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THE REGULATION OF THE EMERGING MARKETS LOAN MARKET

ROSS P. BUCKLEY

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UNSW Law
UNSW Sydney NSW 2052 Australia

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The Regulation of the Emerging Markets Loan Market

by

Ross Buckley*

The secondary market in emerging markets loans began in 1983 after the debt crisis and has grown into one of the worlds more significant capital markets with a turnover in 1996 of over $5 trillion of debt. Even though based in New York, there has been virtually no external regulation of this market. This article explores why this might have been so and concludes that the market in loans is not a securities market and does not naturally fall under the aegis of any U.S. regulatory authority. The market, in fact, is a rare example of a single international over-the-counter market.

The article considers the history of abuse in the market and the efforts in response of the industry organisation, the Emerging Markets Traders Association. The initiatives of the Association in improving the risk management, efficiency and transparency of the market are also assessed.

This article examines the proper characterisation and regulation of the secondary market in emerging markets loans. The secondary market commenced in 1983, in the aftermath of the debt crisis, when these debtors were known as less developed countries (LDCs).[1] The market, centered in New York City, grew explosively to record a turnover of $1.3 trillion face value of debt,[2] after a decade, in 1993 and $5.3 trillion in 1996.[3]

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* King & Wood Mallesons Chair of International Financial Law, Scientia Professor, and Member, Centre for Law, Markets & Regulation, UNSW Sydney.

[1] The term “emerging market” was coined in about 1984 by the International Finance Corporation (a commercial arm of the World Bank Group) while seeking a title for a LDC investment fund. The IFC had previously promoted the Third World Investment Trust, but its acronym was considered unhelpful. The Emerging Markets Growth Fund, on the other hand, was a marketable name. *See* Alain Soulard, *The Role of Multilateral Financial Institutions in Bringing Developing Companies to U.S. Markets*, 17 FORDHAM INT’L L.J. S145, S147 (1994). The terms LDC and emerging markets are used interchangeably in this article.

[2] The market existed in nascent form before the debt crisis but really started to grow after 1982. In 1983 market volume was, in the absence of accurate figures, perhaps $500 -700 million face value of debt, rising to perhaps $2 - 2.5 billion in 1984. (The 1983 figure is from Smith Barney Research, *In the Spotlight (an interview with Martin Schubert)*, BANKNOTES, (undated), at 8; and the 1984 figure from the same source, and confirmed by an estimate of $2 billion by

As the loans were converted into Brady bonds in the successive Brady-style restructurings of the 1990s, the market moved from a little regulated loans market into a well regulated bond market subject to the full U.S. securities law regime.[4] In three parts, the article investigates three aspects of the secondary market in emerging markets loans: (i) the proper characterisation of the market; (ii) the history of abuse of the market; and (iii) the regulation of the market.

I: The Characterisation of the Market

This first part considers three questions which go to the characterisation of the market: (i) is the secondary market for emerging markets loans subject to regulation as a securities market under US law;[5] (ii) is the market an exchange or an over-the-counter market; and (iii) is the market one international securities market or a collection of regional markets?

Is Loan Trading Subject to the Securities Laws?

The answer to the question of whether loan trading is subject to the securities laws turns upon whether a traded LDC loan is a security. The potentially relevant parts of

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Wallenstein, *Debt-Equity Country Funds: Problems and Prospects*, *in* THIRD WORLD DEBT-MANAGING THE CONSEQUENCES 32 (Griffith-Jones ed., 1989).) By 1990 turnover had reached $100 billion, *see* O'Reilly, *Cooling Down the World Debt Bomb*, FORTUNE, May 20, 1991, at 123, 124; Richard Voorhees, *Doses of Reality*, 40 LATINFINANCE 19,26 (1992), although an estimate of $75 billion was given in *NMB Postbank - leading the field*, IFR REVIEW OF THE YEAR 78 (Supp. 1990). EMTA's annual volume survey estimated that $1.978 trillion of loans and bonds were traded in 1993, *see 1993 Debt Trading Volume Near U.S.$2 Trillion*, EMTA BULL., No. 4, 1994, at 1, (copy on file with author); Emerging Markets Traders Association, 1993 DEBT TRADING VOLUME SURVEY, May 1, 1994. This figure is higher than other estimates which ranged from $1 trillion to $1.5 trillion. (The annual LATINFINANCE survey showed a total self-reported volume of the traders surveyed of $1.365 trillion and concluded that "the consensus was that $1 trillion of emerging market debt changed hands", s*ee* Richard Voorhees, *Shooting the Bull; Debt Markets*, 55 LATINFINANCE 30 (1994). A range of $1 trillion to $1.5 trillion was given in Tracy Corrigan, *Picking Up the Pieces of an Emerging Market*, FIN. TIMES, April 5, 1994, at 17 and an estimate of $1.5 trillion was given in Clark, Paper No. 9416, at 1.) The best estimate after eliminating double counting is that perhaps $1.3 trillion of debt in fact changed hands in 1993.

[3] Emerging Markets Traders Association, 1996 DEBT TRADING VOLUME SURVEY, March 17, 1997.

[4] The first year in which Brady bonds accounted for over one-half of market turnover was 1993. According to EMTA's survey, trading volume in Brady bonds in 1993 was $1.02 trillion, some 52 percent of total market volume. *See* Emerging Markets Traders Association, 1993 TRADING VOLUME SURVEY, AUGUST 8, 1994, at 11; Norman Peagram, *How safe are those Bradys?*, EUROMONEY, Sept. 1994, at 50. As the majority of the debt was converted into bonds, the banks began to move their trading arms from their commercial banks and into the their registered broker-dealer subsidiaries and thus out from under the nominal regulation of the banking regulators and into the active regulation of the securities regulators – but more on this later.

[5] This question has been explored only for the U.S. as New York is the principal LDC debt market and the focus of this study.

the lengthy definition of a "security"[6] in section 2(1) of the Securities Act of 1933 (the "1933 Act")[7] are as follows:

> The term "security" means any note ... bond, debenture, evidence of indebtedness, investment contract, ... or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in ... [or] receipt for ... any of the foregoing.

The complete definition is intentionally broad.[8] For a loan or assignment thereof to be a security under the above definition it would have to fall within the meaning of the phrase an "evidence of indebtedness". None of the other classifications assist.[9] An illuminating summary of the conventional view of the relevant US law comes from Lee Buchheit:

> Commercial bankers learn, seemingly with their mothers' milk, that bank loan assignments and participations are not subject to the federal securities laws in the United States. ... One reaches the conclusion that the securities laws only have limited application in this area by extrapolating from judicial precedents which inevitably are based on specific factual circumstances. ... [R]ead literally, the securities laws *would* appear to cover a commercial bank loan agreement ... as an evidence of indebtedness ... and the sale of interests therein. ... [O]ver the years, however, most courts have tended to focus on the introductory words to the definition of a security in both the 1933 Act and the 1934 Act ("... unless the context otherwise requires ..."), as the basis for excluding bank loans, and loan assignments ... from the definition of a security. ... In effect, courts have been persuaded that banks do not require the

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6 Most of the judicial definition of a security has centred on the interpretation of the phrase "investment contract" which is one of the items listed as a security. HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION 24 (2nd ed. 1990). The classic definition of an investment contract was laid down by the U.S. Supreme Court in SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946), 66 S. Ct. 1100, 1103 as a contract or scheme in which a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party. A loan is clearly not an investment contract, so this jurisprudence does not assist us.

7 The term 'security' is defined in virtually identical terms in section 3(a)(10) of the Securities Exchange Act of 1934. The Supreme Court has stated that the term should be given the same meaning under each Act. *See* Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 (1985); Marine Bank v. Weaver, 455 U.S. 551, 555 (1982). The definition of security in the 1934 Act omits the "evidence of indebtedness" language. See the consideration of the differences between the definitions in the two statutes in Arnold Jacobs, *The Meaning of 'Security' under Rule 10b-5*, 29 N.Y.L. SCH. L. REV. 211, 225-28 (1984).

8 In Justice Thurgood Marshall's words, "In defining the scope of the market that it wished to regulate, Congress painted with a broad brush". *See* Reves v. Ernst & Young, 110 S. Ct. 945, 949 (1990).

9 The term "note" may include promissory notes issued in conjunction with loans, but notes were issued with very few LDC sovereign loans.

> protection of the securities laws when lending money to their customers, or when purchasing interests in existing loans originated by other banks.[10]

Buchheit goes on to lay the groundwork for this enquiry, when he writes,

> It is important to note, however, that these precedents provide only a limited amount of comfort. The cases to date generally have involved sales of participations in commercial bank loans to other banks or financial institutions that were negotiated on a case-by-case basis. The market for loan sales has moved well beyond [this].[11]

There are few cases on the sale of LDC loans in the secondary market.[12] The voluminous case law is, as Buchheit has identified, limited principally to the sale of participations in U.S. commercial bank loans[13] and there are sound policy reasons why these participations (and the underlying loan agreements) should not be securities.[14] The courts have been understandably loath to expand the reach of the complex securities law regime to banks in their conventional dealings with other banks. However, a trading floor for LDC loans does not look like the business of conventional commercial banking. It looks like a securities trading room. As Lee Buchheit put to me conversationally, "Is an asset traded by people wearing power ties and power braces and with a telephone in each ear a security?"[15]

The leading case on the definition of "security" is Reves v. Ernst & Young.[16] It dealt specifically with the term "note" in the definition of security but many of its findings

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[10] Lee C Buchheit, "Legal Aspects of Assignments of Interests in Commercial Bank Loans", ch 18 in HANDBOOK OF COMMERCIAL BANK LOAN SALES, 453-54 (Lederman & Feinne, eds, 1991).

[11] *Id.* at 454.

[12] See, for instance, on other issues C.I.B.C. Bank and Trust Co. (Cayman) Ltd. v. Banco Central do Brasil, 886 F. Supp. 1105 (S.D.N.Y. 1995); and Pravin Banker Assocs Ltd. v. Banco Popular del Peru, 165 B.R. 379 (S.D.N.Y. 1994).

[13] See Lehigh Valley Trust Co. v. Central National Bank of Jacksonville, 409 F.2d 989 (5th Cir. 1969) which applied a literal interpretation of the statutory definition to find that a loan participation was a security. The Fifth Circuit subsequently reversed itself on this point, *see* Bellah v. First Nat'l Bank of Hereford, 495 F.2d 1109 (5th Cir. 1974), and the U.S. Supreme Court has since conclusively eschewed the literal approach, *see* Landreth Timber Co. v. Landreth, 471 U.S. 681, 693 (1985); Reves v. Ernst & Young 110 S. Ct. 945 (1990).

[14] For the numerous authorities that bank loans are not securities, *see infra* note 23.

[15] Interview with Lee C. Buchheit, of Cleary, Gottlieb, Steen & Hamilton, in New York City, Dec. 6, 1994. There is much wisdom in this seemingly flippant remark as this 'appearance test' may well be relevant. In dissent in Banco Espanol de Credito v. Security Pacific National Bank, 973 F.2d 51, 57 (1992), Oakes C.J. noted, in concluding that the short-term loan participations were securities, that the loan participation program "was conducted by Merchant Bank's corporate debt department, situated in a room where several trading operations were conducted, including those involving government instruments, foreign currency, and Euro-dollar futures. That department was not part of the commercial loan operation of Security Pacific."

[16] 110 S. Ct. 945.

are applicable to the "evidence of indebtedness" language.[17] As a unanimous decision of the full U.S. Supreme Court on the issues of relevance here, *Reves* is of the highest authority.[18] The Court in *Reves* stressed that the purpose of the Congress "in enacting the securities laws was to regulate *investments,* in whatever form they are made and by whatever name they are called"[19] and that in interpreting the term "security", "form should be disregarded for substance and the emphasis should be on economic reality".[20]

The Court adopted a version of the Second Circuit's "family resemblance" test. Under this test, there is a rebuttable presumption that any "note" (or "evidence of indebtedness") is a security because of the definition in the Securities Acts coupled to a list of categories of instruments that are not securities. The relevant criteria in deciding whether an instrument is a security, or should be added to the list of non-securities, were laid down by the court as follows:

> (i) the motives that would prompt a reasonable seller and buyer to enter into the transaction: if the seller's purpose is to raise money for general business purposes and the buyer's is to profit from the returns the instrument is expected to generate, the instrument is likely a security;
>
> (ii) the intended distribution of the instrument: if it is one in which there will be "common trading for speculation or investment" it is likely a security;
>
> (iii) the reasonable expectations of the investing public: the more the public expects that an instrument will be a security and thus regulated by the securities laws, the more likely it is a security; and
>
> (iv) the existence of another regulatory regime: if there is no other regulatory regime which significantly reduces the risk of the instrument thereby rendering securities regulation necessary, the more likely it is a security.

If we return to the "evidence of indebtedness" language in the statutory definition of a security, it should be noted that typical loan documentation does not evidence

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[17] The Supreme Court in *Reves*, 110 S. Ct. at 949-50, emphasised that the tests should be different for shares and notes because a share of common stock is the quintessential security and the public would rightly expect share transactions to be governed by the securities laws whereas note is a relatively broad term that encompasses instruments used for both investment and commercial purposes and it is only the former that Congress intended to regulate. "Evidence of indebtedness" is as broad a term as "note", if not broader, and thus reasoning by analogy with *Reves* is permissible.

[18] Marshall J. delivered the opinion of the court in which Brennan, Blackmun, Stevens and Kennedy JJ. joined. Rehnquist C.J. filed an opinion, concurring in part and dissenting in part, in which White, O'Connor and Scalia JJ. joined. This latter opinion expressly concurred with the relevant part, for our purposes, of the opinion of the court.

[19] 110 S. Ct. at 949 (emphasis in original).

[20] 110 S. Ct. at 949, adopting the language of the Supreme Court in Tcherepnin v. Knight, 389 U.S. 332, 336 (1967), 88 S. Ct. 548, 553.

indebtedness. Sovereign loans are invariably documented as loan facilities which permit drawdowns after execution. The loan documentation itself will recite the maximum amount of funds which may be advanced but will not actually evidence any indebtedness. Accordingly, the loan agreement is probably not a security. However, the assignment agreement by which the loans are transferred will recite the indebtedness being transferred, as will the notices to the agent bank. Is the assignment agreement an "evidence of indebtedness"?

Are Assignment Agreements Securities?

The answer to the question of whether assignment agreements are securities turns upon whether they are "evidences of indebtedness". Assignment agreements certainly evidence the indebtedness of the borrower to the new creditor. If the new creditor were to bring a suit on the debt shortly after receiving the debt by way of assignment, the assignment agreement might be the only evidence of the indebtedness of the borrower to it. Yet the agreement has not been executed by the borrower. It has to be read with the original loan agreement to establish its effectiveness. It is submitted that this is no bar to an assignment agreement being an evidence of indebtedness -- a bond has to be read with the underlying trust deed for all of its terms to be appreciated but it is nonetheless an evidence of indebtedness. As the U.S. Tenth Circuit wrote of a bank commitment letter which had been traded:

> It is true that the letter of commitment is not an indicium of debt in the same sense as is a promissory note, but as used in the Securities Acts no such restriction is appropriate. In last analysis, this letter of commitment was sold for a substantial consideration, and the buyer received what appeared to be an enforceable obligation which contemplated the flow of funds. It indicated binding and legally enforceable right. Therefore we can find no fault with the ruling of the trial court insofar as it regarded the letter of commitment as plainly being a security.[21]

The other issue is whether the evidence of indebtedness itself has to be traded to be a security, as with a bond? The answer appears clearly to be no, as investment contracts are undoubtedly securities and yet are not themselves traded. In this case, the indebtedness is traded and the evidence of indebtedness (in the form of the assignment agreement) may comprise a security under the statutory definition. It is settled that neither the agreement for a commercial bank loan to a customer for its current operations nor a note evidencing such a loan are securities under the federal securities laws.[22] However this is no bar to a so-called assignment of an interest in such a loan

[21] United States v. Austin, 462 F.2d 724, 736 (1972).

[22] *See, e.g.*, Banco Espanol de Credito v. Security Pac. Nat'l Bank, 763 F. Supp. 36, 41 (S.D.N.Y. 1991); Reves v. Ernst & Young, 494 U.S. 56, 110 S. Ct. 945, 951 (1990); Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930, 938-39 (2d Cir. 1984); American Bank & Trust Co. v. Wallace, 702 F.2d 93, 97 (6th Cir. 1983); Great W. Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976); C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc., 508 F.2d 1354, 1362 (7th Cir. 1975); Bellah v. First Nat'l Bank, 495 F.2d 1109, 1114 (5th Cir. 1974). See also the consideration of this point in Bradley K Sabel, *Loan Participations as Securities under the*

being a security. Numerous cases have held that a participation in a non-security can itself be a security by way of reasoning that applies equally to assignments of loans.[23]

So it seems that the assignment agreement for an interest in an LDC loan could well be a security for the purposes of the federal securities laws. However, the above analysis does not settle the issue, as the "evidence of indebtedness" language is generally accepted as being too broad to permit a literal reading.[24]

There are no cases directly on point. Accordingly, the four factors from *Reves* will be applied to determine whether a court would be likely to hold assignment agreements to be securities.[25] Each factor will be considered in order.

Factor One -- The Buyer's and Seller's Motives

The motivation of the buyer of LDC loans is to earn a return on its funds and the motivation of the seller is to diversify its risk -- in the words of the majority in *Banco Espanol de Credito v Security Pacific National Bank*: "the overall motivation of the parties was the promotion of commercial purposes rather than an investment in a business enterprise".[26] An earlier case drew the following illuminating distinction between investment and commercial purposes in terms of access to information:

> "While banks are subject to risks of misinformation, their ability to verify representations and take supervisory and corrective actions places them in a significantly different posture than the investors sought to be protected through the securities acts. In an investment situation, the issuer has superior access to and control of information material to the investment decision. Rather than relying solely on semi-anonymous and secondhand market

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Glass-Steagall Act, *in* HANDBOOK OF COMMERCIAL BANK LOAN SALES 335, 348 (Lederman & Feinne eds., 1991).

[23] *See, e.g.*, Banco Espanol de Credito v. Security Pac. Nat'l Bank, 973 F.2d 51, 56 (2d Cir. 1992), 763 F. Supp. 36, 41 (S.D.N.Y. 1991); Gary Plastic Packaging v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 756 F.2d 230, 240-42 (2d Cir. 1985). See also Commercial Discount Corp. v. Lincoln First Commercial Corp., 445 F. Supp. 1263, 1267 (S.D.N.Y. 1978) where it was stated: "It is quite logical, and is moreover well established, that a participation in a loan may be a security, even though the underlying loan is not".

