

Proposal for a Directive of the European Parliament and of the Council on financial collateral arrangements

(2001/C 180 E/32)

COM(2001) 168 final — 2001/0086(COD)

(Submitted by the Commission on 27 March 2001)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 95 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Central Bank,

Having regard to the opinion of the Economic and Social Committee,

Having regard to the opinion of the Committee of the Regions,

Acting in accordance with the procedure laid down in Article 251 of the Treaty,

Whereas:

- (1) Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems⁽¹⁾ constituted a milestone in establishing a sound legal framework for payment and securities settlement systems. Implementation of that Directive has demonstrated the importance of limiting systemic risk inherent in such systems stemming from the different influence of several jurisdictions, and the benefits of common rules in relation to collateral pledged to such systems.
- (2) In its Communication of 11 May 1999 to the European Parliament and to the Council on Financial Services: Implementing the Framework for Financial Markets: Action Plan⁽²⁾ the Commission undertook, after consultation with market experts and national authorities, to work on further proposals for legislative action on collateral urging further progress in the field of collateral, beyond the Directive 98/26/EC.
- (3) A Community regime should be created for the provision of securities and cash as collateral under both pledge and title transfer structures including repurchase agreements (repos). This will contribute to the integration and cost-efficiency of the financial market as well as to the stability of the financial system in the Community, thereby supporting the freedom to provide services and the free movement of capital in the single market in financial services. This Directive focuses on the provision of collateral between two parties to a collateral arrangement.
- (4) In order to improve the legal certainty of collateral arrangements, Member States should ensure that certain provisions of insolvency law do not apply to such arrangements, in particular, those that would inhibit the effective realisation of collateral or cast doubt on the validity of current techniques such as close-out netting, the provision of additional collateral in the form of top-up collateral and substitution of collateral.
- (5) The principle in Directive 98/26/EC, whereby the law applicable to book entry securities provided as collateral is the law of the jurisdiction where the relevant register, account or centralised deposit system is located, should be extended in order to create legal certainty regarding the use of such securities held in a cross-border context and used as collateral under the scope of this Directive.
- (6) In order to limit the administrative burdens for participants using book-entry securities as collateral the only perfection requirement should be that the interest be notified to, and recorded by, the relevant entity maintaining the account, while for bearer securities the perfection requirement should be delivery of the collateral.
- (7) The simplification of the use of collateral through the limitation of administrative burdens will promote the efficiency of the cross-border operations of the European Central Bank and the national Central Banks of Member States participating in the Economic and Monetary Union, necessary for the implementation of the common monetary policy. Furthermore, the provision of limited protection of collateral arrangements from some rules of insolvency law will in addition support the wider aspect of the common monetary policy, where the participants in the money market balance the overall amount of liquidity in the market among themselves, by cross-border transactions backed by collateral.
- (8) The *lex rei sitae* rule, according to which the applicable law for determining whether a collateral arrangement is properly perfected and therefore good against third parties is the law of the country where the collateral is located, including where the location is in a third country, is currently recognised by all Member States. The location of book entry collateral should be determined. If the collateral taker has a valid and effective collateral arrangement according to the governing law of the country in which the relevant account is maintained, whether or not that country is a Member State, then the validity against any competing title or interest and enforceability of the collateral should be governed solely by the law of that country, thus preventing legal uncertainty as a result of other unforeseen legislation.

⁽¹⁾ OJ L 166, 11.6.1998, p. 45.

⁽²⁾ COM(1999) 232 final.

- (9) The possibilities for Community counterparties to conclude collateral arrangements with counterparties from third countries should also be enhanced, by Member States ensuring that certain provisions of insolvency law do not apply to such arrangements. Those exceptions should therefore also apply to a Community collateral provider where the collateral taker is from a third country.
- (10) The enforceability of close-out netting should be protected, not only as an enforcement mechanism for title transfer collateral arrangements including repurchase agreements but more widely, where close-out netting forms part of a collateral arrangement. Sound risk management practices commonly used in the financial market should be protected by enabling participants to manage and reduce their credit exposures arising from all kinds of financial transactions on a net basis, where the credit exposure is calculated by combining the estimated current exposures under all outstanding transactions with a counterparty, setting off reciprocal items to produce a single aggregated amount that is compared with the current value of the collateral.
- (11) The sound market practice favoured by regulators where participants in the financial market use top-up collateral arrangements to manage and limit their credit risk to each other by mark-to-market calculations of the current market value of the credit exposure and the value of the collateral and accordingly ask for top-up collateral or return the surplus of collateral should be protected. However, there should be no protection for the provision of top-up collateral which is required upon deterioration of the credit rating of the collateral provider because this could contradict the basic insolvency law policy of Member States, which discourages provisions under which a creditor's position is improved as a result of an insolvency-related event.
- (12) In order to limit the systemic risk in the Community financial market, the formalities, which may be required for the execution of a collateral arrangement should be limited. Penalties for breach of such formalities should not include the invalidity of a collateral arrangement.
- (13) It should be possible to provide cash as collateral under both title transfer and pledge structures respectively protected by the recognition of netting or by the pledge of cash collateral. The collateral provider should therefore be able to retain ownership of the pledged cash and consequently be protected in cases where the collateral taker becomes bankrupt. This is of particular importance in the frequent situations where cash is used in substitution for securities.
- (14) Since the measures necessary for the implementation of this Directive are measures of general scope within the meaning of Article 2 of Council Decision 1999/468/EC of

