement", in that of "financial contract" or in both. That solution would allow the Commission to make it clear that the existence or non-existence of collateral or credit support arrangements did not affect the definition of a financial contract or netting agreement without excluding the contents of such arrangements.

58. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) said that his comments had been made because collateral arrangements were closely linked to the Master Agreement and the netting provided under that instrument. Under certain circumstances, whatever credit support was provided was taken into account through the process of terminating the relationship and settling on a net amount owed to one party by the other.

59. The suggestion made by the United States representative had the virtue of making it clear that the netting agreement was the core relationship even where it entailed the provision of collateral.

60. Ms. WALSH (Observer for Canada) said that she was happy to support the United States proposal. However, she remained convinced that the best solution would be to delete the words "and any collateral or credit support related to any transaction referred to above": the Commission was, in effect, stating that the definition of financial contracts and netting agreements was not dependent on whether they included provision for collateral or credit support.

61. In reply to the comment made by the representative of the United Kingdom, she drew attention to the reference to "repurchase or securities lending transaction" in the EBF definition of "financial contract".

62. The CHAIRMAN said that there appeared to be little support for reconsidering the Canadian proposal.

63. Mr. COHEN (United States of America) said that either the Canadian proposal or the amendment proposed by his own delegation would be preferable to leaving the text in its current form.

64. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) suggested that the matter should be dealt with through informal consultations between the representatives of the United States and the United Kingdom, the observers for Canada, ISDA and EBF, and other interested delegations.

65. Mr. MORÁN BOVIO (Spain) supported that suggestion.

66. Mr. DESCHAMPS (Observer for Canada) said that, while delegations were aware of the importance of not creating problems in connection with the derivative instruments governed by the ISDA Master Agreement, the definition of "financial contract" and the issue of financial contracts governed by netting agreements went far beyond those instruments. It was important not to extend the definition of "financial contract" to a point where large numbers of standard banking transactions would be included.

67. For example, most companies which dealt with banks and sold abroad had access to foreign exchange lines of credit. For mid-size businesses, exposure was secured by general assignment of accounts receivable. The proposed definition of "financial contract" would include all security given to the bank in order to secure the customer's obligations under a financial contract since the term "collateral" would include any kind of security given in order to secure such a contract; such a result must be prevented.

68. The CHAIRMAN pointed out that, under the ad hoc group's proposal, only financial contracts governed by netting agreements would be included.

69. Mr. DESCHAMPS (Observer for Canada) said that the problem remained since hedging contracts, even in the case of small businesses, invariably contained a netting agreement.

70. Mr. WHITELEY (United Kingdom) noted that the protection provided by netting agreements required close-out as a preliminary to the procedure in which different exposures were netted against each other to provide a single amount due. It appeared from the example given by the observer for Canada that, in cases involving the assignment of accounts receivable, it would be difficult for the latter to be closed out in any way.

71. Mr. DESCHAMPS (Observer for Canada) said that, of course, not every assignment of receivables constituted a financial contract. To clarify his point, he gave the example of a company whose dealings with a bank involved both a business loan and a foreign exchange futures transaction; the latter constituted a financial transaction and was invariably governed by a netting agreement since the framework contract stipulated that in case of default all transactions would be terminated. The company's debt to the bank from both the

business loan and the foreign exchange futures transaction was secured by collateral.

72. The definition of "financial contract" included all collateral from financial contracts; thus, if the bank obtained title to all the company's receivables in consideration of everything owed to it from the latter's foreign exchange futures transaction, it might be disappointed to find that the Convention's provisions regarding the collateral related to the receivable did not apply. Yet the purpose of the draft Convention was precisely to cover normal trade receivables. Thus, unless the reference to collateral or credit support was deleted, the result would be quite contrary to the original intention.

73. Mr. WHITELEY (United Kingdom) said that, as he understood the drafting originally proposed, if the collateral arrangement was not part of the netting agreement and did not rely on that agreement to give it effect, it would not be covered by the exclusion. Thus, he saw no need to delete the reference to collateral or credit support.

The meeting rose at 1 p.m.