[24] 7 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 900 (3d ed. 1991). The matter is further complicated by the presence of the phrase only in the definition of security in the Securities Act of 1933 and not also in the otherwise similar definition in the Securities Exchange Act of 1934, an omission held relevant in Zeller v. Bogue Electrical Manufacturing Corp., 476 F.2d 795, 800-801 (2d Cir. 1973).

[25] As Buchhheit has written, "although [Reves] addressed only... are notes 'securities'? the Court's analysis may also affect the transactions by which commercial banks dispose of their loan assets through the sale of loan derivative products". Lee C Buchheit, *When is a loan not a loan?*, INT'L FIN. L. REV., Nov 1990, at 29. *Cf.* also the application of the four factors in Pollack v. Laidlaw Holdings, 27 F.3d 808 (2d Cir. 1994).

[26] *See* Banco Espanol de Credito v. Security Pac. Nat'l Bank, 973 F.2d 51, 55 (2d Cir. 1992); and in the district court, 763 F. Supp. 36, 42-43 (S.D.N.Y. 1991).

> information, as do most investors, the commercial bank deals "face-to-face" with the promisor."[27]

Most participants in the emerging markets loans market have roughly equal access to information and dealt directly with the debtors. It is rare for sellers of debt to enjoy superior access to information concerning the debt. Accordingly, this distinction supports rather strongly the view of this as a commercial rather than investment market.

However, there are countervailing considerations. To apply some of the factors found significant by one judge in the *Banco Espanol de Credito case*: some of the buyers of LDC debt were indeed "non-financial entities not acting as commercial lenders but making an investment, and even [the] ... banks that purchased the [debt] ... generally did so not through their lending departments but through their investment and trading departments."[28] On balance therefore this first factor weighs against assignment agreements being securities, but not heavily.

Factor Two -- The Intended Distribution of the Instrument

The secondary market for LDC loans is comprised almost entirely of banks and institutional investors. The offer of an interest in an LDC loan in the market could well be described as "a limited solicitation to sophisticated financial or commercial institutions and not to the general public"[29] and hence not a security. However, the fact the buyers are sophisticated entities does not exclude them from being a "broad segment of the public"[30] which is all the courts have stipulated for the common trading required of a security.[31] On balance, this second factor also tends against the assignment agreement being a security.

Factor Three -- The Reasonable Expectations of the Investing Public

There is no evidence that the public harbour reasonable expectations that an assignment agreement would be a security and thus regulated by the securities laws. The large size of loan interests typically offered for sale and the relatively complex documentation of loan transfers both mean this market does not resemble a regular securities market.[32] This factor, once again, mitigates against assignment agreements being securities.

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27 Great W. Bank & Trust v. Kotz, 532 F.2d 1252, 1261-62 (9th Cir. 1976).

28 *Banco Espanol de Credito*, 973 F.2d 51, 56 (2d Cir. 1992)(per Oakes C.J., dissentiente).

29 *Banco Espanol de Credito*, 973 F.2d 51, 55 (2d Cir. 1992); and in the district court, 763 F. Supp. 36, 43 (S.D.N.Y. 1991).

30 Reves v. Ernst & Young, 494 U.S. at 68; 110 S.Ct. at 953.

31 *Banco Espanol de Credito*, 973 F.2d 51, 59 (2d Cir. 1992)(per Oakes C.J., dissentiente); Landreth Timber Co. v. Landreth, 471 U.S. 681, 105 S. Ct. 2297.

32 A factor Oakes C.J. found persuasive in his dissenting judgment in *Banco Espanol de Credito*, 973 F.2d at 60.

Factor Four -- The Existence of Another Regulatory Regime

As is considered later, no other regulatory regime significantly reduced the risk of investment in loans assigned by assignment agreements. If before loan trading was moved into registered broker-dealer subsidiaries, the instruments were not securities, as is likely, the market in them was essentially beyond regulation. Accordingly, this final factor weighs in favour of the assignment agreement being a security.

Overall, therefore, the four factor test laid down by the Supreme Court in *Reves* suggests that assignments of LDC loans are not securities.[33] However, this issue is now too complex to be ingested with one's mother's milk. Having begun with Lee Buchheit, let's end with him:

> "banks are well advised to recognise that in future lawsuits the mere fact that the instrument in question evidenced a loan or a beneficial interest in a loan will not, by itself, be determinative for purposes of deciding whether the [loan is a security]. The defendant bank can expect to face a close scrutiny into both the methods by which the instrument was sold and the type of purchaser to which it was sold."[34]

Is Bond Trading Subject to the Securities Laws?

On their face, Brady bonds appear without doubt to be securities and thus subject to regulation. However, the legal position was initially unclear. The SEC issued no-action letters[35] which recognised the Brady bonds were bonds but permitted their distribution by private placements.[36] These no-action letters anticipated the subsequent exemptions created by Regulation S and Rule 144A of the Securities Acts for private placements which meet certain criteria.[37] For securities law purposes, Brady bonds were treated as exempt securities.

For bank regulatory purposes, Brady bonds were treated initially as loans. Much like a modern American marriage, in 1990 a Brady bond was the bond you had when you were not having a bond. How did this come about? A Brady bond looks like a bond. It is one sheet of paper, not the one hundred or so typical of a sovereign loan

[33] If this matter came up for decision today it is submitted that most courts would be very slow to disturb the long-standing understanding within the industry. The most likely view would be that taken in Banco Espanol de Credito v. Security Pacific National Bank, 763 F. Supp. 36, 46 (S.D.N.Y. 1991), "An industry-wide traditional understanding which negates the application of federal securities laws to commercial participations in short-term bank loans should not be overridden by this Court's technical acceptance of a literal definition of a statute whose purposes were not so intended and were enacted in a different context."

[34] Buchheit, *supra* note 26, at 32.

[35] For a consideration of the history and function of no-action letters, *see* Maynard, *What Is An Exchange? -- Proprietary Electronic Securities Trading Systems and the Statutory Definition of an Exchange*, 49 WASH. AND LEE L. REV. 833, 853 (1992).

[36] Interview with T.S. Link, then of Davis Polk & Wardwell, New York City, April 23, 1993.

[37] For more on Reg. S and Rule 144A, *see* HAL S SCOTT & PHILIP A WELLONS, INTERNATIONAL FINANCE -- TRANSACTIONS, POLICY, AND REGULATION 68-79, 89-97 (2d ed. 1995).

agreement. It is designed to be transferable by delivery and its terms are generally similar to those of other sovereign bonds.[38] However, in August 1990, the Brady bonds issued by Mexico, Costa Rica and Venezuela were still treated by the market as bank loans for regulatory purposes.[39] This view was supported by certain statements in the no-action letters issued by the SEC on the Brady bond issues[40] and by statements from a SEC spokesman.[41] The general market view, in the words of Kathy Galbraith, was that "these are conversion bonds and aren't really bonds".[42]

A senior banker at the time ventured the view that "if a Brady bond is held on a bank's books as a long-term asset, then it is a loan. But if a bank hands these bonds over to its trading desk, marking them down to market, then it is a bond."[43] It seems implausible that an instrument's status as a security should turn, without more, upon whether it is held in a bank's investment or trading portfolio. The only plausible explanation of the double-think regarding Brady bonds in 1990 and 1991 is that the regulators were keen to promote the Brady process and prepared to bend the laws to ensure there were no legal impediments to the popularity of Brady bonds.[44]

Interestingly, at some unheralded stage, Brady bonds came to be generally accepted as securities under both the securities and bank regulatory regimes. The mysterious, presumably alchemical, process by which this happened is unknown. What is clear is that Brady bonds are now the securities which their name, form and function always suggested they were[45] and their presence means this market is now a securities market. If trading desks were to segregate the trading of Brady bonds from the trading of loans, it is possible that the latter would not be subject to the securities laws. However, as this is utterly impractical, banks have moved their LDC debt trading units into their registered broker-dealer subsidiaries and accepted that the activities of the entire trading unit are subject to the securities laws and NASD and SEC oversight.[46]

Classification of the Market

As the secondary market has matured into a securities market, the issue arises as to the type of security market it is. In general terms, security markets are classified as either exchanges or over-the-counter markets.

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[38] The differences include the partial collateralisation, the unusual interest rate structures of some bonds, and the unusually long term, often of 30 years.
[39] Steven Murphy, *Who Are the Debt Police?*, 20 LATINFINANCE 45, 48 (1990).
[40] Link Interview, *supra* note 37.
[41] Murphy, *supra* note 40 at 48.
[42] *Id.* at 50.
[43] *Id.*
[44] I record this as a fact without suggesting any impropriety by the regulators.
[45] Buchheit Interview, *supra* note 16.
[46] *Id.*; Link Interview, *supra* note 37.

An exchange is based on auction trading accomplished by the centralisation of trading activity.[47] All buy and sell orders for a security are transmitted to the floor of the exchange where they are executed, usually at the post of the specialist on the floor.[48] Specialists also buy for their own account to facilitate the smooth operation of the market but their primary role is to match buyers with sellers.[49] The New York and London Stock Exchanges, for example, work on this principle and it lies at the heart of the statutory definition of an exchange in section 3(a)(1) of the Securities Exchange Act, 1934:

> any organization ... which constitutes, maintains or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange ...

An over-the-counter ("OTC") market, on the other hand, does not depend on bringing together all buy and sell orders in the one place.[50] An OTC market functions by having a number of dealers who make a market in each stock by trading in it as principals for their own account.[51] These market makers publish buy and sell prices on the securities in which they make a market and, indeed, are required by law to do so "on a regular and continuous basis".[52] In an OTC market, a broker may act as a principal and fill a customer's buy order out of inventory or act as a broker and acquire the security from a market maker for their customer.[53] The largest OTC stock market in the world is NASDAQ: the National Association of Securities Dealers Automatic Quotation System, in the U.S.[54]

Up to 1993, the secondary market in discounted sovereign loans did not satisfy the definition of an exchange in the Securities Acts as there was no market place and purchasers and sellers were not brought together as the primary method of effecting trades in securities.[55] Accordingly, the secondary market was not an exchange for the

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[47] For further consideration of what might be an exchange, *see* Ruben Lee, *What is an Exchange?*, (a discussion paper published by the Capital Markets Forum of the International Bar Association, London)(1992).

[48] Maynard, *supra* note 36 at 833-34.

[49] THOMAS L HAZEN, THE LAW OF SECURITIES REGULATION at 267-69 (1985).

[50] *Id.* at 264-65.

[51] *Id.* at 265.

[52] Section 3(a)(38) of the Securities Exchange Act of 1934.

[53] Maynard, *supra* note 36 at 846.

[54] SCOTT & WELLONS, *supra* note 38, Table B on p 54 lists the twelve largest stock markets in the world in 1994 by turnover. The NYSE was the largest, followed by NASDAQ and then the London Stock Exchange. For an excellent history and analysis of the development of NASDAQ, *see* Michael J. Simon & Robert L.D. Colby, *The National Market System for Over-the-Counter Stocks*, 55 GEO. WASH. L. REV. 17 (1986).

[55] See the consideration of this definition by Maynard, *supra* note 36 at 850-54 and the further analysis at 870-75.

purposes of the Securities Acts and did need not to be registered as such with the SEC.[56] Up to 1993, the secondary loan market was an OTC market because:

(i) it was conducted over the telephone and not in any one location,

(ii) large inventories were held by traders to meet customer's orders, and

(iii) traders often acted as principals in their dealings with customers.

Another major change in the market's practices in 1993 was that live screens (quoting firm prices) became the norm for the major assets. Live screens proved highly efficient at disseminating Brady bond and loan prices and revolutionised trading.[57A] Market practice moved towards screen based trading through brokers and away from traders dealing directly with each other.[57B] As Jorge Jasson, of Chase Manhattan, said at the end of 1995,

> "There's not as much dealer-to-dealer trading now ... direct dealing is done mostly with clients. ... Our commitment to market-making and liquidity ... is to our clients and not to the Street. With more activity through brokers, professionals now are not required to make markets to each other."[57C]

This was a major change in the market's operation. The market of the late 1980s and early 1990s had relied upon the tacit agreement of traders to make markets for each other,[57D] i.e. the market had functioned as an over-the-counter market, in which liquidity was provided by market makers buying and selling for their own account. After 1993, the market began to function more like an electronic exchange, in which liquidity arose from brokers matching buyers and sellers electronically, and less like an over-the-counter market. While the market certainly still treats itself as an OTC market,[57] and almost certainly is one, the issue is not as clear cut as it was prior to 1993 -- brokers, through their trading screens, do provide "facilities for bringing together purchasers and sellers of securities" in the terms of section 3(a)(1) of the Securities Exchange Act 1934.

This analysis under U.S. principles applies equally to the secondary market in other countries. The international market is likewise an OTC market. The issue for the international secondary market for LDC loans is whether it is one market or many.

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[56] Registration of an "exchange" is required by section 5 of the Securities Exchange Act of 1934. *See id.* at 834. While the secondary market does not need to be registered as an exchange, the legal obligations upon securities traders apply as fully in an OTC market as in an exchange.

[57A] Susan Hogg, *Squeezed until the pips squeak*, 2 EMERGING MARKETS INVESTOR, April 1995, 33 at 35.

[57B] "Emerging Market Asset Trading House -- Chase Manhattan -- The art of staying focused", 1112 INT. FIN. REV., Dec 16, 1995.

[57C] *Ibid.*

[57D] Paul Kilby, *Smoother sailing? Latin Brady investment market*, 70 LATINFINANCE, Sept 1995, 34.

[57] Emerging Markers Traders Association, 1996 ANNUAL REPORT, 5: "The marketplace for Emerging Markets debt instruments is mainly an over-the-counter market composed of dealers, brokers and investors located worldwide but linked informally through a network of broker screens as well as normal telecommunication channels."

One Market or Many

In 1991 Van Zandt wrote, "U.S. Treasury bonds and the government securities of other [OECD] countries are traded internationally and for the most part they trade all over the world at the same price ... The market for ... Treasury securities represents a truly international market".[58] However, with respect to private sector stocks and bonds, Van Zandt concluded in 1991 that "a truly international market for securities remains a long way off. Substantial barriers to such a market still exist. Moreover, we have no clear conception of what an international securities market would look like even if it existed."[59] This study of the secondary market for non-OECD government securities (loans and Brady bonds) reveals it to be, by Van Zandt's criteria, a true international securities market.

Van Zandt noted that a true international market may be "either a central market or a set of competing decentralized markets". He identified the five essential characteristics of a central market as:[60]

> (i) investors and issuers have no incentive to restrict their activities to their own jurisdiction;[61]
>
> (ii) an absence of institutional or regulatory barriers to access to the market;[62]
>
> (iii) the rule of one price -- if the market is decentralised, the same security must trade at the same price (after exchange rate adjustment) in each market;[63]
>
> (iv) a set of common confirmation and settlement procedures;[64] and
>
> (v) regulatory cooperation to prevent regulatory barriers to access or different regulatory costs of transacting business.[65]

Each of these criteria will now be applied to the secondary market in discounted sovereign debt.

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[58] David E. Van Zandt, *The Regulatory and Institutional Conditions for an International Securities Market*, 32 VA. J. INT'L L. 47, 57 (1991).

[59] *Id.* at 48.

[60] Van Zandt's article was not written from this perspective. I have extracted these five factors from his analysis and trust I have not done his work an injustice.

[61] *Id.* at 48.

[62] *Id.* at 49.

[63] *Id.* at 50-54.

[64] *Id.* at 67-70. At first glance this may appear procedural rather than substantive, but as Van Zandt points out, the purchase of the same security in New York, where settlement is usually in five days; or in London, where fourteen days is the norm; or in Paris, with one month for settlement, is a different economic proposition and prices in the three markets cannot be the same. Likewise, if one market requires physical delivery for settlement and another does not.

[65] *Id.* at 70-78.

(i) Investors in the Emerging Markets secondary market have no incentive to restrict their activities to their jurisdiction. An investor in Argentine Brady bonds who lives in Buenos Aires may prefer to purchase his bonds through a local trading house, for reasons of convenience and to save the cost of a call to New York, but there will usually be no difference in price or other reason to do so.

(ii) There are typically no institutional or regulatory barriers to access to this market. New trading houses may be set up at will. There are no seats to buy on an exchange or other barriers to entry by traders and new investors may enter the market freely.

(iii) The test of one price is satisfied. New York is the primary market for most Latin American instruments and London for many of the Eastern European instruments, with the debt of different African nations shared between the two centres. However, all Emerging Markets debt can be purchased and sold in either New York or London and in most of the other places where traders operate -- from Sao Paulo to Tokyo, and Frankfurt to Manila. The price in each market will be basically identical -- and if it is not, sophisticated traders will rapidly arbitrage away the difference. Furthermore, there will not usually be any exchange rate issues, as trading prices are a percentage of face value and the face value is usually in US dollars.

(iv) The work of the Emerging Markets Traders Association[66] in particular has led to the use of standard form confirmations and standard settlement procedures in virtually all trading centres. Particularly because most trades by a trader in a smaller centre will be international and not with other traders in that centre, the use of the same confirmation forms and settlement procedures globally is only sensible.

(v) There has been little regulatory cooperation because there has been little regulation. Most regulators around the world have adopted the hands-off approach of the U.S. agencies. Most local regulators have ignored the market except when it has been used by people breaking local exchange control or tax laws. Accordingly, there have been very few regulatory impediments to access and very little regulatory effect on transaction costs. The only impediments have been exchange control limitations of broad application on the movement or conversion of funds and these were often readily avoidable by local investors in Latin American countries because, in the main, they were investing flight capital which was already abroad and beyond the reach of local laws.

Upon the five criteria laid down by Van Zandt, the secondary market in LDC debt, like the market in OECD government securities, is a true international securities market. However, the potential for abuse and manipulation has been greater in this market than in the market in OECD government securities. Why this has been so is the topic of Part II.

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[66] For a full description of the Emerging Markets Traders Association and its functions see text accompanying note 271.

II: The History of Market Abuse

The subject of market abuse will be dealt with in four parts: (i) insider trading; (ii) front running; (iii) offences by employees against employers; and (iv) market manipulation.[67]

Insider Trading

Insider trading is the name commonly given to trading in securities on the basis of material, non-public information. Most trading units in the US were moved into the registered broker-dealer subsidiaries of their parent banks from late-1992 to 1994 in recognition of the growing prominence of Brady bonds in the market and their inherent nature as securities. Since that time, the market has been a securities market and subject to regulation accordingly. The analysis will commence by considering insider trading in the period before the securities laws applied.

