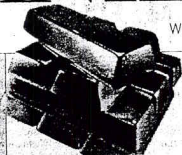


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Markets & Investing



Jeffrey Golden

INSIGHT

We need a world financial court with specialist judges

Do we need an international tribunal for complex financial market disputes and sophisticated, cross-border financial crimes? Should we be recruiting or training specialist judges?

The papers are full of stories about financial market regulators and regulation, but we read little about our courts' preparedness to interpret that regulation and deal with the highly technical cases that could follow financial upheaval.

Financial market regulation is preventive medicine. It deserves to be the centre of attention. Preventive medicine for both personal and financial health is important. Still, the malaise afflicting the financial markets is an epidemic. Financial market patients are seriously – and some terminally – ill, and we can expect more accidents and victims. The courts are our hospitals. Perhaps we should worry more about their condition and whether we have qualified staff to run them.

The sums at risk are staggering. The size of the over-the-counter derivatives market is estimated at \$592,000bn by the Bank for International Settlements. And it is complicated. Having held the pen when the derivatives industry wrote the contracts that most participants use, I know. The multi-jurisdictional element adds complexity.

A trader at the Hong Kong branch of a German bank agrees to a derivatives trade by telephone with someone on the floor of the London branch of a Japanese bank. The deal is done "up in the airwaves". Bonds held in Euroclear are pledged as security. Euroclear's books are in Brussels but if the bonds are issued by a French company, they may be warehoused in Euroclear's French sub-depository, perhaps a Swiss bank's Paris branch. If there is a default or claim by one of the entities in the chain, determining what law governs, let alone the result, could be difficult or, perhaps worse, unpredictable.

High-level financial crime is showing increasing disrespect for national boundaries, too, and can be just as overwhelming for a local judge.

Judges need to be able to unravel facts and apply laws that often pre-date and did not anticipate current practices

We need to ensure (1) that courts stay up to date with global financial market developments, (2) that judges have the requisite competence to unravel facts and apply laws that often pre-date and did not anticipate current practices, or that were too hastily drafted in response to political pressure and (3) that the risk of a wrong decision contributing to systemic risk in a global, highly interconnected marketplace is mitigated.

Widespread use of master agreements across geographical, cultural and language divides promotes legal certainty and cost efficiencies. But it could amplify any mistake that a court makes in deciding a term's meaning. As a result, the market could have a greater interest in the outcome of a case than two private parties who are litigating it.

Recognising this wider market interest is important. That is why we may need a mix of judges with legal training and experience on the one hand and lay experts on the other. We need judges not just with common law training but with knowledge of civil code and Islamic finance, and with broad linguistic capability.

There is another challenge: to capture the collective experience of banking and legal architects who built the industry and understand the issues. Some have shown signs of wanting to give back, and could be recruited to play a gate-keeping role as judges to preserve their legacy.

The reliance on national tribunals of general jurisdiction and ad hoc arbitration is unsatisfactory. It is too decentralised, too inefficient and expensive and, perhaps most importantly, it is failing to produce a settled, authoritative body of law or the predictability that the markets crave and on which financial stability depends.

Do we need a world financial court? If so, where would we put it? London and New York are obvious choices. Perhaps The Hague, a city which bills itself as the legal capital of the world, where it would be possible to leverage off a tradition of international court support and a pool of highly trained and multilingual staff.

Think about it. We have special courts for everything from family law to tax. World trade benefits from the existence of the WTO tribunal and the dedicated bar that it has nurtured. International financial market law is no less global or systemically relevant than international trade law.

Some say that creating a truly world court is too ambitious, that it would take a long time to set up and we cannot wait. Maybe. But if that is the case, we should roll up our sleeves, not put all our eggs in the regulatory basket, and start focused training for our judges on derivatives. Right away.

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The banking and legal architects who built the industry could be recruited to play a senior gate-keeping role as judges