Scandinavian Financial Law

Philip R Wood

1  Introduction  ........................................................................................................... 316
2  What is the Role of Finance?  ............................................................................... 317
3  Jurisdictions of the World and the Scandinavian Group  ......................... 319
4  The Delaware Factor  ........................................................................................ 322
5  Conclusion  ........................................................................................................... 324
1 Introduction

It is a particular privilege to contribute to the 50th anniversary volume of this journal and also to do so round about the time of the seminal inauguration of the Stockholm Centre for Commercial Law. The five Scandinavian countries enjoy colossal international goodwill which is merited.

My field is financial law and, while what I say may have wider application, I will limit myself to this arena.

There is a more important question than “What is Scandinavian law?” This more important question is – “What should Scandinavian law be?”

This second question is particularly germane at the present. This is because of the crescendo in legislative activity in the field of business law over the last five to ten years.


In the field of regulatory law, out of 193 countries in the world, probably at least half of them made major reforms to their financial regulatory regime in the last five years or so. Europe is not the only region which has completely reformulated its regulatory law.

The same is true of private international law where the changes include in Europe the proposals known as Rome I and Rome II and also in Japan a new Code of Private International Law. The Uncitral Model Law on Cross-Border Insolvency has been adopted by many countries.

Some of these changes were useful, some were even necessary, but there are others which were either herd behaviour by legislators or founded on a superstitious misty belief and that the government can by the magic wand of a statute transform their economies, reorient their peoples and conjure assets out of thin air.

In any event, part of the statutory avalanche is a reaction to the increase in financial transactions which in turn reflect increases in population, in productivity, in wealth, in gross domestic product, and the shift in many countries away from a manufacturing and industrial economy to a services economy, leaving agriculture far behind (representing around one or two per cent of GDP in many advanced countries).

One does not want to be too breathless and gush wide-eyed about the amounts involved in international finance, but when people use adjectives like “exponential”, “explosive” and the like, they are actually right. The largest market in the world is the foreign exchange market where the turnover gets through world GDP every few days. This is also true of the turnover in payment
systems which are even larger. Flows of financial assets are much larger than flows of trade goods – maybe 30 times as much. Syndicated credits are six or seven times larger than international bond issues which in turn are much, much larger than issues of equity shares every year. The largest securities settlement system in the world holds securities worth more than half world GDP and the largest securities settlement system in Europe holds securities worth around the GDP of the entire EU 27.

In view of the amounts at risk and what is at stake for societies, the law has a major role to play in mitigating these risks. And the law in Scandinavian countries is no exception.

Scandinavian countries could make a major contribution if they wished in providing a means for keeping this system working. In view of their international goodwill and reputation, their exceptional stability, the resourcefulness and inventiveness of their populations and their sound legal systems, they are well-placed to do so.

London, together with New York, is the largest international financial centre in the world. The largest international securities depositary in the world is located in Brussels. Both Luxembourg and Switzerland are tiny countries but they are nevertheless world leaders in investment management. About 90 per cent of international bonds are listed in either Luxembourg or London. Ireland has captured the aircraft register under the Cape Town Mobile Equipment (Aircraft) Convention. Jersey is a major place of incorporation for special purpose vehicles for securitisations and other special purpose finance.

Naturally these countries benefit financially from their roles. It is not only they who benefit: it is Europe which benefits, it is the world which benefits. This would also be true for any Scandinavian country which chooses to pick up the baton.

The historical factors which enable the country to assert a special role in this field are extremely complex and diverse and they cannot be reproduced overnight. Nevertheless my view is that the legal system is one of the factors and an important one.

2 What is the Role of Finance?

Long before Galileo, Newton and Einstein, long before even the great inventions of the Greeks, there was another invention without which it would be impossible to run a modern society. This was the invention of money. Without the availability of money it would be virtually impossible to buy the simplest thing such as a loaf of bread. One could not conceivably each day hand over in exchange for the loaf some eggs laid by one’s chickens or socks one had knitted last night. So money and extended financial assets, such as bank deposits, equity shares, bonds and the like, are a means of exchange, a store of value and a measure of value – in practice a very poor store and measure of value by reason of the inflation allowed by governments so that money in all currencies nowadays is worth a fraction of one per cent of what it was worth in 1900.
In any event once money was invented it was necessary to have somewhere to put it. Hence the invention of banks. Banks were another remarkable invention. Once banks were established to hold savings, they used these savings by lending it out to borrowers.