The first suggestions in the literature of insider trading in this market appeared in 1987. An article in *The American Banker,* on the day following Citicorp's announcement of its $3 billion addition to loan loss reserves, stated that

> Wall Street brokers wondered aloud if Citicorp's foreign debt traders were tipped off in advance to Mr Reed's market-moving announcement. If so, they likely took a short position in Brazilian debt to take advantage of what is expected to be decline in the value of those credits.[68]

The crucial aspect of this quotation is not the speculation about the possibility of insider trading. This was simply the truth beginning to surface. The crucial aspect is the acknowledgment that, if there had been a tip off, Citicorp's traders *likely* took a short position.[69] Outside Citicorp, no one knew what its traders had done. The

[67] Much of the following analysis is anecdotal, for which I make no apologies. Statistics are simply not available. Insider trading, front running and market manipulation are all potentially illegal and traders engaged in them are likely to keep their activities secret. *See* Steve Thel, *$850,000 in Six Minutes -- The Mechanics of Securities Manipulation,* 79 CORNELL L. REV. 219, 223 (1994).

[68] Sudo & Albert, *Citicorp: Facing Up To Latin Debt*, AM. BANKER, May 21, 1987, at 1, 2.

[69] To go short is to sell an asset one does not own -- and therefore to rely on a decline in the market price so that when one purchases the asset to meet one's contractual obligation a profit will be made as the price has fallen. Short positions were most commonly effected at this stage of the market in one of two ways. The less common way was by "borrowing the debt", i.e. acquiring debt, either through a swap or sale, with an express contract to sell the debt back to the supplier at a certain price on a given future date, and then selling or swapping the debt today so that similar debt will have to be acquired in the future to meet the obligation. (In the author's experience, such transactions were done with some regularity and the supplier of the debt took the view that they were lending their debt for a fee.) The more common way of going short was to take advantage of the usual three week settlement period and contract to sell debt not currently owned (and buy it in the market before the settlement date). Interview with Martin W Schubert, Chairman European InterAmerican Finance Corporation, New York City, Apr. 22, 1993 ("Schubert Interview"). This three week period could at times be extended by agreement

absence of any central exchange or registry meant the information was simply not available.[70] This absence of a central exchange also meant that searching for patterns in trading would have been extremely difficult. In Peter Truell's words, "There's no exchange, no official leadership, no written rules, no reporting system ... the global bazaar [is] almost wholly invisible to regulators".[71]

The first relatively clearly established case of insider trading occurred between January and August 1988 when the Visa Group, a major consumer-products group that produces some of Mexico's most famous beers, was engaged in the renegotiation of its $1.6 billion of debt.[72] During this period the price of its bonds moved from 12 cents on the dollar to around 50 cents on the dollar. It became clear to a number of bankers that some LDC debt traders were receiving precise details of the restructuring and trading on that information. Concern among some bankers[73] ran so high that Michael Chamberlin, then a lawyer with Shearman & Sterling of New York,[74] visited the bank negotiating committee in Mexico City to remind them of their obligations to preserve the confidentiality of the restructuring information.[75] With a fourfold increase in the price of $1.6 billion face value of debt in just seven months, the potential profits from trading on such information would have been massive.

In 1990 and 1991, for the first time in this market, allegations of insider trading became common.[76] Two principal types of insider trading were alleged: trading by the major commercial banks on the basis of knowledge from their rescheduling committees and trading by Latin American investors and certain traders on inside knowledge of the debtor's impending actions.[77] The focus here will be on the former.

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to as much as seven to eight weeks which provided even more scope for going short. Interview with Michael Pettis, now of Bear Stearns & Co, New York City, Feb. 20, 1996 ("Pettis Interview II"). Forward contracts in which debt is sold at a given price for delivery at a certain date in the future were not common in this market. In the former type of transaction, unless the counterparty were told, they could not be certain that a trader was taking a short position and in the more common type of transaction, without being told, the counterparty would have no indication at all.

[70] Peter Truell, *Global Bazaar: U.S. Grand Jury Probes a Wild, Murky Market in Third World Debt*, WALL ST. J., Dec. 12, 1990, at A1, col 6.

[71] *Id.*

[72] Peter Truell, *Loans by U.S. Banks to Latin America Borrowers Come Under Scrutiny of Fed*, WALL ST. J., June 11, 1990, at A3.

[73] A formal complaint was lodged by the Royal Bank of Canada's representative on the negotiating committee.

[74] Michael Chamberlin subsequently served as Executive Director of the Emerging Markets Traders Association.

[75] Truell, *supra* note 72.

[76] *See* D. M. Zornow & T. M. Obermaier, *The LDC Debt Market*, Vol 9 No 20 REV. OF BANKING AND FIN. SERVICES, Nov. 24, 1993; Lee C Buchheit, *Advisory committees: what's in a name?*, INT'L FIN. L. REV., Jan. 1991, at 9, 10.

[77] Schubert identified this type of insider trading when he said, "For the Latin American investor, private or institutional in the know, with close government contacts, speculative buying has reaped huge rewards in the past and will continue to do so in the future as insider knowledge in this unregulated market is more a factor than in most other markets, which are regulated." *See* Martin W Schubert, "The Risks and Rewards of Investment in the High Yield Latin American

Many participants claimed the integrity of the market in the late 1980s and early 1990s was good. Simon Nocera reportedly said, "There is no question in my mind about the integrity of this market. There are a lot of insider rumours, but that's exactly like any other market".[78] Kathy Galbraith, with characteristic vigour, reportedly said that insider trading claims are "simply a load of bull".[79] Others held equally strong views to the contrary. Martin Schubert said that commercial banks "without question" breached the wall between debt rescheduling and trading.[80] Hector Megy was equally emphatic: "I can guarantee that the big traders use their corporate finance information. If you think Chinese walls exist in this market, you'd be absolutely wrong".[81] Stephen Dizard was even more explicit, reportedly nominating Bankers Trust, Chase Manhattan Bank, Manufacturers Hanover and Morgan Guaranty as banks that used debt rescheduling information in debt trading. All four banks, not surprisingly, denied the accusation.[82]

In an "extensive" survey conducted in August 1990 for *LatinFinance* "respondents from investment banks and independent boutique traders generally reported that in their view abuses of the [Chinese walls] are common. Most respondents from commercial banks disagreed."[83] Interestingly, while market participants differ on insider trading abuses by some banks, there was general agreement that certain banks had effective internal controls. Citicorp and Bank of America head the list of banks cited often as having had effective internal regulation.[84]

Debt Market", a speech delivered at the Latin High Yield Conference, New York City, May 30-31, 1990, 23 (copy on file with author). See also the words of Andrew Quale, "The risk of possible insider trading violations is particularly high in an informal, unregulated market such the secondary market for LDC debt, especially when the traders in such marketplace may have ready access to persons who have non-public information concerning the status of negotiations between LDCs and their creditor banks or may themselves be actively involved in such negotiations". Andrew C. Quale Jnr., "Tapping the International Capital Markets Using Sophisticated Asset Securitization Techniques", A paper delivered at the Latin High Yield Conference, New York City, May 30-31, 1991, 13 (copy on file with author).

[78] Kelley Holland, *Tropical Heat at Citibank*, BUS. WK., May 17, 1993, at 86.

[79] Murphy, *supra* note 40 at 50. Saleh Daher likewise believed the major banks' internal regulation, such as Chinese walls, worked well, *see* Interview by telephone with Saleh Daher, a partner in Turan Corp, Apr. 22, 1993 ("Daher Interview").

[80] Murphy, *supra* note 40 at 49; Schubert Interview, *supra* note 69.

[81] Interview by telephone with Hector Megy, President of Megy Advisors, Inc., April 22, 1993 ("Megy Interview").

[82] Murphy, *supra* note 40 at 49. In addition to Schubert and Dizard, XX expressed the view that inside information is abused by the major commercial banks (Interview with XX (name withheld on request) formerly a trader with JP Morgan and other trading houses, New York City, April 19, 1993 ("XX Interview"). See also the reports of insider trading abuses in Holland, *supra* note 78; Zornow & Obermaier, *supra* note 76.

[83] Murphy, *supra* note 40 at 49.

[84] Dizard considered that these two banks carefully observed market proprieties. With respect to Citicorp this view was confirmed by Saleh Daher, *see* Daher Interview, *supra* note 79. These two banks had major roles in the ongoing reschedulings but were less significant players in the secondary market for LDC debt.

Other Insider Trading Opportunities

Sitting on steering committees, or advisory committees as they are also known, for debt reschedulings, debt-equity schemes and the like, gave banks access to potentially valuable information. Other roles of banks could do likewise.

On June 19, 1989 Yugoslavia informed the London branch of Manufacturers Hanover that it wished to postpone by six months the date when a particular credit would be eligible for conversion into loans to other Yugoslav borrowers.[85] Manufacturers Hanover did not notify the other banks until two days later. Traders allege that in those two days Manufacturers Hanover sold $3 million of that particular loan, demand for which evaporated up upon the announcement of Yugoslavia's request.[86] A spokesman for Manufacturers Hanover said at the time that this was pure coincidence, "It would be completely erroneous and irresponsible to suggest that a trade was transacted on inside information."[87]

In May 1993 a trader at Citicorp was accused of using inside information from the debt restructuring negotiations for Panama to sell his holdings of Panamanian debt before a major fall in its price.[88] Citicorp chaired the creditors' committee in the negotiations. An internal investigation found no evidence of impropriety and this appears to have been a case of trading based on clever deductions from public, not inside, information.[89] Indeed, the vehemence of, and publicity given to, these allegations against Citicorp suggest the competitiveness of the market may lead to disclosure of many instances of insider trading and thus supports arguments for self-regulation of the market.[90]

Incidence of Insider Trading

It is not known how much insider trading has occurred in this market. This is not surprising. Even in conventional securities markets, "it is not known how much insider dealing actually takes place and hence how much damage it causes ... reliable

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[85] This is generally called a "re-lending" right.

[86] Truell, *supra* note 70; Gary N. Kleiman, *Failure by the Fed: LDC Debt Trading Goes Unsupervised*, AM. BANKER, Mar. 31, 1992, at 5.

[87] Truell, *supra* note 70. It is probably also a coincidence that Daniel Young, one of the traders on Manufacturers Hanover's London desk, was later implicated in a major trading scandal, *see* Peter Truell, *Inquiry Focuses on Ex-Trader of Foreign Debt*, WALL ST. J., Mar. 19, 1993, at C1. Certainly, confidential market sources attest to Young's probity (*see* Interview with YY, a senior LDC debt trader in New York City, April, 1993 (name withheld on request) ("YY Interview"). For details of the later scandal, see text accompanying note 120.

[88] *See Emerging Markets Traders Association Issues Voluntary Code of Conduct*, Vol 5 No 28 THOMSON'S INT'L BANKING REGULATOR, July 19, 1993, at 1. *See also* Holland, *supra* note 78.

[89] The trader claims he was able to draw the inference that the negotiations were unlikely to lead to a concrete result from the last-minute change in the leadership of Panama's negotiating team at the debt restructuring talks, which was public information. He claimed his trading was based on a superior understanding of Panamanian politics not non-public information, *see Citibank Probe Clears Trader of Insider Trading Suspicions*, LDC DEBT REP., May 10, 1993, at 5.

[90] As the principal trading units are in major banks concerned with their reputation, disclosure is a major sanction.

data is neither available nor likely to become available".[91] In this writer's opinion, it is almost certain that insider trading was significantly more prevalent in this market than in most securities markets.[92] Two factors support this conclusion: (i) human nature and (ii) the prevailing attitudes in, and culture of, this market.

Human nature suggests that where self-interest is involved the number of people prepared to bend and break rules is inversely proportional to the clarity of the rules and to the effectiveness of the enforcement procedures (i.e. the less clear the rules or the less likelihood of being caught, the more likely the rules are to be broken).[93] Traders trading for their own account on inside information would have been able to use a foreign trading desk to front for them and hold the loans as owner of record with a participation in favour of the trader. The risks associated with such trades were almost nil as there was no central database of trades from which to trace the trade to the foreign trading desk and no one outside the foreign trading desk would know the identity of the beneficial owner of the loans.

The culture of the market was principally influenced by two factors: (i) the backgrounds of the traders, and (ii) the inter-bank nature of most transactions. Those who joined this market in the 1980s and early 1990s usually came from a commercial banking, not a securities, background. As Michael Chamberlin said, "Loan traders didn't have the 'securities' awareness of rules that any bond trader would have had".[94] Likewise, because most transactions were between banks, infringements were generally seen to be technical violations of the rules without a moral dimension -- parties were expected to look after themselves.[95] A senior trader summed up the matter thus: "The culture of the market is to ignore the accountants, ignore the lawyers, ignore the rules".[96]

The common market view towards insider trading[97] in 1991 was expressed by Martin Quintin-Archard of Intercapital Brokers:

> There are no insider trading rules in this market. If you're sitting around a negotiating table, you see stuff start to slip. If you're the first man in the

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91 Harry McVea, *Fashioning a System of Civil Penalties for Insider Dealing: Sections 61 and 62 of the Financial Services Act 1986*, 1996 J. BUS. L. 344, 360.

92 A conclusion in which I am supported by Fritz Link, among others. *See* Link Interview, *supra* note 37.

93 For the former proposition, *see* GENNARO F. VITO & RONALD M. HOLMES, CRIMINOLOGY -- THEORY, RESEARCH AND POLICY (1994); and for the latter proposition, *see* J.L. Miller & Andy B. Anderson, *Updating the Deterrence Doctrine*, 77 J. CRIM. L. & CRIMINOLOGY 418, 438 (1986).

94 Interview with Michael Chamberlin, Executive Director of the Emerging Markets Traders Association, in New York City on December 8, 1994 ("Chamberlin Interview").

95 YY Interview, *supra* n 87.

96 *Id.*

97 *See* Zornow & Obermaier, *supra* note 76; and Murphy, *supra* note 40 at 54 who wrote, "abuse in an unregulated market can be in the eye of the beholder: if there are no trading regulations and no public pricing register, can there be trading violations?"

> game to sell, nobody can touch you. It may be immoral, but it's not illegal. The market is still a bit of a Wild West, and the Devil take the hindmost;[98]

and echoed by Martin Schubert,

> The market has become much more of a gambling arena than in earlier days and all of us who deal try to get the competitive edge referred to in regulated markets as "insider information" and in our market as being a sharp trader.[99]

These attitudes are further borne out by the porosity or absence of Chinese walls in most major banks until well into the 1990s,[100] outrageous institutional arrangements such as the same person heading both LDC debt trading and restructuring departments,[101] and the disdain of many traders for the usual rules against market manipulation.[102]

Each of these factors suggests strongly that insider trading was a relatively prominent feature of the first decade of this market's development. At the time Quintin-Archard and Schubert made their frank admissions, the market was not subject to securities regulation because it was a market in loans, not bonds. This gives rise to two questions: (i) how was insider trading regulated, and (ii) were there penalties for insider trading at common law?

Formal Regulation of Insider Trading

The staff of the Board of Governors of the US Federal Reserve System reportedly conducted extensive and rigorous investigations into insider trading abuses in the secondary market between 1990[103] and early 1992.[104] Enquiries about this with the Federal Reserve were met with the response that "the Federal Reserve does not comment upon the existence of investigations".[105] It is widely rumoured that Citicorp in particular was subject to a rigorous examination in the early 1990s which led to a major internal review, improved Chinese walls and other procedures.[106]

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[98] Richard Voorhees, *Taming the Wild West?*, 33 LATINFINANCE 9 (1991).

[99] Schubert, *supra* note 77 at 23.

[100] See text accompanying note 144. For instance, it was common for bankers involved in the negotiations leading up to the implementation of a debt-equity scheme to notify their trading desk that the scheme was pending so that the desk could acquire a stock of the debt before prices rose upon the public announcement of the go-ahead for the scheme. *See* Link Interview, *supra* note 37.

[101] See text accompanying note 145.

[102] For example, see the text accompanying notes 157, 192 and 196.

[103] *Fed inquiry on LDC trading reported*, 832 INT'L FIN. REV. 26 (1990) 26. *Cf. No inquiry* 831 INT'L FIN. REV. 33 (1990).

[104] Quale, *supra* note 77 at 13. According to Fritz Link, the Federal Reserve conducted an extensive and rigorous investigation of a number of banks in this market in late 1991 and the first quarter of 1992, *see* Link Interview, *supra* note 37.

[105] Telephone enquiry by author to Federal Reserve Bank, April 23, 1993.

[106] Daher Interview, *supra* note 79.

Penalties for Insider Trading at Common Law

At common law insider trading of corporate stocks is a matter of state law within the U.S. and one on which different states have differing approaches. The "majority rule" as it was called, held sway in most states at the turn of the century. Following the English case of *Percival v Wright*,[107] directors were held not to owe fiduciary duties to shareholders individually but merely to the corporate entity and to the shareholders in their dealings with or on behalf of the corporation.[108] As a transaction between a director and shareholder, in which the director profits by inside information, results in no financial loss to the company, it gives rise to no cause of action. The only remedies offered by the common law to the shareholder under this approach were in tort for fraud or misrepresentation; a director who made no representations and simply failed to disclose his inside information could therefore trade in his company's shares with impunity.

However, the "majority rule" was soon displaced in some jurisdictions by the so-called "special circumstances" doctrine upheld by the U.S. Supreme Court in *Strong v Repide*.[109] The special circumstances likely to result in directors owing fiduciary duties directly to the shareholders include "the fact that the corporation is closely held ... the familial relationship of the parties ... the forthcoming sale of corporate assets ... the fact that the director initiates the sale ... and the relative ages and experiences in financial affairs of the director and the shareholders".[110] In most states the "special circumstances" doctrine is the law today.[111] In a substantial minority of states, a yet wider view holds sway. Under this so-called "minority rule", directors owe fiduciary duties directly to shareholders individually[112] so that a director must make full disclosure of all material facts in their dealings with shareholders.[113]

One matter on which the various state jurisdictions were in agreement in the early 1930s was that the cause of action for breach of fiduciary duty only arose when there was privity between the plaintiff and defendant.[114] No cause of action lay for transactions in "impersonal" stock markets.[115] As is often the case when a creature of the common law becomes the subject of statute, the development of this body of state

[107] [1902] 2 Ch. 421.

[108] LOSS & SELIGMAN, *supra* note 25 at 3469.

[109] 213 U.S. 419 (1909).

[110] Lazenby v. Goodwin, 253 S.E.2d 489, 492 (N.C. App. 1979). See the decisions of the New Zealand Supreme Court and Court of Appeal in Coleman v. Myers, [1977] N.Z.L.R. 225, particularly at 266-280 where Mahon J. ably chronicles the evolution of these doctrines in the U.S. and elsewhere and identifies the weaknesses in Percival v. Wright; and at 328-334 per Cooke J. in the Court of Appeal.

