

The legal aspects and abstractions of a euro redenomination

([Articolo originale a questo indirizzo http://ftalphaville.ft.com/2011/11/21/754711/the-legal-aspects-and-abstractions-of-a-euro-redenomination/?#](http://ftalphaville.ft.com/2011/11/21/754711/the-legal-aspects-and-abstractions-of-a-euro-redenomination/?#))

Joseph Cotterill

Nov 21 2011 12:36 26 comments Share

And so it came to pass, that everyone who worried about whether the euros which people owed them would stay euros for much longer...

...realised that [this was not a drill](#).

Case in point — a note by Nomura analysts published over the weekend, which has [ruffled](#) a few feathers.

It's one of the first *investment* cases drawing on the legal details of redenomination of euros into another currency. Nomura also treat this as quite an urgent practical matter:

Redenomination risk: Which Euros will stay Euros?...

Since the risk of some form of break-up is now material, investors should be thinking about “redenomination risk”: Which Euro denominated assets (and liabilities) will stay in Euro, and which will potentially be redenominated into new local currencies in a break-up scenario?

Very simply: if one, or more, or all eurozone member states change currency out of the euro, what happens to financial contracts which perform in euros (i.e. pay euros or reference rates like Euribor that are linked to the euro)? The obvious example is sovereign debt but actually the big wall of money here is private debt, derivatives, etc.

While Nomura are thinking about what assets to hold in these scenarios, we really liked their note because they grappled with the often very difficult legal concept of jurisdiction (the governing law of your contract) as a way to understand the problem. So, here is their conclusion:

Investors should consider three main parameters when evaluating “redenomination risk”. The first parameter is the legal jurisdiction under which a given obligation belongs. The second is the likelihood that a break-up can happen in a multilaterally agreed fashion. The third parameter is the type of Eurozone break-up which is being considered, including whether the Euro would cease to exist in a given break-up scenario.

In a scenario of a limited Eurozone break-up, where the Euro remains in existence for core Eurozone countries, the risk of redenomination is likely to be substantially higher for local law obligations in peripheral countries than for foreign law obligations. From this perspective, local law obligations should trade at a discount to similar foreign law obligations.

In a scenario of a full-blown Eurozone break-up, evaluating the redenomination risk is more complex, as even foreign law obligations would have to be redenominated in some form. In this case, redenomination could happen either into new national currencies (using the *Lex Monetae* principle), or into a new European Currency Unit (ECU-2). This

additional complexity in the full-blown break-up scenario leaves it harder to judge the appropriate relative risk premia on local versus foreign law instruments.

“**Lex Monetae**” mentioned in the above being the the principle that a sovereign determines what its legal currency is, whether that’s euro, lira, drachma, or whatever else. More on this below.

Here’s a chart via Nomura, summarising the above:

Fig. 1: Redenomination risk on eurozone assets

	Small Break-Up Scenario: EUR remains the currency of core Eurozone countries		Full-blown Break-up Scenario: Euro ceases to exist
	Unilateral withdrawal	Multilaterally agreed exit	
Securities/Loans etc governed by international law	No redenomination: EUR remains the currency of payment (except in cases of insolvency where local court may decide awards)	No general redenomination: EUR remains currency of payment, although certain EUR contracts/obligations could be redenominated using Lex Monetae principle (if there are special attributes of contracts) and/or an EU directive setting criteria for redenomination	<i>Redenomination happens either to new local currencies by applying Lex Monetae principle or by converting contacts/obligations to ECU-2</i>
Securities/Loans etc governed by local law	<i>Redenomination to new local currency (through change in local currency law, unless not in the interest of the specific sovereign)</i>		

Source: Nomura

You might recognise this “preference” for English (or NY) law assets over local ones from past debates about how investors could insulate themselves from restructuring of sovereign debt. There’s a passing resemblance of **the risk** of sovereigns passing new local laws to alter the terms of their debt (which English law would **protect** against) to the lex monetae issue. The ways in which English-law bonds differ from local ones were also brought out in the great Finnish collateral crisis of Greece’s bailout. This threatened **negative pledge** clauses in the bonds.

At a very basic level, if you want to carry on being paid in euros: if governed under English or New York law your assets be, you (may) get home free. If under legislation Italian or Greek, you are up the creek. If Italy or Greece left the euro, they would pass a monetary law establishing the new lira or drachma as legal tender within their territory. Local-law contracts would be more likely to obey the ‘lex monetae’ created by this legislation.