28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission ⁽¹⁾ they should be adopted by use of the regulatory procedure provided for in Article 5 of that Decision.

- (15) This Act complies with the fundamental rights and follows the principles laid down in particular in the Charter of Fundamental Rights of the European Union as general principles of Community law ⁽²⁾.
- (16) In accordance with the principles of subsidiarity and proportionality, the objectives of the proposed action, to create a minimum regime relating to the use of financial collateral, cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale and effect of the action be better achieved by the Community. This Directive confines itself to the minimum required in order to achieve those objectives and does not go beyond what is necessary for that purpose,

HAVE ADOPTED THIS DIRECTIVE:

Article 1

Subject matter

This Directive lays down a Community regime in relation to financial collateral arrangements between a collateral provider and a collateral taker.

Article 2

Scope of application

1. This Directive shall apply to financial collateral arrangements which satisfy the requirements set out in paragraphs 2, 3 and 4.
2. The arrangement must be in writing or evidenced in writing and signed by or on behalf of the collateral provider.
3. The arrangement must contain the following provisions:
 - (a) it must identify the financial collateral to which it applies; for this purpose it is sufficient if the arrangement identifies the account to which financial collateral can be credited from time to time;
 - (b) it must describe the relevant financial obligations for which the collateral is provided. Where the relevant financial obligations consist of a specified class or kind of obligations, it must describe the class or kind of obligation for which the collateral is provided;

⁽¹⁾ OJ L 184, 17.7.1999, p. 23.

⁽²⁾ OJ C 364, 18.12.2000, p. 1.

- (c) where the arrangement is a security financial collateral arrangement and the financial collateral consists of or includes cash, it must provide for the cash to be deposited with or transferred to the collateral taker or deposited with or transferred to a third party for the account of the collateral taker or to be deposited in an account with a third party designated as an account which is subject to the security financial collateral arrangement;
- (d) where the arrangement is a title transfer financial collateral arrangement and the financial collateral consists of or includes cash, it must provide for the cash to be deposited with or transferred to the collateral taker or a third party for the account of the collateral taker;
- (e) where the financial collateral consists of or includes bearer securities, it must provide for those securities to be delivered to the collateral taker or to another person acting as agent or custodian on behalf of the collateral taker;
- (f) where the arrangement is a security financial collateral arrangement and the financial collateral consists of or includes book entry securities collateral, it must provide for the book entry securities collateral:
 - (i) to be transferred into a securities collateral account; or
 - (ii) to be otherwise held and designated so as to indicate that it is held for the account of the collateral provider but subject to the security financial collateral arrangement;
- (g) where the arrangement is a title transfer financial collateral arrangement and the financial collateral consists of or includes book entry securities collateral, it must provide for the book entry securities collateral to be transferred into an account in the name of the collateral taker or an account in the name of another person designated by the collateral taker.

4. The collateral provider and the collateral taker must each be:

- (a) a public authority or a central bank;
- (b) a financial institution under prudential supervision; or
- (c) a person other than a natural person whose capital base exceeds EUR 100 million or whose gross assets exceed EUR 1 000 million, at the time where financial collateral is actually delivered, according to the most recently prepared account published within a period no greater than two years prior to that time.

5. Except as provided by Article 9, this Directive shall not apply in respect of any financial collateral unless and until that financial collateral is actually delivered, transferred, held or designated in accordance with the collateral arrangement.

6. The relevant financial obligations under a financial collateral arrangement may consist of or include:

- (a) future, contingent or prospective obligations (including such obligations arising under a master agreement or similar arrangement);
- (b) obligations owed to the collateral taker by a person other than the collateral provider; or
- (c) obligations of a specified class or kind arising from time to time.