[111] HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 22 (1966).

[112] McVea, *supra* note 91 at 104.

[113] Westwood v. Continental Can, 80 F.2d 494 (5th Cir. 1935); Hotchkiss v. Fischer, 136 Kan. 530, 16 P.2d 531 (1932); Commercial Nat'l Bank in Shreveport v. Parsons, 144 F.2d 231, 238-39 (5th Cir. 1944); Jacobson v. Yaschik, 249 S.C. 577, 582-86, 155 S.E.2d 601, 604-06 (1967).

[114] *See* Goodwin v. Agassiz, 283 Mass. 358, 361-64; 186 N.E. 659, 660-61. *See generally* Shulman, *Civil Liability and the Securities Acts* 43 YALE L.J. 227, 231-32, 238-40 (1933).

[115] *See* Goodwin v. Agassiz, 283 Mass. 358, 361-64, 186 N.E. 659, 660-61. *See also* McVea, *supra* note 91 at 104 & 105.

common law was arrested with the promulgation of Rule 10b-5 in 1942.[116] It is highly unlikely that a further sixty years of judicial development would have left the doctrine of privity in such command of the scene. There are modern precedents for directors and officers being held liable at common law for trades in an organised impersonal stock market[117] and, in the writer's view, a contemporary US court would be very slow to exclude transactions on a stock exchange from the imposition of such fiduciary duties. If a corporate officer is in possession of non-public information which means the value of the shares will rise shortly, there is no good policy reason to distinguish between the purchase by the officer of shares from a shareholder in a negotiated personal transaction, and the purchase from a shareholder in an impersonal transaction on a stock exchange. In each transaction the corporate insider profits, and the shareholder suffers, equally; to draw such a distinction would mean elevating the old and largely eroded doctrine of privity over commercial reality.

Now how does this common law on insider trading in shares by directors of companies apply to insider trading in LDC loans? A principal type of insider trading in this market was by trading desks trading on information a bank had acquired in sitting on a bank steering committee for a debt rescheduling or restructuring, either under the Brady Plan or otherwise, or in negotiations with a debtor for a debt-equity swap programme, debt buy-back or the like.[118]

When a bank's trading desk trades on material, non-public information gained from its restructuring department, its liability for breach of fiduciary duty will depend upon whether the bank owes a fiduciary duty to the debtor (the party from whom the information is misappropriated). U.S. courts have held, "at the heart of the fiduciary relationship [lies] reliance and de facto control and dominance"[119] and "a fiduciary relationship involves discretionary authority and dependency: [o]ne person depends on another -- the fiduciary -- to serve his interests".[120]

Banks on steering committee are appointed by the debtor[121] to facilitate communication between the debtor and its hundreds of creditors.[122] However, steering

[116] LOSS & SELIGMANN, *supra* note 25 at 3476.

[117] For instance, *United States v O'Hagan* 117 S Ct 2199 (1997); and the first judicial proceeding to hold directors or officers liable for trades in an organized stock market, Securities and Exchange Commission v Texas Gulf Suphur Co, 401 F 2d 833, 848 (2d Cir 1968). See also Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding* 51 VA. L. REV. 1271, 1278 (1965); MANNE, *supra* note 112 at 39-46; and Cox, "United States v O'Hagan: completing the insider trading mosaic", forthcoming 72 AUST. LAW JNL (June 1998) __ .

[118] The other principal type of insider trading was on the basis of inside knowledge of a debtor's impending course of action with respect to a restructuring, the payment of interest, approval of a debt-equity conversion scheme, etc. This type of insider trading was most often by investors who were nationals of the debtor nation and/or had very good connections there, *see* note 77.

[119] United States v. Margiotta, 688 F.2d 108, 125 (2d Cir. 1982).

[120] United States v. Chestman, 947 F.2d 551, 569 (2d Cir. 1991).

[121] Buchheit, *supra* note 76 at 9.

[122] *Id.* In Buchheit's words, "One country, Brazil, tried inviting all of its [700-800] commercial bank lenders to New York in late 1982 for a chat about the subject of Brazilian debt. The result of this meeting was not such as to commend this approach to other sovereign debtors".

committees are usually most careful to describe their function as a mere communications link between the debtor and its universe of lenders – they serve their own interests, not those of the other syndicate banks, or the debtor. The extension of fiduciary duties to steering committee banks in these circumstances is possible but, it is submitted, unlikely.

Accordingly, trading desks of steering committee banks that trade on information from their representative on the committee are unlikely to have committed insider trading based on a fiduciary duty theory. The result will be the same where the trading desk has acquired its non-public information from another bank's restructuring department or from another confidential source, such as connections within the Central Bank of the debtor nation. On a fiduciary basis for insider trading liability, the dispositive factor is not how the information is acquired but whether the acquiree, the trading bank, owes fiduciary duties to the source of the information. Accordingly, the common law does not appear to prohibit insider trading on the basis of inside information from bank steering committees.

Penalties for Insider Trading Under the Securities Laws

As banks moved their trading units into their registered broker-dealer subsidiaries in 1992 and 1993, they came under the regulation of the securities laws. Rule 10b-5, promulgated in 1942 under the Securities Exchange Act of 1934, proscribes "any act, practise, or course of business which operates ... as a fraud or deceit upon any person, in connection with the purchase or sale of any security".[123] As interpreted and applied by the courts,[124] Rule 10b-5 clearly prohibits insider trading when (i) a shareholder is defrauded because an insider, or a 'tippee' from an insider, breaches a fiduciary duty owed to the shareholder by trading on the basis of material, non-public information; or (ii) the source of the inside information is defrauded because an insider, or a 'tippee' from an insider, breaches a fiduciary duty owed to the source by trading on the basis of the inside information.[125] Where fiduciary duties are not owed, the US law remains unsettled. Rule 10b-5 may apply in other circumstances but the courts are still

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[123] Rule 10b-5 is promulgated by the SEC under section 10(b) of the Securities Exchange Act of 1934 and is codified in 17 CFR s 204.10b-5 (1988). Detailed analyses of the complexities of how and when rule 10(b)(5) prohibits the trading of securities on material non-public information are beyond the scope of this work. For further information, *see* Zornow & Obermaier, *supra* note 76; LOSS & SELIGMAN, *supra* note 25; HAZEN, *supra* note 7 at 407-08. For an example of a case, *see* Elkind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980).

[124] See particularly SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968); United States v. Chiarella, 445 U.S. 222 (1980); SEC v. Dirks, 463 U.S. 646, 657 (1983); SEC v Clark 915 F.2d 439 (1990); United States v. Bryan, 58 F.3d 933 (4th Cir. 1995). In the memorable words of Louis Loss: "The Rule 10b-5 story tempts the pen. For it is difficult to think of another instance in the entire *corpus juris* in which the interaction of the legislative, administrative rulemaking, and judicial processes has produced so much from so little". LOSS & SELIGMAN, *supra* note 25 at 3485.

[125] Zornow & Obermaier, *supra* note 76. It is irrelevant whether the inside information prompted the trade. The government only has to prove that the trader was in possession of such information when it effected a trade with the counterparty. The government does not have to prove that the information was the motivation for the trade. Zornow & Obermaier, *supra* note 76.

defining its scope. The other principal basis liability is the "misappropriation theory" which proscribes the misappropriation of private information in breach of a duty of trust and confidence.[126] However, the Supreme Court in *United States v O'Hagan* required "a fiduciary relationship between the defendant and the party from whom the information is misappropriated"[127] for liability under this theory. Accordingly, the law appears fairly settled at present that without the breach of a fiduciary duty there will rarely be liability for insider trading.

Upon the reasoning above, an LDC debt trader will rarely owe fiduciary duties to the debtor and, accordingly, upon either theory it is difficult to envisage a trader which trades on material non-public information regarding emerging markets bonds being liable for insider trading.

Chinese Walls

The protective device used most often to guard against the misappropriation of inside information is known as the Chinese wall.[128] In a major commercial bank the Chinese wall should, at the least, comprise internal policies prohibiting the communication of non-public information by employees working on rescheduling negotiations and other matters, together with restrictions designed to prevent access by the bank's debt traders to the floors of the building housing the employees involved in the rescheduling negotiations and vice versa.[129] In addition, a 1990 SEC report on this topic for broker-dealers recommended the reinforcement of these policies by continuing education programmes for new and existing employees, the introduction of document control and coding procedures, periodic security checks of telephone lines, monitoring of in-house trading activity, the implementation of a 'restricted list' which lists those securities the firm and its employees may not trade and periodic compliance audits.[130] Each of these further steps could be implemented in the secondary market for sovereign debt, with the possible exception of a restricted list. The secondary market is dominated by the debts of a few nations -- it would not be practical for a market maker to stop trading the debt of a significant debtor.[131]

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[126] SEC v. Clark, 915 F.2d 439 (1990). For example, an employee who uses confidential information gained in the course of their employment in breach of his duties of employment would be liable under this theory notwithstanding the employee owed no duties to the party from which it acquired the shares. This basis of liability is far from generally accepted in the US, *see* United States v. Bryan, 58 F.3d 933 (4th Cir. 1995).

[127] Cox, "United States v O'Hagan: completing the insider trading mosaic", forthcoming 72 AUST. LAW JNL (June 1998) __ .

[128] For more information generally on Chinese walls, *see* HARRY MCVEA, FINANCIAL CONGLOMERATES AND THE CHINESE WALL (1993).

[129] In a modern electronic building equipped with swipe card readers for after-hours access, this separation is relatively easy to implement as a reader records the identity of each party who enters through it (or at least the identity of the card they are using).

[130] Report of the Division of Market Regulation of the SEC, *Broker-Dealer Policies and Procedures Designed to Segment the Flow and Prevent the Misuse of Material Non-Public Information* [1989-90 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,520 (Mar 19, 1990).

[131] This is especially the case as many of the major market makers are the U.S. money centre banks sitting on the steering committees. For a major debtor such as Mexico, the imposition of

The prices of the debt were very sensitive to the progress of negotiations[132] for reschedulings and debt-equity schemes[133] -- both matters in which the major banks were usually involved as members of the steering committees.[134] Chinese walls were rarely an issue in this market for other organisations -- other departments of investment banks and brokerages almost never had material non-public information of relevance to their LDC debt trading units.

By the end of 1993 the walls were in place in most major banks. The vital question is did they work all of the time? There is much evidence that, at least in the early 1990s, they did not.[135] Some of the largest banks were slow to tighten their internal procedures. The fundamental basis of a Chinese wall is the physical separation of staff from departments between which non-public information should not flow.[136] Yet, in March 1993, *The Economist* reported that, "Until recently, some of America's top banks -- including the unimpeachable J.P. Morgan, probably the biggest trader -- have run their restructuring and trading operations side by side."[137] Even more egregiously, the same person headed both the rescheduling and trading teams at Swiss Bancorp until well into the 1990s.[138] In most cases, it was not until the trading desks were moved into the banks' broker-dealer affiliates that effective Chinese walls were in place but this rectitude was the product of the securities law requirements for registered broker-dealers,[139] not a choice to upgrade protections within the emerging markets trading divisions.[140]

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a restricted list uniformly by traders could well exclude the majority of market makers from trading its debt and deny the market depth and liquidity. At times of hightened uncertainty, such as during a restructuring, this lack of depth and liquidity could readily lead to dramatic and distressing levels of volatility.

132 Truell, *supra* note 70. In Truell's words, "Information about debt-restructuring negotiations can be extremely profitable, particularly when the original borrower was a big private-sector company that may have a bright future once the debt cloud hanging over it is removed", *see* Truell, *supra* note 72.

133 Truell, *supra* note 72.

134 Truell, *supra* note 70. An incident involving JP Morgan is often cited as evidence of the opacity and efficacy of the major banks' Chinese walls. At the end of the third quarter of 1989 traders at JP Morgan reportedly went long in (i.e. acquired) LDC debt only a few days before their bank announced it would raise loan loss reserves to 100 percent of its LDC exposure, *see Third World Debt*, Vol XIII No 51 BANK LETTER, Dec 25, 1989, at 4. Traditionally throughout the market's history an increase in reserves has led to a decline in market prices. The incident is quoted as if one example of a major bank's Chinese wall working means it always worked.

135 Hector Megy was in no doubt: "If you think the Chinese walls work in the market -- you'd be absolutely wrong ... I know because I have been watching the market for so long". Megy Interview, *supra* note 81.

136 It is essential that the departments are housed on different floors and staff members from one are not allowed on the floor of the other -- for even without a conversation, the demeanour and facial expressions of bankers involved in rescheduling negotiations could tell traders of the debt all they needed to know about the rescheduling.

137 *Cowboys catch the 7.33*, ECONOMIST, March 27, 1993, at 83.

138 Telephone Interview with Peter Truell of *The Wall Street Journal,* New York City, April 22, 1993 ("Truell Interview").

139 For instance, Chinese walls are more likely to be effective because a broker-dealer affiliate is a separate corporation from the bank which sits on the steering committees for debt-equity

Front Running

Front running is trading ahead of clients. A trader in receipt of a client's buy or sell order large enough to move the market may be tempted to buy or sell first for the bank's own account or their own account, or both, before implementing the client's order. There is even more scope for front running when a trader learns its client will probably be buying (or selling) a large position but before the trader receives the order.[141] In this case, if the client intends to make a large purchase, the trader may be tempted to stock up on the required paper in anticipation of selling it to the client. If the trader's purchase is large enough to move the market, the trader will then onsell the paper to the client at the new, higher prices.[142] If the market has been moved by the trader's purchase, the net effect of such front-running is to transfer to the trader money that otherwise would have been the client's. Front running by trading houses for their own account was relatively common in this market, at least with loans.[143] The Swiss and German banks, in particular, were heavily criticised by other traders for front-running. One German trader, in particular, was fond of referring to front-running as "arbitraging the information curve".[144]

If the trader's transaction moves the market, it can be prosecuted as theft of the client's opportunity to purchase at the potentially lower price, or sell at the potentially higher price, which prevailed before the trader effected its transaction.[145] If the trader's transaction is not large enough to move the market, the client will not suffer any loss, but the trader's conduct may still be in breach of the fiduciary duties which, as an agent for the sale or purchase of debt, it owes its clients.

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programmes, restructurings, and the like. In addition, a broker-dealer affiliate has its own, separate research staff from the bank: Link Interview, *supra* note 37.

[140] Link Interview, *supra* note 37. The popularity of new bond issues by LDCs in 1992 and 1993 created a need for new Chinese walls in the trading houses; walls that in the main were not put in place. An investment bank involved in the structuring and pricing of a new eurobond issue, for instance, might learn valuable confidential information which could affect the price of that country's secondary market debt. *See Emerging Markets Traders Association Issues Voluntary Code of Conduct*, *supra* note 88 at 1. While the information is unlikely to be as price sensitive as the progress of a rescheduling, and in many bond issues no such information would come to light, there remains a clear risk of the bank's traders learning of material non-public information -- a risk that very few investment banks protected themselves against. Almost invariably the banks' emerging markets division handled both new bond issues and secondary market trading. Some traders, surprisingly, saw absolutely no problem with the one person heading new issues and secondary market trading. *See* Interview with WW, an experienced trader with experience with major banks in New York and London, in London, May 5, 1993.

[141] *Id.*

[142] Likewise, if the trader learns of a major intended sale by a client, the trader might sell the same debt from its trading portfolio in advance of the client's trade and then buy the client's debt to restock its trading portfolio. If the trader's sale depressed market prices at all, the client will only be paid the new, lower price and the trader will have profited at the client's direct expense.

[143] Schubert Interview, *supra* note 69.

[144] YY Interview, *supra* note 87.

[145] Zornow & Obermaier, *supra* note 76. For example, see the prosecution of Young & Liberatore for theft of a corporate opportunity from Manufacturers Hanover -- see text accompanying note 177.

However, there appears to have been no effective regulation of banks' front running for their own account in this market. While front running of LDC loans sales can be prosecuted as theft of corporate opportunity and breach of fiduciary duty, there was no effective way for clients to learn of it and the only practical restraint upon a bank's engaging in front running would appear to be its own policies. However, once the loans had been converted into Brady bonds, and were being treated as securities, this behaviour was in clear breach of the securities laws and subject to SEC regulation.

The anecdotal evidence is that trading desks in even the largest of banks front run for their own account, in particular upon upcoming developments in restructurings. The *Economist* reported:

> Some outside the banks suggest that commercial banks' restructuring arms have been colluding with their traders. They point to price movements that can come only from "front-running" by banks involved in steering-group talks with debtor countries.[146]

Such front running is to all intents and purposes the same as insider trading.

Detection of a trader front running for its own personal account would be even more difficult in this market. Sensible traders engaging in such transactions would use a trading unit in another country to front for them and purchase or sell securities in that unit's name but on the traders' behalf. Any trader in New York or London would have no difficulty in finding offshore trading houses willing, for a fee, to act for them in complete confidence. By the use of participation agreements, the foreign trading unit could remain the owner of record of the debt and unless the foreign trading unit broke the confidence, detection would be practically impossible.

Furthermore, some traders, even at the most reputable of houses, took the view that trading ahead of one's client before the client had in fact placed its order is not front running,[147] i.e. a trader is free to buy or sell ahead of orders which the trader knows the client is likely but not certain to place. This is a highly problematic view. Such conduct is clearly in breach of the fiduciary duties owed by a trader to its clients. However, the currency of this view as late as 1993 reflects the lax attitude to legal niceties in the market.

Finally, the profits from illicit trades effected through an offshore trading desk, whether as the result of front running, inside information or other abuses, would hardly be declared as income and thus there was the inevitable fraud on government revenue.[148]

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146 *Cowboys catch the 7.33*, *supra* note 144.
147 WW Interview, *supra* note 147.
148 Truell Interview, *supra* note 145.

Offences by Employees Against Employers

Some commentators believe that the major victims of abuses in this market have been the banks at the hands of their own traders.[149] If the individual trader's own transaction moves the market, the bank loses the benefit of that move in prices (although in all bar the exotics it would have been unusual for an individual's trades to move the market). However, as has been considered, there was very little possibility of detection if traders traded for their own personal accounts in front of major transactions by the traders' bank for its own account.[150]

The more common way in which banks suffered at the hands of their own traders was by sales at an undervalue to a company which the trader and/or his accomplices owned. The two prosecutions next considered bear this out.

The Angotti Case

Antonio Angotti was hired by Security Pacific in early 1988 to head a trading desk for LDC debt, the primary role[151] of which was to liquidate Security Pacific's own portfolio of some $1.8 billion of LDC loans.[152] Over the next fifteen months some $1.3 billion of debt was sold.