When one switches on the light, the light comes on. It comes on because there is a power station. The power station has been built out of bank money. The money derives from the savings of the depositors, that is, the citizens. So it is the citizens’ money which makes it possible to switch on the light.

In most societies it is banks mainly which channel or funnel savings to borrowers. But they are not the only suppliers of credit. The other suppliers are institutions such as insurance companies, pension funds and mutual funds. They lend money by way of marketable bond issues which they can sell and also they invest in issues of equity shares. Again, it is not their money which they use, but the money of the citizens – the insurance premiums, the pension fund contributions, the investments in mutual funds. Hence the real creditors, the real claimants in interests are not these banks and institutions, these intermediaries: the real creditors, if we strip aside all the veils of incorporation, are the people.

Banks and bondholders are not angels and a lot of the money is wasted on futile projects. But then, apart from some notable exceptions, most of the rest of us are not angels either and most of us waste our lives: this is considered not unreasonable.

Whatever view we may have about capital and credit in advanced countries, the fact is that for those who are poor, for those who have no light, for those who have no clean running water, it is they who need the power station, the water treatment plant, the hospital; it is they who need to have access to the pooled savings of others. The concept is essentially communist in that there is a redistribution of wealth, a point completely misunderstood by Karl Marx.

There are many characteristics of financial assets which distinguish them from immovables (land, real property) and tangible movables (goods). For example, they are directly useful to people only if exchanged into real things; they can only be sold by description as opposed to physical display; they are invisible unless wrapped in paper; they are very easily transferred across borders; their legal location causes conundrums; they are claimable in a hierarchy or ladder on insolvency and so on. But their most important characteristic and source of most of the problems of the law in this area is the fact that financial assets have no existence without at least two persons, roughly a debtor and a creditor. There must be a bank and a depositor, a borrower and a lender, a company and a shareholder. Hence politics, wealth and redistribution conflicts and emotions are built into the assets itself. The law is not about the asset itself, but rather about the two people on either end of the asset who are locked together by the manacles of statute or contract, who circle each other and regard each other with suspicion. The tension arises from the anxiety of the creditor that the debtor may not be able to perform when the time comes and attempts by the creditor to ensure that the debtor will be able to perform. The debtor resents this control by the creditor. This intense conflict results in differences between legal systems about who to protect, who is the most worthy of the law’s sympathy.
3  Jurisdictions of the World and the Scandinavian Group

There are currently about 193 sovereign states – East Timor and Montenegro are the latest. They are divided into a total of about 320 jurisdictions, ranging from enormous jurisdictions, both in terms of population and geographic size, like China and Brazil, to tiny microstates like Niue in the Pacific.

In order to organise these jurisdictions, one has to have criteria to measure their financial law, including that of the Scandinavian jurisdictions. The characteristics of these criteria should include the following: they must have an important impact on legal systems and not be trivial or insignificant or minor; they must be measurable with reasonable precision which means that the data must be adequate (criteria relating to general style and culture are very difficult to measure); they should have definitive power in the sense that, like litmus paper in chemistry or the number of electrons in the outer ring, they reveal basic attitudes to financial law so that they are reasonably predictive; and they should be limited in number so that the picture is not confused by too much detail.

I have developed about five key criteria for financial law and another seven or eight in addition. Out of the five key indicators, three of them are major, two minor. The major indicators are the availability of insolvency set-off, the scope of security interests and the availability of the universal trust. The two minor criteria, though of doctrinal and symbolic significance, relate to the ability to transfer receivables without compulsory notice to the debtor for the validity of the transfer on the insolvency of the seller, and the ability to trace embezzled or tainted money through comingled bank accounts on the insolvency of the recipient. Many of the latter are unjust enrichment claims.

All of the indicators are tested mainly on insolvency. Insolvency is a destroyer and is the point at which the law has to make difficult and unavoidable choices between colliding principles. Since there is not enough to go round, the law has to decide the victor and the victim. Hence the importance of insolvency as a legal determinant. It tests the real strength of a legal principle. For example, set-off is not greatly important between solvent parties, but is crucial on insolvency. A trust which fails on the insolvency of a trustee is of little value because the real owner is expropriated to pay the creditors of the trustee. Unjust enrichment claims, such as claims for embezzled money or mistaken payments, are flawed if the money cannot be traced as the victim’s property on the insolvency of the recipient.