First problem here: there aren’t that many foreign-law eurozone sovereign bonds to go round, if you’re planning to pile into them. Relatively speaking anyway. Foreign-law bonds are a small part of Italian debt, but Nomura estimates that they still come to €198bn. Generally though, you probably aren’t going to buy up foreign-law bonds as sell local-law ones. Furthermore, this issue goes beyond sovereign debt — representative chart from Nomura, which sorts financial transactions across all asset classes into local and foreign law:

Fig. 1: Governing law and standard financial securities and contracts

Governing Law	Security Type	Body of Law	Examples
Local Law	Sovereign Bonds, Bills	Local Statute/Contract	GGBs, Bunds, OATs
	International Bonds	Local Contract	Rep of Italy, Kingdom of Spain, etc
	Corporate Bonds	Contract	
	Covered Bonds (Pfandbriefe, OF, Cedulas, etc)	Covered Bond Law (Pfandbriefe)	Pfandbriefe, Obligations Foncières, Cedulas, Irish CBs
	Schuldscheine (marketable loans)	Contract	Banking schuldscheine
	Loans	Contract	
	Equities	Company	Any EU Equity
	Commercial Contracts	Contract	
	Deposits	Banking Law	CDs
English Law	Sovereign Bonds	Contract	Greek Euro-bonds, Rep Italy Eurobonds, Kingdom of Belgium USD-denominated bonds
	Corporate Bonds (Euro-bonds)	Contract	
	Loans (Euro-Loans)	Contract	Euro-Loans
	Commercial Contracts	Contract	
NY/ Other Law	Sovereign Bonds	Contract	Yankees, Samurai, Kangaroos, Maple, Bulldogs, Dim Sum, Kauri, Sukuk, etc
	Corporate Bonds	Contract	
	Loans	Contract	
	Commercial Contracts	Contract	
Master Agreements	International Swap Dealers Association (ISDA)	English or NY Contract	IR Swap/Fwd, FX Swap/Fwd, CDS, Bond options
	Commodity Master Agreements	Various for each commodity	Gold Swaps/Forwards, Electricity Swaps/Fwds, etc
	Rahmenvertrag für Finanztermingeschäfte (DRV)	German Contract	Swaps and Repos with German counterparties
	Fédération Bancaire Française (AFB/FBF)	French Contract	Swaps with French counterparties and all local authorities
	Contrato Marco de Operaciones Financieras (CMOF)	Spanish Contract	Swaps with Spanish counterparties
	ICMA Global Master Repurchase Agreement (GMRA)	English Contract	Repo Agreements
	Master Repurchase Agreement (MRA)	NY Contract	Standard NY Law Repo Agreements
	European Master Agreement (EMA)	English Contract	Repo with Euro-systems NCB/ECB
	General Master Securities Loan Agreement (GMSLA)	English Contract	Sec lending
	Master Securities Loan Agreement (MSLA)	NY Contract	Sec lending
(Euro) Medium Term Note Programme (MTN/EMTN)	English or NY Contract	WB, Rep Italy, EIB MTN Programmes	
Other	Bond Futures (Eurex)	German Contract	Bund, Bobl, Schatz, BTP Futures on Exchange
	IR Futures (Liffe)	English Contract	Euribor Contracts on Exchange
	Equity Futures	Local Law/English Law	SX5E, DAX, CAC40, MIB, IDX, IBEX, BEL20, PSI-20, WBAATX
	OTC Futures	English or NY Contract	Client back-to-back futures with member firm
	Clearing Houses (LCH, ICE, etc)	English Contract, etc	Repo, CDS etc via clearing houses
	Cash Sales	Sales or Transaction	All cash sales prior to settlement (i.e., before T+3)

Complicated, isn't it?

Going back to the *lex monetae* principle, there is a significant amount of case law behind it. "Serbian Loans" and "Brazilian Loans" are interesting interwar cases (relating to when France fell off the gold standard) which still matter today.

Unfortunately, it is not actually as simple as that when you come to think about how courts would actually apply jurisdiction *in practice*, to contracts with very specific terms.

The wonders of jurisdiction

Best to contemplate this using an example.

Let's say the Greek parliament passes legislation — call it the Drachma Conversion Law, whatever — on 31 March 2012, ruling that the New Drachma will become Greece's sole domestic currency from midnight, 1 April 2012. (It's a weekend! Much easier to go round the ATMs with technicians, train border guards to spot suitcases stuffed with cash, and so on.) Euro-denominated obligations *in Greece* will be converted to New Drachma at so-and-so a statutory conversion rate, the legislation further provides.

The law and the statutory conversion rate are what *lex monetae* is in practice. However, Greece has passed its law, covering Greece, but no further. Herein lies the rub. In the case of a contract with a Greek counterparty that designates English law, will the courts in the UK acknowledge the principle of *lex monetae* as it pertains to Greece, as sovereign, *or* as it pertains to the remaining eurozone states that set up the currency (and that may still retain it among remaining members)? If the latter, then the contract should remain denominated in euro.

The note by Nomura also draws our attention to the substantial difference between an unlawful, unilateral withdrawal from the euro and a consensual, lawful exit. In the case of the former, the UK courts are unlikely to recognise the redenomination anyway as such an exit is contrary to being part of the EU.