Three other traders were hired with Angotti.[153] In early 1989 the three prepared an 80-page report detailing fifteen questionable trades by Angotti and delivered it directly to the Chairman of Security Pacific. Two weeks later, after an internal review, Security Pacific closed the debt trading unit suddenly, saying it had done its job (even though Security Pacific still held $500 million of LDC debt).[154] The bank sought to keep the matter private but the story emerged and Angotti was subsequently charged before a federal grand jury.[155]

Some of the questionable trades included an unusually large sale by Angotti to Fintech Inc., a small, specialised broker, of $120.47 million of debt at 53 cents on the dollar. Fintech resold the loans shortly afterwards for 53.75 cents,[156] mostly to Libra Bank. Libra's traders were incredulous that Security Pacific had brought in a third party broker and not made the sale to them directly.[157] In November 1988 Angotti sold $16 million of Venezuelan debt to Fintech at 38 cents on the dollar when the other traders

[149] Buchheit Interview, *supra* note 16.
[150] Front running of LDC loans by a trader for his or her own account would have been against bank policy in most banks.
[151] The secondary role of the trading desk was to earn profits by speculating on the secondary market. *See* Truell, *supra* note 70.
[152] Steven Murphy, *Mutiny on the Debt Desk*, 20 LATINFINANCE 53 (1990); Peter Truell, *New Clues Surface to Security Pacific's Closing of Debt Unit -- Credit-Trading Operation Was Shut Down in 1989, Puzzling Many Traders*, WALL ST. J., June 19, 1990, A22; Truell, *supra* note 70;Truell, *supra* note 72.
[153] Stephen Maitland-Lewis, George Buxton and William Cisneros.
[154] Murphy, *supra* note 162.
[155] Truell, *supra* note 162.
[156] Truell, *supra* note 162; Truell, *supra* note 70.
[157] Truell, *supra* note 70.

knew such debt was selling for at least 39.25 cents.[158] Fintech was a small brokerage which did not regularly engage in transactions of this magnitude. It was owned and managed by Jaime Montealegre and David Martinez, two men with whom Angotti had been close friends when the three worked together at Citicorp in the mid-1980s.[159] Later in the same month, Angotti sold some $59 million of Argentine debt to Swiss Bank and NMB for 17 and 17.75 cents on the dollar "at a time when Merrill Lynch had offered in writing to buy much of the same debt for 18 ½ cents".[160] Swiss Bank and NMB were later discovered to have often acted as a brokers, or 'fronting agents', for Fintech.

In a number of other sales Angotti requested special payment arrangements for the debt. In one case, for instance, in which Uruguayan debt was sold for 60.25 cents on the dollar, Angotti had the purchaser pay 58 cents on the dollar directly to his employer and the balance of 2.25 cents on the dollar (some $73,000 in this case) into an account in the Cayman Islands.[161]

The report of the three traders identified the misappropriation of up to $25 million.[162] However, the grand jury found insufficient evidence to commit Angotti for trial.[163] The lack of any central exchange with records of trades and prices would have enormously complicated the task of analysing these transactions in the secondary market. The writer wonders what the grand jury members made of this little understood secondary market: for most people the concept of a loan being sold is quite difficult to grasp; the sale of loans with a face value of $1.3 billion must have seemed surreal. The regulatory lesson from this episode appears to be that it is very difficult to regulate and prosecute transactions completed some years earlier without a central database of transactions from which to establish trading patterns and market prices.

In line with the traditional treatment of whistleblowers, the closure of the trading unit by Security Pacific cost the three traders who had exposed these transactions their jobs[164] whereas Angotti left to take up a prestigious White House Fellowship in the Treasury's international debt policy office. He was said to have "designed some fairly novel techniques for handling Third World debt"[165] -- a task in which he apparently had considerable experience.

158 *Id.*
159 *Id.*
160 *Id.*
161 *Id.*
162 *Id.*
163 *Third-world debt -- Cowboys catch the 7.33, supra* note 144.
164 One joined Bank of Tokyo as a trader, the other two went into different fields of investment banking, *see* Truell, *supra* note 70; Murphy, *supra* note 162 at 54. The banker who elected to stay in this market had tremendous difficulty securing another trading position at a time when anyone with any trading experience was typically beseiged with offers from executive recruitment firms. Eventually the trader joined Bank of Tokyo, a very low prestige trading house in this market -- yet another example of the common fate of whistleblowers. *See* Pettis' Interview II, *supra* note 69.
165 Bruce Hasenkamp quoted in Truell, *supra* note 70.

The Young Case

The first major public[166] investigation into the market was conducted by the Federal Reserve and the Manhattan District Attorney's office.[167] It was focused on the conduct of Daniel Young. Mr Young was a trader with Manufacturers Hanover in August 1990 when he acquired certain Colombian Deutsche Mark loans for the bank at 61.75 percent of face value.

The indictment alleged that in October 1990, after Young met with potential investors and urged Manufacturers Hanover to sell the loans, the head of LDC debt trading told Young that the bank did not wish to sell the asset as it had been acquired "with a view toward longer term appreciation" but three days later Young prevailed upon a junior LDC trader to "auction" the assets and give to a firm called Tritech the right to match the highest bid received. According to the indictment, Tritech was a small partnership which, unbeknownst to Manufacturers Hanover, Young owned and controlled along with three former Manufacturers Hanover bankers.[168] Tritech purchased the loans at 67.5 percent of face value. Young resigned, at the bank's request, in December, 1990. The indictment contends that Tritech sold the loans for 93 percent of face value in November 1991 for a profit in excess of $500,000.[169]

Young and one of the other alleged owners of Tritech, George Liberatore, were indicted for conspiracy to misappropriate and for misappropriating bank assets[170] and for giving and receiving a bribe.[171] The Federal Reserve commenced separate proceedings against Young for violations of U.S. banking laws and, among other sanctions, sought to have him barred for life from the banking industry.[172] These actions were resolved by a plea bargain in which Young pleaded guilty to a felony and was required to perform community service. The charges against Liberatore were dropped shortly afterwards.

[166] The Federal Reserve conducts its investigations confidentially and will not comment unless an investigation leads to prosecutions and/or disciplinary action.

[167] Peter Truell, *Inquiry Focuses On Ex-Trader of Foreign Debt*, WALL ST. J., March 19, 1995, at C1.

[168] The parallels with the Angotti case are striking.

[169] The details in the above paragraph are all as alleged in the indictment of Daniel Young and George Liberatore, as described in Zornow & Obermaier, *supra* note 76; and Federal Reserve, Press Release, *Daniel Young ... Notice of Intent to Prohibit ...*, May 17, 1993 (copy on file with author). *See also* Peter Truell, *Two Indicted In Trading Scam Involving Debt*, WALL ST. J., May 18, 1993, at A3; Peter Truell & Thomas T Vogel, "Secretary's Suspicions Led to New York Probe and Indictments Against Two Debt Traders", *The Wall Street Journal*, May 21, 1993, at A5D, col 1; and *LDC Trader Indictments Sully Debt Market's Image*, LDC DEBT REP., May 24, 1993, at 1.

[170] In violation of New York Penal Law section 105.05(1) and New York Banking Law section 673, *see* Zornow and Obermaier, *supra* note 76.

[171] That is, Liberatore was charged with bribing Young to misuse his position at Manufacturers Hanover and Young was charged with taking the benefit offered, *see* Zornow and Obermaier, *supra* note 76.

[172] Peter Truell, *Two Indicted in Trading Scam Involving Debt*, WALL ST. J., May 18, 1993, at A3; Federal Reserve, Press Release, *supra* note 179.

The above account of the matter is from the publicly available sources. However, it may reflect only Manufacturers Hanover's version of events and what actually occurred may not be so clear-cut.

Market Manipulation

Some individual trading houses made a practice of attempting to manipulate the market. In the 1980s the lack of depth in the market meant such conduct was often successful. As the market grew dramatically in the 1990s this became more difficult especially when the object was the debt of a major debtor. However, even towards the end of 1993, it remained possible for a major trading house acting alone, with the courage to commit substantial sums and take the associated risks, to manipulate the market for the debt of a major debtor. As one senior trader said in 1993: "Right now, $100 million of debt will bring any price down in this market, except perhaps Mexico's".[173] Manipulation was facilitated by extraordinary external conditions, as was the case in October 1991, and some trading houses were assisted by the willingness of some of the large hedge funds to join with them in attempts to push prices around.[174]

While manipulation of the major debts was open only to the largest players with sufficient traders and capital, price manipulation in the thinly traded 'exotics' has been open to virtually all traders throughout the market's history. "Exotics" is the market's term for countries such as Peru, Cuba, Ecuador, Nigeria, Morocco, Poland and the former Soviet Union.[175] The thinness and extreme volatility of the markets in these credits means such tactics have always enjoyed a reasonable prospect of success.[176] The principal type of manipulation in this market was ramping.[177]

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[173] Schubert Interview, *supra* note 69. *See also* Interview with Felix Robyns, Managing Director, Emerging Markets, Bankers Trust, London, May 5, 1993 ("Robyns Interview"). There were stories in the Autumn of 1992 of some bankers trying hard to drive down the price of Argentine debt so as to be able to effect a debt-equity conversion cheaply, *see* Holland, *supra* note 78 at 86.

[174] YY Interview, *supra* note 87.

[175] Richard Voorhees, *The bull run of 93*, 50 LATINFINANCE 28 (1993).

[176] As an example of the extreme volatility of some exotic debt, consider the debt of the former Soviet Union. In the first eight months of 1993 its price went from 14 cents on the dollar to 44 cents on the dollar and in August alone rose from 25 cents to 44 cents before ending at 37 cents, *see id.* Trading volume in Russian debt was estimated at between $3 billion and $4 billion in 1993, *see* Tracy Corrigan, *Risk and Reward: Secondary market investors turn to Eastern Europe*, FIN. TIMES, Sept 20, 1993, at 23.

[177] Another minor market abuse, which will not be considered in any depth in this work, is parking. In January, 1993 the director of LDC trading at First Boston left the firm after allegedly "parking" some $9 million of Venezuelan securities in breach of SEC rules. *See Emerging Markets Traders Association Issues Voluntary Code of Conduct, supra* note 88. Parking involves a bogus sale of securities to another party; in this case the "sale" was made at year-end so that First Boston would not have to carry extraordinarily large reserves against its holding of these securities. The extraordinarily large reserves were called for by a quirk in accounting guidelines. For an analysis of the elements of parking, *see* Zornow & Obermaier, *supra* note 76.

Ramping

Ramping has been defined as "a practice that can be used in any market to create an impression of generalised market activity that forces prices higher, so that advantage can be taken of the higher prices to sell out at a quick profit".[178]

One of the very largest traders would from time to time attempt what it termed an 'exercise'. The 'exercise' would involve each of its traders, perhaps fifteen or so, working the telephones making buy or sell enquiries and entering into minor transactions of a certain asset in an attempt to drive the market up or down, as the case may be.[179] For instance, if the trading house had gone short, say $150 million, on a particular credit, it would strive through a concerted barrage of sell offers, and perhaps ten or twelve sales of $1 million or $2 million pieces of debt, to drive down the asset's price in anticipation of acquiring the asset to close out its short position. This procedure did work at times, even on major assets, in 1992 and 1993.[180] Certainly the procedure worked often enough to be worthwhile -- the trading house concerned was renowned for its 'exercises'. It justified its 'exercises' as "simply testing the market".[181]

There was a lot of ramping during the October collapse of 1991.[182] The settlement periods meant that traders could regularly go short a few days, which was "a long time in these markets" especially in the dismal days of October, 1991.[183]

In an interview in 1993 an experienced trader explained how that morning he had wanted to sell a parcel of Ecuadorian loans. He was pretty confident that few others would be interested in selling Ecuadorian debt that day. He and his staff spent some time placing bogus buy orders at slowly increasing prices on the trading screens to drive the price up.[184] The orders were bogus as the trader had no intention of honouring them; if any one had responded he would have said he had just bought the debt (such a deception works when prices are merely indicative and not firm). With the posting of ever-higher buy prices, some other trader placed a buy order, presumably suspecting some type of rally in Ecuadorian debt. The first trader then took that order and sold his parcel of debt, at a considerable profit over the price at which trading had commenced for the day. The trader related this story quite openly and was evidently pleased with the success of his efforts. In his words, "I got the sucker ... This is not really manipulation, it is simply finding a price at which debt gets sold ... it is suckering people but not manipulation, that is a legal term, it is not that".

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178 EDNA CAREW, THE LANGUAGE OF MONEY 200 (1988).

179 XX Interview, *supra* note 77 (XX was a former trader for this major trading house); WW Interview, *supra* note 147.

180 XX Interview, *supra* note 77.

181 *Id.*

182 *Bloodletting Continues*, 900 INT'L FIN. REV. (1991).

183 *Id.*

184 The screens did not quote 'live' prices for Ecuadorian debt. Prices were indicative only. Trades could be concluded only by subsequent negotiation with the trader who had posted the price. Thus there was the potential for this type of manipulation.

The strength of his denial gives the game away -- this is, of course, a classic case of ramping.

In 1992 a number of traders reportedly depressed the price of Ecuadorian debt by selling their holdings, successfully anticipating a large sale of the debt by a Japanese bank. The traders then profited upon the subsequent repurchase of the debt at much lower prices[185] Such trading would only be improper if made on the basis of non-public information somehow obtained from within the Japanese bank. If the decision was based on information in the public arena, albeit known to perhaps few people in the U.S., it was perfectly legitimate. It is the placing of bogus buy or sell orders -- orders which the trader never intends to complete -- which is manipulation. In this case, the traders actually sold their debt.

Reasons to Control Market Manipulation

The regulatory regime proscribing market manipulation in the United States was introduced over sixty years ago by the Securities Exchange Act of 1934.[186] This Act recited that securities are susceptible to manipulation which, in turn, causes, intensifies and prolongs national crises like the Great Depression of the early 1930s.[187] Fischel and Ross challenged this position in 1991, arguing that attempts to control manipulation are misguided as trading is so costly and trades so rarely move prices, people will rarely even try to manipulate prices.[188] Fischel and Ross argue that prohibiting manipulation involves social costs as some appropriate trading will almost inevitably be deterred and regulation is expensive to administer. These authors argue these social costs outweigh the minimal benefits of the proscription of manipulation and that regulation should be abandoned.[189]

Whether the analysis of Fischel and Ross is correct for mature securities markets is beyond the scope of this work, although highly persuasive arguments have been made against it.[190] This study, however, clearly establishes that the reasoning of Fischel & Ross does not apply to this market. Prices of emerging markets loans do move in response to trading. The information is so imperfect, and the markets in the debts of some nations so thin, that at times prices move in response to the mere offering of debt for sale or purchase or in response to rumours of future demand for debt. Furthermore, manipulation in this market can be effected at times without great cost as trades may not be required. In disputing the thesis of Fischel and Ross, Thel and others have concluded that manipulation is theoretically possible and probably occurs

185 Holland, *supra* note 78 at 86.

186 Pub. L. No. 73-291, 48 Stat. 881 (codified with amendments in 15 U.S.C. § 78a-78ll (1988)).

187 15 U.S.C. § 78b(3) & (4) (1988). *See also* Thel, *supra* note 67.

188 Daniel R. Fischel & David J. Ross, *Should the Law Prohibit "Manipulation" in Financial Markets?* 105 HARV. L. REV. 503, 512-529 (1991).

189 *Id.* at 522-23. *See also* Thel, supra note 67 at 220-21.

190 Thel, *supra* note 67, has argued persuasively against Fischel & Ross' thesis. Loss & Seligman accept manipulation as a fact of life, stating that it "is probably as old as the securities markets", *see* LOSS & SELIGMAN, *supra* note 25 at 3939, and that: "To judge from this type of [recent] historical experience, manipulation seems no more capable of total eradication than its first cousin, 'fraud'", *id.* at 3985.

fairly often in mature securities markets.[191] In this market, manipulation is not only possible but has occurred frequently throughout its history, particularly in its first decade.

Sanctions for Market Manipulation

The primary determinant of the relevant sanctions against market manipulation is whether or not the securities laws apply. The manipulation of markets in loans was subject to the common law and the manipulation of markets in Brady bonds is today subject to the sanctions of the securities laws.

Sanctions under the Common Law

The common law of market manipulation commenced with the English case of *Rex v de Berenger*[192] which dealt with manipulation by spreading false rumours of the end of the Napoleonic war. The defendants were convicted of a conspiracy to raise the price of government securities and to injure the public who might buy the securities.[193] As a result, the concept of a free and open market became part of British law with criminal sanctions for interference. As Loss puts it, "The essence of the matter is that the public has a right that a natural market should not be tampered with".[194]

The US common law on manipulation broadly followed the British.[195] Criminal sanctions for manipulation in the US were found in the federal mail fraud statute,[196] in special state legislation in New York,[197] and in the inherent nature of manipulative trading as a fraudulent device. In the words of Woolsey J,

> When an outsider, a member of the public, reads the price quotations of a stock listed on an exchange, he is justified in supposing that the quoted price is an appraisal of the value of that stock due to a series of actual sales between various persons dealing at arm's length in a free and open market on the exchange, and so represents a true chancering of the market value of that

[191] *See* Thel, *supra* note 67 at 222-23; Franklin Allen & Douglas Gale, *Stock-Price Manipulation*, (1992) 5 REV. FIN. STUD. 503; Franklin Allen & Gary Gorton, *Stock Price Manipulation, Market Microstructure and Asymmetric Information*, 36 EUR. ECON. REV. 624 (1992); Robert A. Jarrow, *Market Manipulation, Bubbles, Corners, and Short Squeezes*, 27 J. FIN. & QUANTITATIVE ANALYSIS 311 (1992).

[192] 3 Maule & S. 67; 105 E.R. 536 (K.B. 1814).

[193] For an excellent summary of the history of regulation of market manipulation in the U.K. and the U.S. see LOSS & SELIGMAN, *supra* note 25 at 3942-52.

[194] LOSS & SELIGMAN, *supra* note 25 at 3944.

[195] *Id.* at 3947.

[196] On federal mail fraud liability, see Harris v. United States, 48 F.2d 771 (9th Cir. 1931) and Goddard v. United States, 86 F.2d 884 (10th Cir. 1936).

[197] The New York provisions were originally in the New York Penal Law of 1909 and are now to be found in the New York General Business Law, s 339.

> stock thereon under the process of attrition due to supply operating against demand.[198]

Upon this analysis, whether the manipulative trading is of loans in this secondary market or of stocks on the New York Stock Exchange should make absolutely no difference. Such manipulation is a fraud which is enjoined by the common law.