Nearly all of these devices are intended to enhance efficiency and risk reduction but, in doing so, they challenge philosophical notions of insolvency equality by conferring priority and they challenge the transparent absolute ownership of assets which do not disappear on insolvency.

I do not use the degree of codification as a determinant because the test of the law is not how it is written down but rather what it says. I do not regard the doctrine of precedent as being particularly relevant. I do not regard contract law as showing the degree of difference which is shown by the chosen indicators, although contract law is one of the two foundations of commercial and financial law, the other being the law of property.
I do not seek to measure the legal and political infrastructure of a country. Thus France and Congo Kinshasa both belong to the same legal group, but the actual legal and political environment is very different. Naturally unsatisfactory governments, inefficient legal systems and poor legal enforcement can be showstoppers but generally they are highly visible, usually obvious and well documented by many studies.

The regulatory regime is a criterion, but the differences are a matter of intensity, in particular the degree of criminalisation of fiduciary law, micromanagement by extremely detailed regulatory codes and the punitive intensity of punishment for violation in terms of the amount of fines and other penalties.

The criteria tend to position the legal systems of the world into around eight groups which follow the groups developed by the classical comparativists in the main. What the analysis shows is that in one way or another most of the world’s jurisdictions either now belong to or did belong to one of three basic philosophies, which I term the Anglo-American common law, the Napoleonic and Roman-Germanic, each systemised by Western European countries and then spread by colonialism, emulation and other means to the rest of the world – about 280 out of the 320 jurisdictions.

Around 1975, the three major philosophies represented into a triple polarised triptych in which the Napoleonic jurisdictions were negative on all five key indicators, the Roman-Germanic were negative on half and positive on the other half, and the Anglo-American common law jurisdictions were positive on all five. These philosophies crystallised long before that. Since then there have been many erosions of this simple triple polarisation as countries react to credit economies in all sorts of complicated ways, as shown by the bald recital of the number of bankruptcy and regulatory laws earlier in this paper. This is not so much a convergence as a shattering or fragmentation of legal systems, like a stone hitting a windscreen. The Scandinavian jurisdictions have not escaped this process. I place the Scandinavian jurisdictions as members of the Roman-Germanic group.

An example will suffice. In the 19th century the English developed an extraordinary corporate security interest or charge. It was possible for a company to create a charge over all its present and future assets to secure all present and future debt supergenerically which only had to be registered once at the Company’s Registry to be enforceable against all creditors (no registration in land or other asset title registers was necessary, no notice to debtors was necessary, no possession of goods was necessary). Its only weakness was that taxes and charges trumped the floating collateral. If the debtor failed to pay, the bank could within the hour, if the security agreement so provided, appoint an accountant to run the business over the heads of the directors, without any need for sale and without any need to apply to the court. One could hardly imagine a more potentially abusive system. Almost no country in the other groups has accepted this proposition.

Nevertheless the proponents of this system would argue that it worked well in a pragmatic way. Because lenders were safer, the amount of credit for the power station was increased and the credit was cheaper. If anything went wrong, there
was a seamless change of management and it was not necessary to switch off the power station. Because lenders do not lie in wait to pounce but almost invariably (in the writer’s experience) prefer to keep the business operating if this is at all possible, the banks would continue to pay out employees and essential suppliers so that effectively these unsecured creditors would become senior instead of subordinated to the bank’s security, unless they were caught at the very last moment - of which they usually had ample warning. In addition suppliers could protect themselves by super-super priority retention of title clauses and usually did. It was not just banks who were being protected, it was the depositors who were the real creditors in interest. So proponents of this system would argue that in the real world debtors were better off, creditors were better off and the economy was better off – the Holy Grail of financial law.

The English attitude was developed at the time of Adam Smith laissez-faire, when capital was king. The railways must be built.