Article 3

Definitions

1. For the purpose of this Directive:

- (a) 'financial collateral arrangement' means a title transfer financial collateral arrangement or a security financial collateral arrangement;
- (b) 'title transfer financial collateral arrangement' means a sale and repurchase agreement or an arrangement under which a collateral provider transfers ownership of financial collateral to a collateral taker, for the purpose of securing the performance of relevant financial obligations;
- (c) 'security financial collateral arrangement' means an arrangement under which a collateral provider disposes of, or delivers financial collateral by way of security in favour of, or to, a collateral taker, for the purpose of securing the performance of relevant financial obligations, where ownership of the financial collateral remains with the collateral provider unless and until the financial collateral is transferred or appropriated to the collateral taker or transferred to a third party as a result of:
 - (i) the exercise of the rights of the collateral taker following the occurrence of an enforcement event; or
 - (ii) the exercise of a right of use;
- (d) 'sale and repurchase agreement' means an agreement under which a collateral provider sells financial instruments or interests in or in respect of financial instruments to a collateral taker subject to an agreement by the collateral provider to purchase and by the collateral taker to sell equivalent financial instruments at a future date (the 'repurchase date') or on demand, and at a price (the 'repurchase price'), specified in or determined as provided in the agreement and includes any term of such an agreement under which:
 - (i) either party is obliged to transfer to the other full ownership of financial collateral in order to maintain a specified ratio or margin between the current market value of the equivalent financial instruments due to be purchased at the repurchase date and the repurchase price; or
 - (ii) the collateral provider is entitled, before the repurchase date, to require the collateral taker to transfer to it full ownership of financial instruments equivalent to some or all of those sold in exchange for the transfer to the collateral taker of full ownership of other financial instruments by way of substitution;

- (e) 'collateral provider' means the party providing financial collateral under a financial collateral arrangement, whether or not that party is from a Member State;
- (f) 'collateral taker' means the party receiving financial collateral under a financial collateral arrangement, whether or not that party is from a Member State;
- (g) 'financial collateral' means cash in any currency ('cash collateral') and financial instruments;
- (h) 'financial instruments' means shares in companies and other securities equivalent to shares in companies and bonds and other forms of securitized debt if these are negotiable on the capital market and any other securities normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement excluding instruments of payment and it means as well units in collective investment undertakings, money market instruments and interests in or in respect of any of the foregoing;
- (i) 'relevant financial obligations' means, in relation to a financial collateral arrangement, the obligations in respect of which the financial collateral is provided and on the discharge of which the collateral provider is entitled to the retransfer of the financial collateral or the transfer of equivalent collateral;
- (j) 'book entry securities collateral' means financial collateral which consists of financial instruments, title to which is evidenced by entries in a register or account;
- (k) 'relevant intermediary' means, in relation to book entry securities collateral which is subject to a financial collateral arrangement, the person — who may also be the collateral provider or the collateral taker — who maintains the relevant account;
- (l) 'relevant account' means:
- (i) in relation to cash collateral, the account to which that cash collateral is credited;
- (ii) in relation to book entry securities collateral which is subject to a financial collateral arrangement, the register or account in which the entries by which that book entry securities collateral is transferred to or disposed of in favour of the collateral taker are made;
- (m) 'securities collateral account' means, in relation to book entry securities, collateral provided under a security financial collateral arrangement:
- (i) an account with the relevant intermediary in the name of the collateral taker, or of a third party acting for the collateral taker, designated as an account for holding book entry securities collateral under that security financial collateral arrangement; or
- (ii) an account or sub-account with the relevant intermediary in the name of the collateral provider, or of a third party acting for the collateral provider, on which the interest of the collateral taker under that security financial collateral arrangement has been noted;
- (n) 'equivalent collateral':
- (i) in relation to an amount of cash, means a payment of the same amount and in the same currency;
- (ii) in relation to financial instruments, means financial instruments of the same issuer or debtor, forming part of the same issue and of the same nominal amount, currency and description or, where a financial collateral arrangement provides for the transfer of other assets following the occurrence of any event relating to or affecting any financial instruments provided as financial collateral, those other assets;
- (o) 'winding-up proceedings' means collective proceedings involving realisation of the assets and distribution of the proceeds among the creditors, shareholders or members as appropriate, which necessarily involve any intervention by administrative or judicial authorities, including where the collective proceedings are terminated by a composition or other analogous measure, whether or not they are founded on insolvency or are voluntary or compulsory;
- (p) 'reorganisation measures' means measures involving any intervention by administrative bodies or judicial authorities which are intended to preserve or restore the financial situation and which affect pre-existing rights of third parties, including but not limited to measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims;
- (q) 'enforcement event' means an event on the occurrence of which, under the terms of a financial collateral arrangement, the collateral taker is entitled to realise or appropriate financial collateral or a close-out netting provision comes into effect;
- (r) 'right of use' means the right of the collateral taker to use and dispose of financial collateral held under a security financial collateral arrangement as though he were the absolute owner of it, in accordance with the security financial collateral arrangement;
- (s) 'close-out netting provision' means a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, under which, on the occurrence of an enforcement event:
- (i) the relevant financial obligations are accelerated so as to be immediately due and expressed as an obligation to pay an amount representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount, in either case in accordance with points (iii) and (iv);