Sanctions Under the Securities Laws

The U.S. regulatory schema for securities has no general prohibition on trading for the purpose of influencing prices and only prohibits the employment of manipulative devices in certain circumstances.[199] The SEC has promulgated a series of rules which proscribe specific practices,[200] irrespective of the trader's intention, and the general fraud provisions[201] prohibit many forms of market manipulation.[202] The Supreme Court has held that the intention of Congress in enacting the Exchange Act provisions was "to prohibit the full range of ingenious devices that might be used to manipulate securities prices".[203] In practice, however, these provisions are less than effective as one of their elements is an intention to deceive,[204] often a difficult matter to prove. Nonetheless, and in particular, any attempt to manipulate a securities market by artificially stimulating demand or reducing supply violates rule 10b-5.[205] Furthermore, section 9 of the Securities Exchange Act of 1934 applies to securities (including options and other derivatives) that are registered on a national securities exchange. Section 9 prohibits the creation of a false or misleading appearance of active trading and any actions that raise or depress the price of a security for the purpose of inducing its purchase or sale by others.[206]

Knowing and wilful violations of these or any other securities laws are criminal offences under section 32(a) of the Securities Exchange Act with severe penalties,

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[198] United States v. Brown, 5 F. Supp. 81, 85 (S.D.N.Y. 1933); *aff'd* 79 F.2d 321 (2d Cir. 1935). The conviction was affirmed on appeal but the Second Circuit expressly declined to address the issue of general market manipulation as a crime, preferring to base their decision on the narrower grounds of touting, wash sales and the like. Nonetheless, the appeal court did not overrule "the district court's holding to the effect that interference with a free and open market by manipulative trading is itself fraudulent": LOSS & SELIGMAN, *supra* note 25 at 3944. Judge Woolsey's statement appears to represent the U.S. common law today.

[199] Thel, *supra* note 67 at 287.

[200] For instance, inter alia, SEC Rule 10b-21(T) which regulates short-selling in connection with secondary offerings into the market; Rule 10a-1 which prohibits short sales of exchange listed stocks except on or after an uptick; Rule 15c1-8 which prohibits broker-dealers in certain circumstances from offering securities represented to be at the market price, unless an independent market exists; and Rule 10b-2 which prohibits the payment of compensation to a person for soliciting a third person to purchase a security on an exchange.

[201] Sections 17(a) of the Securities Act of 1933 and 10(b) and 15(c)(1) & (2) of the Securities Exchange Act of 1934 and rule 10b-5 thereunder.

[202] *See generally* Zornow & Obermaier, supra note 76.

[203] Santa Fe Industries, Inc. v. Green, 4340 U.S. 462, 477 (1977).

[204] Thel, *supra* note 67 at 293.

[205] Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).

[206] 15 U.S.C. § 78i(a).

including jail terms of up to ten years for individuals. Attempts to manipulate Brady bonds are theoretically as perilous as the manipulation of any security in the United States -- the sanctions are severe. In practice the manipulation of Brady bonds is subject to two factors which counterbalance each other: (i) the likelihood of detection is less with Brady bonds than other securities as there is no central database of trades and investigations have to be conducted through the records of brokers and/or individual banks without the ready ability to scan for patterns of trading; and (ii) the size and depth of the markets in Brady bonds would make manipulation very difficult.

In summary, the secondary emerging markets loan market was wide open to abuse and manipulation prior to its evolution into a securities market in 1993. The regulation, such as it was, of the market in that period is the subject of the next and final part of this article.

III: The Regulation of the Market

The earliest recorded official attitude to the secondary market was positive. On January 10, 1984 the Vice-Chairman of the Federal Reserve Bank, Preston Martin, addressed the International Management and Development Institute in Washington, D.C.[207] Under the headline, "Fed Likes Secondary Market for LDC Debt", the *American Banker* reported that "[t]he Federal Reserve is becoming one of the stronger advocates of nurturing the secondary market for buying, selling and trading the extensive foreign loans of US commercial banks".[208] The reported comments of Mr Martin suggest he was more interested in the development of a secondary market in LDC equities than in debt, as this would have opened a new route for foreign capital into these economies. Nonetheless, his comments reflect an openness on the part of the Federal Reserve in 1984 to new developments such as the secondary market in debt. [209]

For the next few years, the relevant US regulatory environment remained unchanged. The Federal Reserve Board and the Comptroller of the Currency regularly conduct all of their investigations into bank activity in the strictest confidence[210] so it is not known whether either of these bodies were overseeing the market. However, there is no record of any official investigation into the market and no apparent modification of market practices which might have occurred in response to an investigation. [211]

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207 *Fed Likes Secondary Market for LDC Debt*, AM. BANKER, Jan 12, 1984, at 2.

208 *Id.*

209 This was an openness to new developments such as this market. There is no evidence the Federal Reserve approved, or was even aware, of current trading practices in the market. Contrast the approach, seven years later of Gerald Corrigan, President of the New York Federal Reserve Bank, in text accompanying notes 42 & 51.

210 The author's enquiries of officers within the Federal Reserve who it was suggested had been involved in investigations into this market in the early 1990s were always met with a curt 'No comment' or a profession of (unlikely) ignorance.

211 Some of the regulators, however, were at least keeping an interested and astute eye on developments. The Office of the Comptroller of the Currency was well informed about the

In 1990 a new regulatory concern emerged -- the market was accused, accurately, of aiding the infringement of local tax and currency regulations in Mexico and Chile.[212]

Infringement of Local Regulations

Complaints were made by the Mexican and Chilean governments to the US government that secondary market traders were aiding and abetting the infringement by local companies of the foreign exchange and tax laws by enabling their participation in round-tripping transactions.[213] In a round tripping transaction an investor, having brought foreign funds into a country under some advantageous investment promotion scheme, proceeds to take them back offshore and recycle them a second time through the investment promotion scheme thus securing, two or more times, inducements intended to be available only once.

Mexico complained that companies and individuals were failing to report as income profits earned on secondary market buybacks of their own debt or were repaying obligations under the Ficorca programme (a scheme to permit peso repayment of foreign denominated loans) by improper means. While there were various abuses of the local currency and Ficorca regulations, the Mexican authorities, as is often the case, found prosecutions for tax evasion the simplest and most effective means of enforcement.[214]

The Chilean authorities had chosen to ignore these schemes for some time, believing they served some of Chile's goals. Their complaints now were not of routine round tripping transactions, but of a series of particularly nefarious transactions in which round tripping was used to defraud the debt-equity conversion scheme. Foreign investors (usually fronting for a Chilean national) would acquire debt and submit it for conversion into equity. Under the debt-equity conversion guidelines, the converted funds could only be used for investment into the nominated, government-approved project. However, in these cases, the funds never reached the project and, often, the

market as the insightful addresses in 1987 of the Comptroller and Deputy Comptroller to various conferences and congressional subcommittees bear out. *See* Statement of C.T. Conover, Comptroller of the Currency, before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, Washington, DC April 21, 1983, (1983) O.C.C.Q.J. 17; and the remarks of Robert R Bench, Deputy Comptroller of the Currency, to a Heritage Foundation conference on Debt/Equity Conversion on January 21, 1987 (op cit at 60 et seq); to the Euromoney Debt/Equity Conference on March 12, 1987 (Robert R Bench, "The Regulatory Environment for Debt-Equity Swaps", Vol 6 No 2 OCCQJ (June 1987) 17); and his remarks before the Senate Subcommittee on International Finance and Monetary Policy of the Committee on Banking, Housing and Urban Affairs, Washington, DC, April 2, 1987 (Robert R Bench, Vol 6 No 2 OCCQJ (June 1987) 21).)

212 These concerns are from Murphy, *supra* note 40.

213 YY Interview, *supra* note 87.

214 Mike Zellner, *No More Mr. Nice Guy*, 20 *LatinFinance* 46 (1990). For more on these manipulations of the Ficorca programme, *see* Martin Schubert, *The Mexican Debt Crisis and Debt/Equity Conversions - One Year Later*, An address delivered at the XLIII Annual Plenary Meeting of the Mexico - U.S. Business Committee, New Orleans, November 4-7, 1987, 24-25 (copy on file with author); Truell, *supra* note 72.

entire proposed investment was fictitious. Instead, the proceeds of the debt-equity conversion were converted into foreign currency and removed from Chile. These round-tripping transactions had an enormous potential for profit, limited only by the amount of foreign exchange that could be assembled and the number of times it could be brought into the country and repatriated abroad again. They amounted to straight theft from the Chilean government. A major U.S. money centre bank was involved in many of these debt-equity round tripping transactions. Although the resulting scandal was able to be suppressed, the Chilean government was nonetheless furious when it learned of these schemes.[215] It reportedly came close to banning the bank from doing business in Chile as punishment, but instead the bank agreed to fire its three most senior officers in Chile and to pay a fine in the order of $20 million.[216]

US Regulatory Efforts

By 1991, US regulators were starting to look at the market. In December 1991, E. Gerald Corrigan, President of the Federal Reserve Bank of New York, issued a stern warning: "He made it clear that either the market gets and keeps its house in order or outside regulators will ... [He also] promised more detailed audits of loan transactions."[217]

The intensive audits had been commenced some two months earlier.[218] The initial audits were of money-centre banks in New York and some foreign banks such as NMB and Bank of Tokyo. They were conducted jointly by the Federal Reserve Board and some regional Federal Reserve Banks. The audits were described by the Federal Reserve Bank of New York as "rigorous" and designed to ensure "the tightest possible controls".[219] The industry agreed: a senior banking lawyer described the audits in early 1992 as "truly horrendous".[220] These "target surveys" and focused audits of early 1992 were not one-off events. The New York Federal Reserve and the Office of the Comptroller of the Currency thereafter examined the emerging markets trading desks under their respective supervision as part of their annual examinations of those banks.[221] This ongoing regulatory supervision, while not as thorough as the focused audits of early 1992, did much to stimulate changes in the trading culture.[222] As one

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215 YY Interview, *supra* note 87.
216 *Id.*
217 *Corrigan is Watching*, 34 LATINFINANCE 43 (1992). *See also* Richard Voorhees, *Asking for It*, 43 LATINFINANCE 9 (1992); *LDC Debt Traders Group: Corrigan hands out a warning*, 909 INT'L FIN. REV. 24 (1991). Corrigan had apparently been stimulated to act by the reporting of market abuses by Peter Truell in *The Wall Street Journal*. *See* Link Interview, *supra* note 37.
218 James R Krause, *Fed Probes Third World Debt Trades At Top Banks*, AM. BANKER, Jan 17, 1992, at 1.
219 *Id.* Contrast the regulatory regime for stock exchange specialists which imposes upon them a raft of special regulations and enforces these through random detailed one-week inspections of each specialists' activities and books. These random inspections are conducted by the exchanges about eight times each year. *See* HAZEN, *supra* note 7 at 534-35.
220 Link Interview, *supra* note 7.
221 Buchheit Interview, *supra* note 16.
222 Chamberlin Interview, *supra* note 95.

senior market source put it in 1994, "The snooping of the Fed has caused them to find religion".[223]

The audits had apparently been prompted by complaints from some debtor nation's governments and some debt traders that traders were engaged in unfair market practices. In particular, some Latin American governments alleged that "banks involved in restructuring their countries' foreign debts had profited from inside knowledge by buying securities then reselling them to investors at a higher price".[224] The Brazilian collapse in October 1991 had also troubled regulators.

In early 1992 Corrigan[225] thumped his fists on the table in a private meeting with emerging markets traders as he emphasised the need for proper standards in trading.[226] Traders present at the time have reported that Corrigan's speech "scared the s **..** t out of a lot of people".[227] There were calls in the press at this time for formal regulation of the market by the Federal Reserve.[228] Corrigan's withering blast stimulated some serious rethinking about market practices in at least some of the major trading units.[229] In general the market appeared to take his warnings seriously, with many trading units reportedly commencing staff education programmes.[230]

In January 1992 at Corrigan's suggestion,[231] the Emerging Markets Traders Association had begun work on its code of conduct. Notwithstanding the audits and exhortations, the voluntary code of conduct was formulated by EMTA at a leisurely pace. A draft code of conduct was released in June, 1992[232] and the final form not approved by EMTA's Board until June, 1993.[233]

In November 1992 a small investment house wrote to the Federal Reserve Bank of New York requesting an investigation of the market. The chairman of the investment

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[223] YY Interview, *supra* note 87.

[224] Krause, *supra* note 230.

[225] Corrigan was, by now, also the new Chairman of the Basle Committee of Banking Supervisors.

[226] *Corrigan Issues Regulatory Threats Over Swaps, LDC Debt Markets*, Vol 2 No 6 THOMSON'S INT'L BANKING REGULATOR, Feb 17, 1992.

[227] YY Interview, *supra* note 87.

[228] Kleiman, *supra* note 86. While the New York Federal Reserve sent a letter to CEOs of New York based banks on March 20 registering concern over certain trading activities, the Federal Reserve did not appear particularly interested in taking on the formal regulation of the market. On the first point, *see* Mary Ambrosio, *Guidelines for Trading LDC Debt Should Be Issued this Summer*, Vol 2 No 4 THOMSON'S INT'L BANKING REGULATOR, June 22, 1992. There were unconfirmed rumours that the LDC debt market was being used for the laundering of drug proceeds: Henry Tricks, *Budding LDC Debt Market Seen Ripe for Regulation*, REUTERS, June 8, 1992, citing Scott MacDonald, of the Office of the Comptroller of the Currency.

[229] Link Interview, *supra* note 37.

[230] Chamberlin Interview, *supra* note 95.

[231] *Emerging Markets Traders Association Issues Voluntary Code of Conduct*, *supra* note 88.

[232] Tricks, *supra* note 240.

[233] *See* EMTA BULL. July/August, 1993, at 1 (copy on file with author). *See also Emerging Markets Traders Association Issues Voluntary Code of Conduct*, *supra* note 88; *cf.* Ambrosio, *supra* note 240. *See also* Michael M Chamberlin, *Regulating the Emerging Markets Trading Industry* (July 13, 1994) (draft paper, copy on file with author).

house alleged that in November there was a concerted effort by the major traders to drive down debt prices.[234] But the Federal Reserve was not eager to undertake further formal supervision of the market. Its response was that EMTA's voluntary code of conduct was a 'constructive approach' and that it would continue to supervise banks participating in LDC debt but only on an individual basis.[235]

The Absence of External Regulation

The history of external regulation of this market was well put by a partner at a leading Wall Street law firm in 1993: "To the extent securities are involved, SEC Rule[s] ... apply; but if securities are not involved there's nothing. To date, caveat emptor has been the standard".[236] Certainly, until the end of 1991, external regulators largely ignored this market and overall there was little effective external regulation until the market evolved into a securities market.

There were a number of reasons for this inaction of regulators.[237] Probably the major one was overwork. The Securities and Exchange Commission (the "SEC"), the Federal Reserve Bank system and the Office of the Comptroller of the Currency (the "OCC"), like most regulatory bodies, have relatively modest resources to stretch over many functions. In the early 1990s, in addition to their demanding routine functions, the regulatory agencies had to respond to the massive Savings & Loans crisis,[238] the relaxation of the Glass-Steagall regime,[239] the lifting of some restrictions on inter-state banking, and the regulatory revisions to accommodate Brady bonds. This was an extraordinary workload. None of the regulators appeared keen to add to this workload the difficult task of regulating this market.

A second reason for the regulatory lethargy was that banking regulators are in the business of protecting the deposits of the public and maintaining the stability of the system. Accordingly, trading practices are not traditionally high on their agenda

[234] Voorhees, *supra* note 229. Other sources have identified the trading house as Eurinam, and thus the chairman in question as Martin Schubert.
[235] *Id.*
[236] Murphy, *supra* note 40 at 49.
[237] Regulatory initiatives of a general kind to control the debt crisis and ensure the survival of the financial system in the 1980s are beyond the scope of this work. However, there are parallels with the regulation of this market. The regulation of the debt crisis was characterised by inaction and promising proposals never implemented. *See generally* Lee C Buchheit, *Alternative Techniques in Sovereign Debt Restructuring*, 1988 U. ILL. L. REV. 371, 379-380; Monteagudo, *The Debt Problem: The Baker Plan and the Brady Initiative: A Latin American Perspective*, 28 INT'L LAW. 59, 65-66, 77-78 (1994); and Statement of Allan Mendelowitz of the US Accounting Office before the Subcommittee on International Development, Finance, Trade and Monetary Policy of the Committee on Banking, Finance and Urban Affairs, 101st Congress, 1st session, 1989, 67 at 77. In short, the topic of the creation, carrying and subsequent trading of LDC debt had a long history of being put in the 'too-hard' baskets of regulators.
[238] Murphy, *supra* note 40 at 49.
[239] *Id.*

unless such practices threaten a bank's soundness[240] which was not the case with emerging markets loan trading[241]. The Securities and Exchange Commission is in the business of maintaining fair and efficient securities markets, so trading practices are very much on their agenda. However, the SEC's jurisdiction runs only to the regulation of securities and LDC loans were never considered securities.[242] Accordingly, before the securitisation of the loans into Brady bonds, loan trading fell through a gap in the regulatory regime.[243]

A third reason the regulators may have largely ignored this market is that, as an essentially private market for sophisticated participants, it did not call for regulation as strongly as does a public market.[244] The strength of this argument declined during the early 1990s as banks in ever greater numbers promoted emerging markets debt to wealthy individuals as an attractive high-yield investment.[245]

The fourth reason for regulatory inaction may have been the expectation that the workings of the Brady Plan would in time solve the regulatory dilemma. As the loans became bonds, and thus securities, the debt trading units which traded them needed to be registered as broker-dealers[246] with the SEC under section 15(a) of the Securities Exchange Act of 1934.[247] As efficiency required that the trading of Brady bonds and unsecuritised loans be carried out in the same units, the development of the Brady process carried within it a regulatory requirement for the entire market. In the early 1990s securities regulators may have been content to sit back and wait, in anticipation that time and the Brady process would bring the market under their purview.[248]

The fifth and final reason for this regulatory inaction was the divided regulatory regime. Debt trading units in commercial banks and investment banks perform identical functions, yet the former answer primarily to the Federal Reserve system and the latter to the SEC. This division of responsibility certainly complicated regulatory

[240] *Emerging Markets Traders Association Issues Voluntary Code of Conduct*, *supra* note 88. *See also* Zornow & Obermaier, *supra* note 76.

[241] While the debt crisis shook the international financial system to its core, the subsequent trading in the debt has had no similar effects.

[242] *Emerging Markets Traders Association Issues Voluntary Code of Conduct*, *supra* note 88.

[243] Kelley Holland, *The LDC Debt Market: It's a Jungle Out There*, BUS. WK., March 15, 1993, at 86.