The English have to some degree weakened this system, as is also the case in common law Canada and in Ireland. Nevertheless it still remains more or less intact in Australia and Singapore and more so in Hong Kong and other traditional English countries. A remarkable feature in the current English compromises between secured and unsecured creditors is that the security interest regime now has a ladder of eight or nine tiers ranging from complete contract freedom immune from insolvency (security interests in settlement systems) to extremely poor security interests (individuals). This process of negotiation, resulting in the laddering of legal systems, is being repeated around the world and is resulting in a quite unnecessary complication of legal systems both internally and externally. 320 x 8 = 2,560.

In any event, the approach of the Scandinavian jurisdictions towards the universal security interest has been quite cautious. Both Sweden and Finland and more recently Denmark introduced universal corporate charges, but the idea did not really take hold in either Norway or Iceland. Sweden and Finland have stays on the enforcement of security interests in the event of reorganisation proceedings. There is no possessory arrangement via a receiver. One could multiply detailed comparisons between the Scandinavian jurisdictions on the one hand and England on the other but the central point is that it is true to say that on the question of security interests the Scandinavian jurisdictions are not as convinced as the English common law jurisdictions of their role in risk reduction, as against the protection of unsecured creditors.

Insolvency set-off is the great litmus test of insolvency policies. Either the creditor is paid or the debtor is paid. All the Scandinavian jurisdictions are at one in their support. Both Sweden and Finland and perhaps Norway have however brought netting into question by introducing a stay on certain contract cancellations in the event of rescue proceedings.

All of the jurisdictions are conservative about the trust, which is somewhat puzzling in view of the usefulness in modern economies of the idea of a titleholder who holds the assets of others on the basis that the assets are immune from the private creditors of the trustee. This idea is central to the concept of deposit or bailment. The English trust was developed in relation to succession and family property, but these private uses – both gifts – are totally dwarfed by
trusteeship in the commercial and financial spheres, e.g. global custodianship, settlement systems, portfolio management of securities, trustees of security interests and trustees of bondholders, amongst many other cases.

It is interesting to note that China introduced a trust in 2001 – probably one of the most important events in financial law in the past 25 years – and that France introduced a somewhat restricted and tentative trust law in 2007. A great many countries have partial trusts, such as for client securities, including Germany, Austria, Russia, the Ukraine and many others, especially in Latin America.

In relation to the remaining two out of the five key criteria, it is believed that all the Scandinavian jurisdictions require that notice of the assignment of a receivable is given to the debtor for the assignment to be valid on the insolvency of the seller, even though the notice can be quite informal. This tends to show adherence to the original traditional Roman-Germanic view that in rem property rights must be publicised if they are to be effective on insolvency, an adherence difficult to justify in this case because nobody can see the debt, let alone see if notice has been given. The publicity motive is not achieved.

It is believed that none of the Scandinavian jurisdictions allow the tracing of delinquent money through transformations and mixtures on the insolvency of the final holder, e.g. the recovery of money by virtue of a claim for embezzlement, mistake or misappropriation of assets by a director or other fiduciary. Many of these are unjust enrichment claims and are not economically important, although they show an intense collision of fundamental principles of property, notably the need for publicity, specificity of transfers, priorities and in rem proprietary separatist rights on insolvency, as against the need to capture tainted money and to return it to its rightful owner. Tracing through commingled money seems to be almost exclusively a common law remedy.

4 The Delaware Factor

A peculiarity of the financial arena is the development of unusual legal monopolies – the Delaware factor.

It would seem that more than 70 per cent of the corporations listed on the New York Stock Exchange are incorporated in Delaware, which has a population of about 850,000, against the overall US population of 300 million. In order to appreciate the magnitude of this concentration in Delaware, these corporations may well command around 30 per cent of world trade. It does not matter whether it is 20 per cent or 40 per cent – the amounts are extremely large.

There are two basic reasons why this happened. In the first place the five Justices of the Delaware Court of Chancery resolved that their corporation law would, amongst other things, respect the business judgement of the officers if properly considered and would not support populist big pocket theories of liability. In other words they would not adopt the attitudes of the punitive zealot or moral bigot about corporations, i.e. that all corporations are inherently wicked. In addition the Delaware corporate law is extremely liberal and flexible, including on such matters as maintenance of capital. For example, Delaware never adopted the originally English-based rule preventing a company...
from giving financial assistance for the purchase of its own shares. US insolvency law generally is highly protective of directors and does not adopt the various attitudes in other countries of director personal liability for wrongful trading (England, Ireland, Singapore, but not Hong Kong) or impose duties on directors to petition if the company should become insolvent (France, Guernsey, many others). To some people this is a race for the bottom; to others this liberal view which renounces populism, which treats businessmen as adults, which prefers freedom, is a race for the top. In any event it is inconceivable that some of the world’s greatest corporations would choose a jurisdiction which represented low ethical standards.