- (ii) any obligation of the collateral taker to deliver equivalent collateral, or to cause equivalent collateral to be credited to a securities collateral account, is accelerated so as to be immediately performable and expressed as an obligation to pay an amount representing its current value or replacement value or its estimated current value or replacement value, or is replaced by an obligation to pay such an amount, in either case in accordance with points (iii) and (iv);
- (iii) any obligations arising under point (i) or (ii) which are expressed in different currencies are converted into one single currency; and
- (iv) an account is taken of what is due from each party to the other in respect of the obligations arising under points (i) to (iii) and those obligations fall to be discharged by the payment of an aggregate net sum equal to the balance of the account by the party from whom the larger amount is due.

2. References to 'writing' include recording in electronic form and references to 'signature' include electronic signature with authentication.

Article 4

Formal requirements on financial collateral arrangement

1. Member States shall ensure that the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement shall not be dependent on the performance by the collateral provider or the collateral taker or by a third party of any formal act beyond those specified in Article 2(1).
2. The formal acts referred to in the first paragraph include, but are not limited to:
 - (a) the execution of a document in a particular form or in a particular manner;
 - (b) the making of any filing with an official or public body or registration in a public or private register;
 - (c) advertisement in a newspaper or journal, in an official register or publication or in any other manner;
 - (d) notification to a public officer, to a custodian or agent or to any other person;
 - (e) the provision of evidence in a particular form as to the date of execution of a document or instrument, the amount of the relevant financial obligations or any other matter.

Article 5

Enforcement of financial collateral arrangement

1. On the occurrence of an enforcement event, the collateral taker shall be able to realise any of the following financial

collateral provided under, and in accordance with the terms in, a security financial collateral arrangement:

- (a) financial instruments by sale without any requirement:
 - (i) that notice of the intention to sell shall have been given;
 - (ii) that the terms of the sale be approved by any court, public officer or other person;
 - (iii) that the sale be conducted by public auction or in any other prescribed manner; or
 - (iv) that any additional time period shall have elapsed.
- (b) cash collateral by setting it off against or applying it in discharge of relevant financial obligations without any requirement that prior notice of the intention to realise the cash collateral shall have been given.

2. On the occurrence of an enforcement event, it must be possible for a close-out netting provision to take effect in accordance with its terms without any requirement that prior notice shall have been given. Paragraph 1(a) applies where the value of any item taken into account in the close-out netting provision is or may be determined by reference to the sale of equivalent securities or any other asset.

3. Member States shall ensure that a financial collateral arrangement can be enforced in the event of winding-up proceedings or reorganisation measures. Any of the following events may be enforcement events if the terms of a financial collateral arrangement so provide:

- (a) the commencement of winding-up proceedings or reorganisation measures in respect of the collateral provider or the collateral taker;
- (b) the occurrence of an event on the basis of which winding-up proceedings or reorganisation measures could be commenced in respect of the collateral provider or the collateral taker;
- (c) the occurrence of an event referred to in point (a) or (b) followed by the lapse of a specified period without the relevant insolvency event having been reversed or cancelled; or
- (d) the occurrence of an event referred to in point (a), (b) or (c) coupled with the giving of a notice by the collateral taker, where the relevant event occurs in relation to the collateral provider, or by the collateral provider, where the relevant event occurs in relation to the collateral taker, electing to treat such occurrence as an enforcement event.

4. This Article is without prejudice to any requirement imposed by applicable law, that the realisation or valuation of financial collateral is conducted in a commercially reasonable manner.

*Article 6***Right of use of financial collateral under security financial collateral arrangement**

1. Where a collateral taker exercises a right of use, he thereby incurs an obligation to cause equivalent collateral to be transferred so as again to be held subject to the security financial collateral arrangement in the manner referred to in Article 2(3) or, subject to the discharge of the relevant financial obligations, to be transferred to the collateral provider.

2. Where a collateral taker, in discharge of an obligation as described in paragraph 1, causes equivalent collateral to be transferred so as again to be held in the manner referred to in Article 2(3), that equivalent collateral shall be subject to the security financial collateral arrangement to which the original collateral was subject.