What side a court in the UK ultimately lands on is also likely to hinge on what the *intent* of the parties to the contract was. Did they mean to follow the *lex monetae* principle of the eurozone members or of the individual sovereign? This is a point put rather elegantly in [an article](#) by Charles Proctor, over a year ago:

It hardly needs to be stated that parties contracting in euro will not have given any thought to this issue which, to say the least, exists at a certain level of abstraction. The intention of the parties will therefore have to be inferred from the terms of the contract and the surrounding circumstances, and will inevitably depend on the weight of factors connecting the contract with Greece. This formulation may well be legally accurate but it is of rather limited practical value.

We can see how proving intent may indeed be rather hard if the thing you are meant to have had intentions about never even occurred to you.

And even if a case is won in the English courts, declaring that a euro-denominated Greek bond cannot be converted to drachma, that could just be the beginning of a long legal journey. Attempting to enforce the judgement and pursue a claim will itself come with a host of challenges.

Da Goofynomics

(**Articolo originale a questo link** <http://goofynomics.blogspot.it/2012/09/a-rata-der-mutuo.html>)

Ai rapporti di debito/credito regolati dal diritto nazionale, lo Stato che uscirà applicherà il principio della *Lex Monetae*, in base al quale uno Stato sovrano sceglie liberamente quale valuta usare. Ne consegue che i contratti regolati dal diritto nazionale possono essere semplicemente riconvertiti nella nuova unità di conto, senza che alcuna delle parti contraenti possa eccepire questa conversione come motivo di recesso dalle obbligazioni contrattuali (né avrebbe particolare interesse a farlo, con buona pace degli strampalati blogger che temono il complotto delle banche cattive). E questo vale per i depositi bancari, e per i mutui, ecc.

Le conseguenze pratiche di questo principio sono disciplinate dagli art. 1277 e seguenti del Codice Civile (Torny santo subito dopo il concerto di Ligabue):

Art. 1277 Debito di somma di danaro

I debiti pecuniari si estinguono con moneta avente corso legale nello Stato al tempo del pagamento e per il suo valore nominale.

Se la somma dovuta era determinata in una moneta che non ha più corso legale al tempo del pagamento, questo deve farsi in moneta legale ragguagliata per valore alla prima.

Art. 1278 Debito di somma di monete non aventi corso legale

Se la somma dovuta è determinata in una moneta non avente corso legale nello Stato, il debitore ha facoltà di pagare in moneta legale al corso del cambio nel giorno della scadenza e nel luogo stabilito per il pagamento.

Art. 1281 Leggi speciali

Le norme che precedono si osservano in quanto non siano in contrasto con i principi derivanti da leggi speciali.

Sono salve le disposizioni particolari concernenti pagamenti da farsi fuori del territorio dello Stato.

L'art. 1277 si applicherebbe laddove l'Eurozona esplodesse. In quel caso l'euro non ci sarebbe più, non avrebbe più corso legale da nessuna parte al tempo del pagamento, e i pagamenti andrebbero fatti in moneta legale (nuova lira) ragguagliata per valore all'euro, e il rapporto di cambio sarebbe quello del *changeover*, cioè uno a uno (mi riferisco al *changeover* "in uscita", non a quello "in entrata". Solo qualche sprovveduto può pensare che si torni al 1936,27, ma lasciamo stare: non è un blog di psichiatria).

L'art. 1278 si applicherebbe laddove l'Eurozona *non* esplodesse, per cui l'euro continuerebbe ad avere corso legale, ma *non* nello Stato italiano. In questo caso il debitore *potrebbe* pagare in euro, ma *ha facoltà* di pagare in moneta legale (nuova lira) al cambio corrente alla scadenza. "Ecco!" Interviene il luogocomunista terrorista "Vedi! Il povero consumatore sarà schiacciato dalle rate del mutuo, perché dovrà pagarle in euro, o. ciò che è lo stesso, in nuove lire svalutate". Calma. Leggiamo tutto. Queste disposizioni si applicano a meno che non intervengano leggi speciali, previste dall'art. 1281, e lo Stato *ovviamente* dovrà, nel decreto di uscita, prevedere una deroga all'art. 1278 stabilendo che i rapporti di debito e di credito in euro disciplinati dal Codice Civile saranno regolati in nuove lire al cambio previsto alla data del *changeover* (cioè uno a uno), e non a quella della scadenza del pagamento (che incorporerebbe la svalutazione).

Perché dico *ovviamente*? Perché se non lo facesse condannerebbe all'insolvenza una quantità abnorme di famiglie e di imprese. Nessun governo prenderebbe una decisione simile, se non altro perché significherebbe mettere una pietra tombale su qualsiasi aspirazione politica dei suoi componenti. Del resto, non è questo quello che si aspettano i mercati e non è questo quello che gli studiosi esteri (Sapir, Bootle, ecc.) prefigurano. Dobbiamo pensare che esiste una minima razionalità: una volta presa la decisione, il buon senso dovrà necessariamente prevalere.