[244] In the words of Alex Rodzianko, "In theory, there's no need for a policing function in a private market, as there would be in a public market", quoted in Murphy, *supra* note 40 at 49.

[245] In the words of a market observer:, "With mainline banks like J.P. Morgan actively promoting the sale of Latin debt as high-yield investment securities, the LDC market is no longer an interbank affair", quoted in Murphy, *supra* note 40.

[246] A "broker" is defined in the 1934 Act to include any person, other than a bank, in the business of buying and selling securities for others: 15 U.S.C.A. § 78c(a)(4). *See* HAZEN, , *supra* note 7 at 511. A "dealer" is defined in the 1934 Act to include any person, other than a bank, in the business of buying or selling securities for his or her own account: 15 U.S.C.A. § 78c(a)(5). *See* HAZEN, *supra* note 7 at 511. Banks may now fall within these definitions in some situations, *see* HAZEN, , *supra* note 7 at 513-34.

[247] Section 15(a) requires registration of all broker-dealers who are engaged in business involving securities transactions. *See* Steven Murphy, *Moving Up*, 25 LATINFINANCE 55 (1991). S*ee generally*, HAZEN, *supra* note 7 at 494 *et seq*.

[248] The credibility of this perspective depends upon one's view of the foresight of regulators.

initiatives and contributed to the inaction of regulators. Its impact will be considered further.

The Divided Regulatory Regime

The US bank regulatory regime is complex. There are three principal regulatory agencies: the Federal Reserve system, the SEC and the Office of the Comptroller of the Currency (OCC). In 1933 the Glass-Steagall Act[249] separated the banking and underwriting functions and restricted commercial banks to the former and investment banks to the latter.[250] The Federal Reserve System has primary oversight of commercial banks and the SEC of investment banks and securities dealers.

Commercial Bank Regulation

The Board of Governors of the Federal Reserve and the regional Federal Reserve Banks[251] administer a raft of banking legislation. The OCC, an agency within the US Treasury Department, serves as a second bank regulator. The principal concern of the Federal Reserve and the OCC is the safety and soundness of the banking system as a whole and the consequent protection of public deposits.[252] Regulation is further complicated by the existence of national chartered and state chartered commercial banks. National chartered banks are supervised by the Federal Reserve and the OCC. Those state chartered banks which are members of the Federal Reserve System are supervised by the Federal Reserve and the relevant state agency. Non-member state chartered banks are supervised by the relevant state agency and, if they have obtained federal deposit insurance, by the Federal Deposit Insurance Corporation.[253] Finally, federally licensed branches of foreign banks in the US and branches and affiliates of US national banks abroad are supervised by the OCC.[254]

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[249] As is customary with U.S. legislation, this Act is commonly referred to by the names of the members of Congress who put it forward. Its central provisions are to be found in sections 16, 20, 21 and 32 of the Banking Act of 1933. Section 16 prohibits national banks from dealing and underwriting securities, sec. 20 prohibits affiliates of banks from being principally engaged in issuing, underwriting or publicly selling securities; sec. 21 prohibits securities firms from taking deposits; and sec. 32 prohibits individuals in the securities business from serving as directors, officers or employees of a bank.

[250] After the Crash of 1929, U.S. regulators came to the view that the separation of underwriting from deposit taking would insulate deposit taking institutions from undue risk and lead to a more stable system.

[251] The Federal Reserve System is comprised of 12 banks and 25 branches.

[252] Holland, *supra* note 255 at 86; Zornow & Obermaier, , *supra* note 76. In the words of Richard Breeden, Chairman of the SEC, "We have to be terribly, terribly sensitive to the fact that we are entrusted at the public level with responsibility for promoting the stability of the market and the safety of the public's funds, whether they are in a bank, a securities firm, a commodities firm or an insurance company, and there is an economic and macroeconomic purpose that is very important to protecting that stability". *See Administrative Conference of the United States Colloquy: Globalization of Securities and Financial Market Regulation in the 1990s*, 10 ANN. REV. BANKING L. 365 (1991).

[253] R.M. PECCHIOLI, PRUDENTIAL SUPERVISION IN BANKING 156 (1987).

[254] *Id.*

Securities Regulation

The SEC is responsible for administering the Securities Act of 1933 and the Securities Exchange Act of 1934 which govern the issuance, distribution and trading of securities.[255] The regulatory schema is further complicated by the role of the National Association of Securities Dealers (the NASD) and the stock exchanges. The SEC has authority to regulate broker-dealers directly but in practice delegates the great bulk of day-to-day regulation to the NASD (the largest self-regulatory organisation subject to SEC oversight).[256] Likewise, the SEC exercises most of its control of stock exchange activity indirectly through its supervision of the self-regulatory rules and conduct of the various stock exchange bodies.[257]

This complex web of regulators and regulation is not suited to the control of a rapidly growing and changing new market. If one includes the self-regulatory organisations such as the NASD, the stock exchanges, and the Emerging Markets Traders Association, there are six bodies with varying degrees of potential regulatory oversight of this market. The US securities regulatory regime has been subject to strident criticism and to calls for its complete restructure.[258] Certainly the high number of potential regulators of the emerging markets loan market served to make its external regulation more difficult. The next section considers the alternative to external regulation.

Self Regulation

By 1990 this market had grown in size and sophistication to the point where a degree of centralised regulation would promote efficiency. The market had not yet evolved into a securities market and there was little effective external regulation. The need was for a self-regulatory organisation.

The Emerging Markets Traders Association (EMTA) was born into, and partly because of, this regulatory vacuum. It is considered here because its activities were principally directed towards the self-regulation of the market, in the sense of rationalising and standardising market practices, improving the conduct of traders and generally promoting the efficiency and transparency of the market.

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[255] *See generally* HAZEN, *supra* note 7 at 254.
[256] *Id.* at 499.
[257] *Id.* at 499-503.
[258] One proposal is for one single standard-setting organisation with a separate enforcement agency. (See the comments of Judge Stanley Sporkin in *Administrative Conference of the United States Colloquy: Globalization of Securities and Financial Market Regulation in the 1990s*, 10 ANN. REV. BANKING L. 345, 348 (1991). The proposal of the Chicago Mercantile Exchange calls for one cabinet level department, the Federal Financial Regulatory Service, with eight divisions created along functional lines -- so that all activity of the one type is regulated by the one division. *See* Michael H Moskow, "Rethinking Bank Regulation in an Era of Change", A paper presented at a Conference: Positioning Financial Institutions for Turbulent Times, May 31, 1996, 1-6.

EMTA is a not-for-profit service organisation,[259] headquartered in New York City. Its Mission Statement recites that it is "dedicated to promoting the orderly development of a fair, efficient and transparent trading market for Emerging Markets instruments and to supporting the globalization and integration of the emerging capital markets".[260] In late 1990 eleven major trading houses[261] decided to form the LDC Debt Traders Association, with the declared purpose of concentrating on the standardisation of procedures and documentation.[262] In mid-1992 it changed its name to the Emerging Markets Traders Association.[263] By the end of 1993, EMTA had grown to 118 members;[264] and by March 1997, to approximately 168 members, of which 65 were full members actively engaged in trading emerging markets instruments.[265] EMTA had 13 full-time professional staff in 1993, and 15 in 1996.[266] Together with support staff they were based in an office on Wall Street.

The founding Chairman, Nicolas Rohatyn, was at pains to stress in an early interview in 1991 that "[t]his is in no way, shape or form a self-regulatory organization".[267] Indeed, so vehement were the denials by Rohatyn and others[268] of any self-regulatory aspect to the Association, the text of the interview brings to mind Shakespeare's immortal aphorism, "[he] doth protest too much, methinks".[269]

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[259] EMTA is exempt from federal income tax under sec. 501(c)(6) of the Internal Revenue Code and from state and local taxes under similar provisions of state and local tax laws: Emerging Markets Traders Association, 1993 ANNUAL REPORT, at 20 (copy on file with author).

[260] Mission Statement reproduced on inside front cover of Emerging Markets Traders Association, 1993 ANNUAL REPORT.

[261] Michael M. Chamberlin, *Regulating the LDC debt markets*, INT'L FIN L. REV., August 1992, at 16.

[262] *Dead Credits Society*, 24 LATINFINANCE 8 (1991). The initial officers of the Association were: Nicolas Rohatyn (JP Morgan) chairman, Stephen Dizard (Salomons) and Peter Geraghty (NMB) vice chairmen, Kathy Galbraith (Chase Manhattan) treasurer, and Alex Rodzianko (Manufacturers Hanover) secretary, *see id*. The Mission Statement of the Association states that it is a "not-for-profit corporation dedicated to promoting the orderly development of a fair, efficient and transparent trading market for Emerging Markets instruments and to supporting the globalization and integration of the emerging capital markets" (Taken from the inside front cover of EMTA's first Annual Report, *see* Emerging Markets Traders Association, 1993 ANNUAL REPORT.

[263] This name change was in line with the general change in name for the LDC debt market.

[264] *Id.* at 14.

[265] Emerging Markets Trading Association, 1996 ANNUAL REPORT, 6.

[266] Emerging Markets Trading Association, 1993 ANNUAL REPORT, 5; and Emerging Markets Trading Association, 1996 ANNUAL REPORT, 30.

[267] *The Breakfast Club*, 25 LATINFINANCE 63 (1991).

[268] Hugo Verdegaal, a member of the LDC Debt Traders Association, was asked in the interview, "Isn't there an element of self-regulation here, in the sense that you are making market practices more uniform?" His reply: "I would say no -- not in the way you do business in a day to day basis, or in the way it relates to the laws and regulations of the country in which you are operating". Yet the professed aim of the Association, given by Nicolas Rohatyn in answer to the preceding question, was to make the trading in loans and bonds more simple, smooth and efficient by agreeing on various market practices, which definitely impacts on the way business is done day-to-day.

[269] WILLIAM SHAKESPEARE, HAMLET, act 2, sc. 2. Some commentators believe that EMTA was formed in response to pressure from the Federal Reserve Bank of New York, see on this point

In 1990, with the advent of Brady bonds and the explosion in the market's size, there were good reasons to form an Association to seek to standardise market practices and thereby render the market more efficient. Likewise, there were good reasons to form an Association to play a self-regulatory role and to serve as a unified industry voice, both of which might tend to resist outside regulation of this market. In this writer's view, EMTA was formed in part as the industry's response to fears of external regulation.[270] In any event, whether the Association was founded with a self-regulatory intent or not; by the beginning of 1992, only ten months after the interview mentioned above, the Association was engaged in preparing a code of conduct for the industry.[271]

EMTA's Self-regulatory Efforts

EMTA provided a forum for market participants to discuss and explore issues of common interest through specialised committees and working groups, most of which met monthly. The Market Practices Committee was the hub of EMTA's work and the most significant committee. It met monthly to develop and recognise market practices. At the request of one or more members it would consider an existing or proposed market practice, either in the monthly open forum meeting or in a closed session. Recommended market practices would be proposed at the monthly open-forum meeting and adopted at the next open-forum meeting, unless significant comments or objections were received. Upon adoption, each market practice, any associated recommended legal documentation and a recommendation from EMTA as to the use of the practice and documentation, would be distributed to all members.[272]

EMTA's first project was to prepare some much-needed standard confirmations. In early 1991, the Association drafted a set of twelve confirmations to cover each category of trade of Mexico's Brady bonds, a standard confirmation for trading loans and three standard interest payment reconciliation clauses for inclusion in assignment agreements.[273] The Association also promulgated eight Market Practices covering

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and on earlier ideas for a traders' association. *See The Making of a Market*, INSTITUTIONAL INVESTOR, April 1994, at 66. Certainly, EMTA's work on a Code of Conduct for the Market was undertaken at the behest of the Federal Reserve Bank of New York.

[270] The Federal Reserve Board reportedly conducted a short-lived examination of the market in 1990. *See* Peter Truell, *Fed Is Investigating Trading Practices in Market for Developing-Country Debt*, WALL ST. J., Feb 19, 1993, at A3. In the semi-annual *LatinFinance* survey of LDC debt traders published in March 1991, three out of four respondents expected additional scrutiny of the market in the future by the US government because of the growing business in Brady bonds and the growth of the market for non-bank investors. *See* Murphy, *supra* note 259 at 65. In mid-1990 articles began to appear in newspapers and journals raising the spectre, from the trader's perspective, of a pressing need for external regulation. See Truell, *supra* note 72, and Truell, *supra* note 162, in which Truell wrote: "the Federal Reserve is looking into some suspected irregularities and improprieties in the so-called secondary loan market". *See also* Murphy, *supra* note 40.

[271] Memorandum to Members, Emerging Markets Traders Association (Sept 30, 1992) which states on p2: "For the past nine months, the Board has been working with the Association's legal counsel to develop a Code of Conduct ..." (copy on file with author).

[272] *Id.*

[273] Bruce Wolfson, *Paving the Paper Trail*, 26 LATINFINANCE 49, 51 (1991).

matters such as bond settlement practices, the timing of confirmations, and the standard settlement period for generic loans assets.[274] In mid-1992 the Association proposed recommended trading practices for the Argentine Brady-style restructuring, including treatment of accrued but unpaid interest[275] and treatment of the when-issued trades of Brady bonds.[276] Amended and updated versions of these practices were promulgated throughout the balance of 1992 and into 1993 as the Argentine restructuring lumbered towards completion.[277] Similar issues were also addressed by EMTA for the Brazilian Brady-style restructuring.[278] In 1993, EMTA promulgated a general trading practice regarding the treatment of interest and principal payments made between the trade date and the settlement date[279] and suggested market practices for options transactions.[280] By the end of 1993 EMTA had also drafted standard confirmations for each category of Brady bonds as issued by each new issuer, standard terms for options, a bilateral netting agreement and trading forms for when-issued trading of Brady bonds.[281]

Throughout the succeeding years, EMTA continued to recommended market practices on a host of matters.[282] Among the more significant were (i) the reduction of the

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[274] Memorandum entitled "Market Practices Approved to Date - Bulletin #1" from Nicolas S Rohatyn, Chairman, LDC Debt Traders Association, to Members (June 27, 1991) (copy on file with author). The practices specified included the following: (i) confirmations to be sent by seller within 24 hours of trade date; (ii) execution of confirmations by buyer not necessary unless otherwise agreed or required by law; (iii) standard settlement period for loan assets to be three weeks from trade date; (iv) for bond sales, instructions to be submitted to appropriate clearing house within 48 hours of the verbal agreement on the trade; (v) the relevant default interest rate to be paid by a non-settling bond buyer to the seller is the Euroclear Overdraft Rate; (vi) a non-settling bond seller should pay compensation to the buyer for damages occurred, with compensation claims to be filed within 30 days of actual settlement; and (vii) for loans, the counterparty obliged to pay over interest amounts should do so promptly, irrespective of whether it has received the interest, provided: (a) such interest has in fact been paid by the agent or servicing bank; and (b) the parties are able to verify where in the assignment chain such interest was paid.

[275] Memorandum entitled "Recommended treatment of interest on interest for Argentina medium-term debt" (June 17, 1992) (copy on file with author).

[276] Including the final trading date, expiry date, netting procedures, pricing of accrued interest and the like for when-issued trades. Memorandum entitled "Recommended Trading Practices Argentina 1992 Financing Plan" (July 16, 1992) (copy on file with author).

[277] Memorandum entitled "Recommended trading practice concerning pricing of accrued but unpaid interest on debt to be exchanged for bonds under the Argentina 1992 financing plan" (September 1992); Memorandum entitled "Market practice concerning issuance of Argentina Brady bonds into escrow" (February 1993) (copies on file with author).

[278] Memorandum entitled "Recommended trading practice concerning settlement of when-issued trades of bonds to be issued under Brazil's 1989/1990 interest arrangements" (October 1992); and Memorandum entitled "Recommended trading practice concerning settlement of when-issued trades of bonds to be issued on the first exchange date under Brazil's 1989/1990 interest arrangements" (November 18, 1992) (copy on file).

[279] Memorandum entitled "Recommended trading practice concerning certain payments made between trade date and settlement date for loan sales" (January 1993).

[280] Draft memorandum entitled "Market Practices for Options" (February 12, 1993) (copy on file with author).

[281] Chamberlin, *supra* note 243 at 3.

[282] See the quarterly Bulletins issued by EMTA, of which virtually every one from 1994 onwards identifies at least one new market practice recommended by the Association.

settlement period for Brady bonds from trade date plus 7 calendar days (T+7) to trade date plus 3 business days (T+3) after June 1, 1995 (to conform to the new standard for international securities);[283] and (ii) the reduction of the settlement period for loans from trade date plus 21 calendar days (T+21) to trade date plus ten business days (T+10) from January 1, 1996.[284]

By the end of the extraordinary bull market of 1993, the backlogs in the processing of loan trades by the back offices of trading units and by the agent banks for the loans had become so large as to threaten to paralyse loan trading.[285] Many trades from 1993 remained unprocessed in mid-1994. Loans had simply never been designed to be traded and the turnover of 1993 and 1994 overtaxed the resources of the trading houses and agent banks alike.[286] EMTA responded to these problems in two ways. First, and most significantly, EMTA began to develop a multilateral netting facility to speed processing of trades by the back offices of the trading houses and to ensure that only the net change in the trading position had to be reported to the agent banks. The first netting was of Russian loans in July 1994[287] and by April, 1995, 1,400 trades of Russian and Peruvian loans with a face value in excess of $3 billion had been netted and settled.[288] Secondly, to ensure future backlogs did not accumulate, EMTA prepared a set of standard terms for loan sales which came into use in late 1994.[289] The standard terms were designed to be incorporated by reference into trade confirmations, for which standard forms were also provided,[290] and served to standardise and simplify the processing of loan trades. Over time further sets of standard terms, tailored to the loans of particular countries, such as Peru, Russia and Yugoslavia, were produced.[291]

In 1995, EMTA took the operational efficiency of the market to a new level with the introduction of Match-EM, an automated trade confirmation and matching system. Match-EM permitted nearly instantaneous electronic confirmation and matching of trades of loans and Brady bonds, thereby eliminating the risk of errors and other problems between the execution and settlement of trades. Within four months of

283 Emerging Markets Traders Association, BULLETIN, 1995 No. 1, 2nd Quarter, 1995; and EMTA Press Release, "EMTA Recommends Shorter Settlement Period for Brady Bond Trades", May 2, 1995 (copy on file with author).

284 Emerging Markets Traders Association, BULLETIN, 1995 No. 4, 4th Quarter, 1995, 3.

285 Ross Buckley, *The Facilitation of the Brady Plan: Emerging Markets Debt Trading from 1989 to 1993*, FORDHAM INT'L L. J. (forthcoming, May 1988) __ ; and Emerging Markets Traders Association, BULLETIN, 1994 No. 3, July - Sept, 1994, 2.