There are many other examples of these legal monopolies. For example, the Uniform Customs and Practice for Documentary Credits 600 published by the International Chamber of Commerce is incorporated in trade letters of credit almost universally in the world. Virtually all international payment messages are communicated through Swift, which is a bank-owned co-operative located in Brussels. The CLS Bank incorporated in New York and operating largely in London, is the central netting counterparty of choice for the great bulk of international foreign exchange transactions. Virtually all dematerialised securities on the New York Stock Exchange are held and cleared through a single settlement system, namely the Depositary Trust Corporation and its affiliates, and the same is almost true of international bonds which are held by the international securities depositaries, Euroclear in Belgium and Clearstream in Luxembourg. The ISDA master agreement is probably used for 90 per cent by volume of mainstream derivative transactions in the private markets.

One of the most remarkable legal monopolies is shown by the dominant position of both English or New York law as the governing law of the world’s major financial transactions – international syndicated credits, international bond issues and international derivatives transactions. Nobody quite knows the proportion of these transactions which are governed by either English or New York law but one would not be surprised to discover that these legal systems command perhaps 80 per cent of the market in the case of international as opposed to domestic transactions.

The reasons for this dominance are partly historical. In the 19th century Britain was the world’s largest economic power, and the United States was and is the world’s largest economic power, a mantle which it assumed around 1900. Financial institutions tend to prefer their home law and so it was inevitable that countries which gave birth to these banks and very deep capital markets would see a tendency for those banks and markets to choose their own law with which they were familiar.

Once a legal system views itself as international and has been used in major commercial and financial transactions, then courts, judges and legislators tend to see it as their job to ensure the law meets the requirements of the users.

Very quickly the Delaware factor takes over. This fact is that markets cannot be bothered with a proliferation of choices: they are content with even a single option, provided that the chosen option reasonably meets their needs and their legitimate expectations. Hence the development of these near monopolies.
So far as English law is concerned, some of the foundations of the approach were and are

- The need for a reasonable degree of contract predictability, i.e. that the courts will not rewrite contracts merely because they do not consider the contract to be fair. Provided there is no unconscionability or grossly disproportionate bargaining power, then (outside the consumer sphere) the courts leave it to the parties to negotiate the contract as they wish, e.g. the insertion of grace periods, anti-forfeiture clauses, materiality tests, notice periods and the like. In return for this, the jurisdiction accepts that there will be abuses, even gross abuses on occasion.

- The jurisdiction does not use the law as an occasion for redistribution. For example, insolvency law is not used as a means of redistribution from banks and bondholders to other creditors such as employees’ business law is not used as a means of redistribution from financial firms to their customers. Under this view the proper means of redistribution is via taxation which is open and voted upon, rather than by the covert means of insolvency law or the law relating to financial services.

- The legal systems has a strong policy in favour of risk reduction, e.g. insolvency set-off, security interests and the ability to cancel controls on the insolvency of the counterparty. This can cut across policies of debtor rescue.

- The regulatory regime, although tough and perhaps over-criminalised, aims at the famous light touch and eschews disproportionate punitive zealotry.

- There is a tendency to support the freedom of the parties in their transactions instead of a rigid framework of legal intrusion.

5 Conclusion

One could legitimately argue either way on whether these propositions are or are not desirable in the complicated modern world.

Whatever view the Scandinavian jurisdictions ultimately come to on these issues, my view is that these basic questions are worth the most careful consideration. There is a cost: a legal system which assumes international responsibilities must forego a comfortable domestic protectionism, a welfare state of law which protects its citizens against most legal risk.

Of course Scandinavians must decide for themselves. For my part I would hope that so much Scandinavian legal genius, so much Scandinavian vigour and creativity, so much Scandinavian pragmatism and common sense, could be put to beneficial use in this field.