Why ESM bonds changed to Luxembourgish law

By David Eatough

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Since October last year the European Stability Mechanism has been issuing new euro-denominated bills and bonds under Luxembourgish law rather than English law.[1] Here is why it makes sense.

The ESM is a significant issuer of bonds in the international capital markets. Since its creation in 2012, the ESM has used a market-standard funding platform known as a "Debt Issuance Programme". Programmes like these are a very efficient way for [illegible] to place large volumes of securities throughout the world on a regular basis.

Indeed, back in 1996, when this platform was relatively new, I drafted some of the standard terms for the template documentation in the market when I was in private practice in London. Ever since that time, the choice of law specified in such documentation for most participants in the international fixed-income market, has been English law, irrespective of their location. This contrasts with domestic securities markets where the relevant national law applies, and, of course, with securities offered in the United States, where New York law has been the overwhelming choice.

When we established the ESM Debt Issuance Programme, we were a new issuer with a slightly unusual profile, regularly requiring large amounts of funding. We were an IFI with

a very high credit rating, mostly provided by our €80 billion of paid-in capital. We were also a so-called "supra sovereign" created in Luxembourg under the ESM Treaty by the euro area member states.

Judged By the Law of the Land

On the other hand, we were not a pure sovereign, nor were we part of the EU legal framework, and we were not an EU institution. For technical legal reasons, we needed to specify that the local courts of Luxembourg would have jurisdiction to hear any law suits brought against us by investors.

However, as the "new kid on the block", we decided to follow the majority of issuers in the market and specify English law as one of two alternatives for the governing law itself, the other being, of course, Luxembourgish law. Before October 1, the ESM issued exclusively under English law simply by stating in the final terms of each issue that English law is the chosen governing law.

Then came the Brexit threat. How did this affect us and our choice of English law?

We set up a working group, led by our Risk department, to look at every aspect of our operations and take any necessary precautions against an adverse effect of Brexit. When we looked at the securities markets, there seemed to be two general legal concerns among participants. The first was that the convention which guarantees the reciprocal recognition of the judgments of English courts across borders in the EU would no longer apply. This is the Brussels Convention (EU Regulation No 1215/2012).[2]

However, as I have explained, this did not affect the ESM because we had already specified Luxembourgish courts, not the English courts, and Luxembourgish courts would continue to be recognised across the EU even if they were applying English law.

The second was MREL – the "Minimum Requirement for Own Funds and Eligible Liabilities".[3] This defines certain European Central Bank rules for subordinated bonds issued by banks and relates to the Bank Recovery and Resolution Directive (BRRD).

Again, the ESM was not affected. The ESM is not a bank and is not subject to the BRRD.

Yet, when I looked at the landscape of issuers in the public sector in Europe, including our "big-brother" down the road here in Luxembourg, the European Investment Bank (EIB), we saw that many had already made the switch to Luxembourgish law. Indeed, in

the case of the EIB, for some issuance they had been using Luxembourgish law for many years.

It was also clear, and reinforced by external legal advice, that using the law of another country in the courts of Luxembourg could add to litigation costs because of the need for expert advice from the UK. It would also likely be less efficient, because the judges would be required to use a law which was not their own. It is not without precedent, and, at the birth of the ESM, it was perhaps a wise decision.

Right Rules, Right Time

But now is the right time to use the Luxembourgish governing law alternative already provided for in our documentation, as well as Luxembourgish courts for the applicable jurisdiction. The market acceptance was high.

The large investors our Chief Financial Officer Kalin Anev Janse spoke to confirmed that they were more than happy with Luxembourg, both as a dispute resolution forum and for the choice of law. The timing, given that the market was reassessing the use of English law for technical reasons in the Brexit context, also made sense.

The ESM is maturing as an institution and our decision to change to Luxembourgish law, to match our original specification of the Luxembourgish courts back in 2012, should be seen in this context.

It is, of course, also a vote of confidence in the legal system of our host country, a practical step to promote the European capital markets union, and perhaps a sign of self-sufficiency for the Euro area and for the wider EU. We are proud to be part of that project and look forward to many years of successful bond issuance in the future – preferably litigation-free!

[1] ESM (2019) Investor Newsletter no. 33, 26 September 2019
[2] The European Parliament and the Council (2012) Regulation (EU) no 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, 20 December 2012
[3] Single Resolution Board (2019) Minimum Requirement for own funds and Eligible Liabilities (MREL), 7 June 2019