286 Emerging Markets Traders Association, BULLETIN, 1994 No. 2, April-June, 1994, 2.

287 Emerging Markets Traders Association, BULLETIN, 1994 No. 3, July - Sept, 1994, 2.

288 Emerging Markets Traders Association, 1994 ANNUAL REPORT, 1.

289 Emerging Markets Traders Association, Standard Terms for Assignments of Loan Assets, (copy on file with author). See also Emerging Markets Traders Association, BULLETIN, 1995, No 1, 1st Quarter, 4. These standard terms had been on the drawing board for years, and if EMTA had been more active in its early years, the standard terms would have been in place to ameliorate the backlogs which developed in 1993: *see* Interview with Thomas Winslade, then Executive Director of EMTA, April 23, 1993, in New York City ("Winslade Interview").

290 Emerging Markets Traders Association, BULLETIN, 1994, No 4, Oct-Dec, 1994, 2.

291 Emerging Markets Traders Association, BULLETIN, 1996 No. 3, 3rd Quarter, 1996, 6; and Emerging Markets Traders Association, BULLETIN, 1996 No. 4, 4th Quarter, 1996, 8.

commencement, about one-half of the market, and most brokers, were wired into Match-EM.[292] By year-end, there was a daily average of 1,200 trade inputs being entered into the system with an average matching rate of 92 percent.[293] The implementation of Match-EM allowed EMTA to begin to collect and disseminate more accurate volume and price information on a close to real-time basis.[294]

Emerging Markets Clearing Corporation

In early 1995 the Emerging Markets Traders Association (EMTA) began developing proposals for a clearing corporation that would "accept matched trades of emerging markets debt ... , net aggregate trade positions and issue net delivery and payment instructions to Euroclear and Cedel."[295] The Emerging Markets Clearing Corporation (EMCC) was established in conjunction with, is operated by, the International Securities Clearing Corporation. It is owned by the emerging markets trading industry and the ISSC. The EMCC was originally scheduled for an April, 1997 launch. The launch was postponed three times, principally as a result of delays in receiving SEC approval, and the clearing corporation commenced operation in April, 1998.[296]

The EMCC was primarily established to promote the efficiency and orderly development of the market and to end the over-concentration of counterparty risk in two sets of institutions: the commercial clearers of emerging markets debt, dominated by Daiwa Securities America, and the brokers. Rapid rises in market turnover led to increases in the number of Daiwa's counterparties, exposing the firm to ever higher levels of counterparty risk. Likewise, higher turnover exposes brokers to a greater risk of having, unintentionally, to maintain positions overnight or longer. As all trades between members are guaranteed, and the EMCC is fully collateralised by all members, counterparty risk is massively reduced[297] upon some estimates by up to 75 percent.[298]

Upon its inception in April 1998, EMCC initially provided clearing services for U.S. dollar denominated Brady bonds, with the intention of expanding its services in time to global bonds issued in exchange for Brady bonds, emerging markets eurobonds and, eventually, local market instruments and loans.[299]

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[292] Kilby, *supra* note 57D; and *EMTA -- Moving ahead*, 1112 INT'L FIN. REV., Dec 16, 1995.
[293] Emerging Markets Traders Association, 1995 ANNUAL REPORT, 13.
[294] Emerging Markets Traders Association, 1995 No 1 BULLETIN, 1st Quarter 1995, 6.
[295] Michael Chamberlin, "EMTA offers electronic matching for Brady bonds and loans", *International Financial Law Review*, June 1996, 48 at 50.
[296] "EMCC receives clearance", 1221 IFR, Feb 21, 1998; and "Lift off -- at last", 5 *Emerging Markets Investor*, April 1998, 5.
[297] "Enterprising EMTA", 3 *Emerging Markets Investor*, Sept 1996, 7.
[298] "EMCC receives clearance", 1221 IFR, Feb 21, 1998.
[299] Emerging Markets Traders Association, 1997 No 3, BULLETIN, 3rd Quarter 1997, 5-6.

In summary, Match-EM and the EMCC effect substantial reductions in settlement risk, enable participants to manage their inventories more effectively and greatly enhance the efficiency and transparency of the market.[300]

Other activities of EMTA include providing price and volume information and legal information about the market. In 1992 EMTA instituted an annual trading volume survey to provide basic information about the market (such as its overall size, most heavily traded types of debt and major participants).[301] In time this was supplemented by month-end closing price information and then, in April 1996, through Match-EM, the provision of daily market volume and price data on screens.[302] EMTA also commissioned a number of surveys of legal requirements in local emerging markets jurisdictions by preparing questionnaires for local counsel on matters such as securities, derivatives, and foreign exchange regulations.[303] Most of these initiatives would have been beyond the capacity or means of any one trading house[304] and were significant steps in the maturation of the market.

Throughout its existence EMTA's primary focus has been on improving the risk management, efficiency and transparency of the market. Risk management was enhanced by the survey of local legal requirements and by developments such as standardised confirmations, multilateral netting, Match-EM and the Emerging Markets Clearing Corporation which promoted the early settlement of transactions. Efficiency was enhanced by such developments as well as by the issuance of innumerable market practices and the promulgation of standard terms for loan sales. Transparency was promoted by producing the annual volume survey, and by providing daily price and volume information.

EMTA's other focus has been on improving the conduct of market participants.

EMTA's Code of Conduct

EMTA's Code of Conduct serves an important self-regulatory role. It is not legally binding on members[305] and the sanctions for non-compliance are only the disapproval of other members and potential exclusion from the Association. The Code is often given more force within institutions, however, by either being expressly incorporated into the in-house trading guidelines or forming the basis of those guidelines. The

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[300] Emerging Markets Traders Association, 1994 ANNUAL REPORT, 9.

[301] Emerging Markets Traders Association, 1992 TRADING VOLUME SURVEY, September 15, 1993.

[302] Emerging Markets Traders Association, BULLETIN, 1996 No. 3, 3rd Quarter, 1996, 4.

[303] *Id.* and Emerging Markets Traders Association, BULLETIN, 1997 No. 2, 2nd Quarter, 1997, 6.

[304] Emerging Markets Traders Association, BULLETIN, 1996 No. 3, 3rd Quarter, 1996, 4.

[305] Provision A(1)(c) of the Code provides that "[t]he Association is a voluntary trade association that does not have any formal rulemaking or enforcement powers. Accordingly, neither this Code nor the Market Practices recognized from time to time by the Association are legally binding on its Members or have the force of law. Nevertheless, in the interest of a fair and efficient market, all Members are expected to use their best efforts to comply with the letter and spirit of this Code ..."

Code has been well received by market participants and their primary regulators and supervisors[306] and is widely observed throughout the market.[307] Compliance with the Code of Conduct is to some extent driven by the long-term self-interest of market participants. As the Executive Director of EMTA wrote in mid-1994,

> The long-term success of the code will in large part depend upon whether it is widely perceived by market participants (and their regulators) to respond to the LDC debt market's need for greater efficiency and professionalism. If the Code is not perceived as successful, the various banking and securities regulators can be expected to act as they deem necessary to ensure that the trading market for Emerging Markets Instruments is both orderly and fair.[308]

The Code is broad ranging. It applies to the trading of all Emerging Markets instruments; defined widely as loans, bonds and equities issued or guaranteed by public or private sector entities located in non-OECD countries.[309] The Code expressly does not apply to trading in local markets in these countries, as this is properly the subject of local regulation and market practices.[310] Emerging markets trading houses come from many different countries and may be subject to the diverse legal and regulatory regimes of their home jurisdiction and the various jurisdictions in which they conduct business.[311] To accommodate this diversity, many provisions of the Code are general in nature and, in some areas, the Code merely encourages each EMTA member to develop, implement and enforce its own internal policies and procedures.[312] The Code is designed to supplement other regulatory regimes to which the trading house may be subject.[313]

The Code includes general policy provisions on matters such as financial responsibility, inside information, conflicts of interest, back-office support, recordkeeping, control mechanisms and the like. In addition, the Code specifies detailed procedures on matters such as the firmness of price quotations, the binding nature of oral trades, trade confirmations, settlement instructions and preparation of legal documentation.[314] In particular, the Code addresses the following issues:

Clarity of Role: "Each member should ensure that its identity and the capacity in which it is acting ... are clear to its counterparties".[315]

Trading Policies: The Code calls for (i) adequate supervision and training of traders; (ii) disclosure of information so that misrepresentations (whether by words or

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306 Chamberlin, *supra* note 243 at 6.
307 *Introduction to EMTA and the Emerging Markets*, EMTA MANUAL, Part 1 (June 1, 1995).
308 Chamberlin, *supra* note 243 at 6.
309 Schedule A of the Code; Chamberlin, *supra* note 243 at 5.
310 Chamberlin, *supra* note 273.
311 Chamberlin, *supra* note 245 at 3.
312 *Id.* at 5.
313 *Id.* at 4. The Code does not have the standing to supersede other regulatory regimes.
314 *Id.* at notes 12 & 13 on pp. 10-11. See also the summary of the Code's provisions in *Zornow & Obermaier*, *supra* note 76.
315 Provision B(1) of the Code.

silence) are avoided; (iii) preservation of customer confidentiality; (iv) appropriate policies and controls to ensure that each member's trading activities do not knowingly conceal or facilitate fraud or other improper activity, such as money laundering, in any jurisdiction; (v) appropriate internal policies and procedures regarding the trading of Emerging Markets instruments after business hours or off business premises and by traders for their personal account; and (vi) the avoidance of "any trading practices that are intended to manipulate prices".[316]

Inside Information: The Code calls for appropriate internal policies and procedures (which may include restrictions on trading of certain instruments or the implementation of Chinese walls) to prevent the misuse of inside information and any appearance of such misuse.[317]

Back Office Support: In a provision which reflects the back office breakdowns and bottlenecks which accompanied the dramatic growth in this market, "each member is strongly encouraged to ensure that its trading activities are supported by adequate back office personnel".[318]

Control Mechanisms & Risk Management: Members are expected to maintain accurate books and records; to establish and enforce adequate internal control mechanisms to ensure that its internal policies and procedures are observed (such as the segregation of duties, internal audits and the like); and to implement policies to ensure appropriate risk management.

Trading Principles and Procedures for Loans and Brady Bonds: The Code states that the following principles and procedures will apply to the trading of loans and Brady bonds: (i) members are to specify whether quotes are firm or merely indicative, and, if firm, for how long they will be firm (if no such specification of duration is made the quote is only firm for the duration of that conversation); (ii) trades are concluded when price, quantity and other material terms are agreed, whether orally or in writing (subsequent written confirmation merely confirms the oral agreement); (iii) confirmations should be sent by the seller within one working day after the trade, and whenever possible before the close of business on the trade date; (iv) confirmations should substantially conform to the standard forms developed by EMTA and should be sent by fax; and (v) most confirmations do not require countersignature by the buyer unless either party seeks a countersignature, in which case they are entitled to it.[319]

Functions of the Code

The Code of Conduct has three principal functions. First, it can serve as a resource for trading units involved in developing their own policies and procedures for emerging

[316] Provision B(2) of the Code.
[317] Provision B(2)(e) & (f) of the Code; *see Emerging Markets Traders Association Issues Voluntary Code of Conduct*, *supra* note 88.
[318] Provision B(5) of the Code.
[319] These trading principles and procedures are set forth in Schedule B of the Code.

markets trading.[320] Secondly, it can be incorporated into and used as part of a firm's ongoing compliance efforts. Thirdly, it may provide guidelines in settling disputes between traders as to certain trades.[321]

The use of the Code in developing internal policies and controls and in ongoing compliance is given indirect impetus by the provisions of the US Sentencing Guidelines for Organizations.[322] These guidelines govern the sentencing of individuals and corporations for violations of most federal laws, including the securities laws. They require long prison terms and large fines for individuals and restitution and massive fines for firms and corporations.[323] The most effective way a firm can reduce its fines under the Sentencing Guidelines is to put in place an "effective program to prevent and detect violations of law". Various requirements for an effective program are laid down by the Guidelines. A firm which has implemented rigorous internal policies and compliance procedures which comply, as a minimum, with the industry standards, is "in a far better position to argue to the prosecutor that criminal prosecution is unwarranted; and if that fails, such procedures will mitigate its exposure under the [Guidelines] to the fullest extent possible."[324] Under the Guidelines, "industry standards ... play a significant role in determining whether a company's compliance measures are 'effective'".[325] Accordingly, while the Code of Conduct is strictly voluntary, firms will expose themselves to greater sanctions for the misbehaviour of their traders if they fail to implement internal policies and procedures based on, or drawn from, the Code. The prospect of mitigation under the Sentencing Guidelines virtually requires firms to implement the Code.

EMTA as a Self-Regulatory Organisation

Between 1990 and 1993, EMTA worked to establish itself as a self-regulatory organisation on the British model. There were difficulties. New York City is not London and most LDC debt traders had not learned their patterns of behaviour on the playing fields of English public schools. The culture of this market had always had plenty of the Wild West in it and traders had prospered by being quick on the draw. The mythical cowboy does not, of course, take kindly to authority figures; and invariably chooses to ride off into the sunset rather than stay in town and settle down. Perhaps partly for this reason, EMTA was disliked by many in the market in these early years. It was seen to be dominated by the big commercial banks (Morgan Guaranty had after all contributed its founding Chairman in Nicolas Rohatyn and its founding Executive Director in Thomas Winslade) and seen to be unresponsive to the

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320 *Emerging Markets Traders Association Issues Voluntary Code of Conduct*, *supra* note 88.

321 Michael Chamberlin says that EMTA receives calls daily by traders in dispute over a transaction and that by pointing to the Code, EMTA's Market Practices or other external sources of guidance, EMTA is usually able to resolve the dispute (because most traders are willing to abide by recognised market and industry practice). *See* Chamberlin Interview, *supra* note 95.

322 "Crime and Criminal Procedure Sentencing Guidelines for the United States Courts" Ch. 8, Sentencing of Organizations, 18 U.S.C.S. App.

323 Zornow & Obermaier, *supra* note 76.

324 *Id.*

325 *Id.*

quite different interests of investment banks and other trading houses which were not creditors of the debtors.[326] EMTA grew, nonetheless, and appeared to be somewhat responsive to these criticisms. In 1994 there was a new Executive Director in Michael Chamberlin. As a former partner at Shearman & Sterling, Chamberlin came from a position of greater autonomy than the man he replaced and his quiet, firm manner brought the appearance of greater authority and autonomy to the role of Executive Director. In 1995 Alex Rodzianko of Chemical Bank was joined by Peter Geraghty of ING as Co-Chair so that for the first time there was a Chairperson who was not from a major creditor bank to LDCs. EMTA was growing and responding to more of its constituency.

As a self-regulatory organisation (SRO), EMTA offered an advantage to its members, and an advantage to government, relative to the alternative of government regulation. The advantage to its members was that as a SRO it should be more responsive to changes within the market,[327] and its work in issuing market practices on issues such as the "when-issued" trading of Brady bonds bears this out. The advantage to government is that the traders bore the cost of EMTA: $1.5 million in 1993, climbing to $4.5 million in 1996.[328]

However, EMTA is not a true self-regulatory organisation as it has no enforcement powers. Its edicts are not enforceable; its rules able to be broken without legal sanction. EMTA performed many useful functions and made a direct contribution to the maturation of the market in many ways but was destined never to grow into a true SRO. The need for it to do so was waning by the end of 1993. As the loans became bonds under the Brady process, so the trading units became registered broker-dealers and thus subject to the direct oversight of the National Association of Securities Dealers and to the securities laws. In 1994 virtually all banks which had not already transferred their trading operations into their registered broker-dealer division did so. A market which had been effectively unregulated at the end of 1992 was subject to the quite stringent regulation of the NASD, the SEC and the US securities laws by the end of 1994.[329]

Securities Regulation

As the debtors began to return as issuers to the voluntary Eurobond markets[330] and the loans were converted into bonds in the succession of Brady-style restructurings, the traders of these Eurobonds and Brady bonds were subject to the securities regulation regime and had to be registered as broker-dealers. As it was inefficient to have some traders restricted to trading loans only, and because the broker dealer affiliates of banks were the proper place for securities to be traded in a bank under the Glass-

[326] Robyns Interview, *supra* note 184; YY Interview, *supra* note 87.
[327] Tim Herrington & Richard Parlour, *The Regulation of Global Trading and Investment* 1 J. INT'L BANKING L. 9, 11 (1992).
[328] Emerging Markets Traders Association, 1993 ANNUAL REPORT, 17.
[329] Chamberlin Interview, *supra* note 95.
[330] Link Interview, *supra* note 37.

Steagall Act, trading units had to become registered broker-dealers.[331] However, the trading practices of securities brokers were different in many respects from those that had prevailed in this unregulated market, and it required more than the sitting of examinations and being moved into the broker-dealer affiliate of the bank to change the practices of years.[332] Change occurred but it took time.

By mid 1993, JP Morgan and Chemical Bank had moved their emerging markets trading groups into their broker-dealer affiliates in the US and in the balance of 1993 and early 1994 most of the other banks involved in the market followed suit.[333] Registered broker-dealers are subject to the full panoply of SEC and NASD regulation.

Conclusion

The secondary market in emerging markets loans is a rare example of a single, international, over-the-counter financial market.

The market was subject to no effective external regulation (and little self regulation) until it evolved into a securities market. As such, up to 1993, the market was wide open to abuse and manipulation. The actual incidence of these practices is impossible to assess, although the available, scanty evidence suggests these practices were not dramatically more common in this market than in others. As Michael Pettis said in 1993, "Given there was no supervisor, perhaps what is remarkable is not that the market is so dirty, but that it is so clean".[334] Since 1993, the conversion of loans into bonds has brought market participants under the regulation of the U.S. securities laws.

The Emerging Markets Traders Association, after a slow start in the early years of the 1990s, became progressively more active over time. Its production of numerous market practices, standard terms for loan sales, and the Code of Conduct, coupled to its implementation of multilateral netting, Match-EM and the Emerging Markets Clearing Corporation, revolutionised the operation of the market. EMTA's performance from 1995 onwards in improving the risk management, efficiency and transparency of the market has been impressive. While EMTA's performance in its first three years highlights one of the risks of self-regulatory organisations -- a certain somnolence – its recent activities highlight the potential of self-regulatory organisations.

[331] *Id.*
[332] Chamberlin Interview, *supra* note 95.
[333] Winslade Interview, *supra* note 302.
[334] Interview with Michael Pettis, now a Managing Director of Bear Stearns & Co, in New York City, April 24, 1993.