3. For the purposes of any rule of law under which any disposition is deemed to be invalid or may be reversed or declared void by reason of or by reference to the time at which it is made, that equivalent collateral shall be treated as having been delivered or disposed of under that security financial collateral arrangement at the time when the original collateral was first transferred so as to be held in the manner referred to in Article 2(3).

4. If an enforcement event occurs while an obligation as described in paragraph 1 remains outstanding, the obligation may be the subject of a close-out netting provision.

*Article 7***Recognition of title transfer financial collateral arrangements**

If a financial collateral arrangement provides that ownership of financial collateral is to pass to the collateral taker on delivery or payment, subject to an obligation to deliver equivalent collateral, Member States shall recognise that ownership of the financial collateral passes to the collateral taker in accordance with the arrangement.

*Article 8***Recognition of close-out netting provisions**

1. A close-out netting provision shall be effective notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider and/or the collateral taker.

2. A close-out netting provision shall be effective in accordance with its terms notwithstanding any purported assignment, judicial or other attachment or other disposition of or in respect of such rights.

*Article 9***Certain insolvency provisions disapplied**

1. Winding-up proceedings or reorganisation measures shall not have retroactive effects on the rights and obligations under a financial collateral arrangement.

2. Where under a financial collateral arrangement a collateral provider:

- (a) has an obligation to provide financial collateral or additional financial collateral in order to take account of changes in the value of the financial collateral or in the amount of the relevant financial obligations; or
- (b) has a right to withdraw financial collateral on providing, by way of substitution or exchange, financial collateral of substantially the same value;

the provision of the financial collateral, additional financial collateral or substitute or replacement financial collateral shall not be treated as invalid, defective or voidable under any such rule of law as is described in paragraph 3 unless, and then only to the extent that, the financial collateral arrangement is itself treated as invalid, defective or voidable.

3. Paragraphs 1 and 2 apply to any rule of law under which a disposition or transfer of financial collateral is or may be deemed to be invalid, or may be reversed or declared void if made within a prescribed period defined by reference to the commencement of winding-up proceedings or reorganisation measures or by reference to the making of any order or decree or the taking of any other action or occurrence of any other event in the course of such proceedings or measures. This includes any rule under which an order or decree made in the course of such proceedings or measures takes effect from a time earlier than the time when it is actually made.

*Article 10***Conflict of laws**

1. Any question with respect to any of the matters specified in paragraph 3 arising in relation to the application of a financial collateral arrangement to any book entry securities collateral or cash collateral shall be governed by the law of the country or, where appropriate, the law of the part of the country in which the relevant account is maintained, whether or not that country is a Member State. The reference to the law of a country or part of a country is a reference to its domestic law, disregarding any rule under which, in deciding the relevant question, reference would be made to the law of another country.

2. A relevant account shall be treated for the purposes of this Article as maintained at any given time:

- (a) at the office or branch of the relevant intermediary identified in the agreement governing the relevant account, provided that the relevant intermediary allocates the relevant account to that office or branch for purposes of reporting to its account holders or for regulatory or accounting purposes;

- (b) where the relevant intermediary is legally established or, where the relevant intermediary is acting in relation to the relevant account through a branch, where that branch is legally established, in any other case.

3. The matters referred to in paragraph 1 are:
- (a) the creation of any title to or interest in the book entry securities collateral arising under the financial collateral arrangement and the ranking or priority of any such title or interest as against any competing title or interest claimed by another person;
 - (b) any act or thing necessary to ensure that any title to or interest in the book entry securities collateral arising under the financial collateral arrangement may be asserted generally against third parties;
 - (c) the steps required for the realisation of the collateral following the occurrence of an enforcement event, including any act or thing necessary to ensure that any disposal of the collateral will be effective generally as against persons who are not parties to the financial collateral arrangement.

Article 11

Updating of thresholds

The Commission shall update the thresholds relating to capital base and gross assets in Article 2(4)(c) in order to adjust to development in the market practice. In updating those thresholds the Commission shall act in accordance with the procedure referred to in Article 12(2).

Article 12

Committee

1. The Commission shall be assisted by the [Securities Committee], instituted by ...

2. Where reference is made to this paragraph, the regulatory procedure laid down in Article 5 of Decision 1999/468/EC shall apply, in compliance with Article 7 [and Article 8] thereof.

3. The period provided for in Article 5(6) of Decision 1999/468/EC shall be [maximum of three months].

Article 13

Implementation

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by [31 December 2004] at the latest. They shall forthwith inform the Commission thereof.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

Article 14

Entry into force

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Communities*.

Article 15

Addressees

This Directive is addressed to the Member States.
