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 (1),

Having regard to the opinion of the European Central Bank (2),

Having regard to the opinion of the Economic and Social Committee (3),

Acting in accordance with the procedure laid down in Article 251 of the Treaty (4),

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 (5) 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 constituted 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, 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 Directive 98/26/EC.

(3) A Community regime should be created for the provision of securities and cash as collateral under both security interest 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 bilateral financial collateral arrangements.

(4) This Directive is adopted in a European legal context which consists in particular of the said Directive 98/26/EC as well as Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (6), Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding-up of insurance undertakings (7) and Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (8). This Directive is in line with the general pattern of these previous legal acts and is not opposed to it. Indeed, this Directive complements these existing legal acts by dealing with further issues and going beyond them in connection with particular matters already dealt with by these legal acts.

(5) In order to improve the legal certainty of financial 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 financial collateral or cast doubt on the validity of current techniques such as bilateral close-out netting, the provision of additional collateral in the form of top-up collateral and substitution of collateral.

(6) This Directive does not address rights which any person may have in respect of assets provided as financial collateral, and which arise otherwise than under the terms of the financial collateral arrangement and otherwise than on the basis of any legal provision or rule of law arising by reason of the commencement or continuation of winding-up proceedings or reorganisation measures, such as restitution arising from mistake, error or lack of capacity.

(7) 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 financial collateral under the scope of this Directive.

(8) The lex rei sitae rule, according to which the applicable law for determining whether a financial collateral arrangement is properly perfected and therefore good against third parties is the law of the country where the financial collateral is located, is currently recognised by all Member States. Without affecting the application of this Directive to directly-held securities, the location of book entry securities provided as financial collateral and held through one or more intermediaries 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, then the validity against any competing title or interest and the 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.

(9) In order to limit the administrative burdens for parties using financial collateral under the scope of this Directive, the only perfection requirement which national law may impose as respects financial collateral should be that the financial collateral is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or of a person acting on the collateral-taker's behalf while not excluding collateral techniques where the collateral-provider is allowed to substitute collateral or to withdraw excess collateral.

(10) For the same reasons, the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement, or the provision of financial collateral under a financial collateral arrangement, should not be made dependent on the performance of any formal act such as the execution of any document in a specific form or in a particular manner, the making of any filing with an official or public body or registration in a public register, advertisement in a newspaper or journal, in an official register or publication or in any other matter, notification to a public officer or 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. This Directive must however provide a balance between market efficiency and the safety of the parties to the arrangement and third parties, thereby avoiding, inter alia, the risk of fraud. This balance should be achieved through the scope of this Directive covering only those financial collateral arrangements which provide for some form of dispossession, i.e. the provision of the financial collateral, and where the provision of the financial collateral can be evidenced in writing or in a durable medium, ensuring thereby the traceability of that collateral. For the purpose of this Directive, acts required under the law of a Member State as conditions for transferring or creating a security interest on financial instruments, other than book entry securities, such as endorsement in the case of instruments to order, or recording on the issuer's register in the case of registered instruments, should not be considered as formal acts.

(11) Moreover this Directive should protect only financial collateral arrangements which can be evidenced. Such evidence can be given in writing or in any other legally enforceable manner provided by the law which is applicable to the financial collateral arrangement.

(12) The simplification of the use of financial collateral through the limitation of administrative burdens promotes the efficiency of the cross-border operations of the European Central Bank and the national central banks of Member States participating in economic and monetary union, necessary for the implementation of the common monetary policy. Furthermore, the provision of limited protection of financial collateral arrangements from some rules of insolvency law in addition supports 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.

(13) This Directive seeks to protect the validity of financial collateral arrangements which are based on the transfer of the full ownership of the financial collateral, such as by eliminating the 'recharacterisation' of such financial collateral arrangements (including repurchase agreements) as security interests.

(14) The enforceability of bilateral close-out netting should be protected, not only as an enforcement mechanism for title transfer financial collateral arrangements including repurchase agreements but more widely, where close-out netting forms part of a financial 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.
(15) This Directive should be without prejudice to any restrictions or requirements under national law on bringing into account claims, on obligations to set-off, or on netting, for example relating to their reciprocity or the fact that they have been concluded prior to when the collateral-taker knew or ought to have known of the commencement (or of any mandatory legal act leading to the commencement) of winding-up proceedings or reorganisation measures in respect of the collateral-provider.

(16) The sound market practice favoured by regulators whereby participants in the financial market use top-up financial 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 financial collateral and accordingly ask for top-up financial collateral or return the surplus of financial collateral should be protected against certain automatic avoidance rules. The same applies to the possibility of substituting for assets provided as financial collateral other assets of the same value. The intention is merely that the provision of top-up or substitution financial collateral cannot be questioned on the sole basis that the relevant financial obligations existed before that financial collateral was provided, or that the financial collateral was provided during a prescribed period. However, this does not prejudice the possibility of questioning under national law the financial collateral arrangement and the provision of financial collateral as part of the initial provision, top-up or substitution of financial collateral, for example where this has been intentionally done to the detriment of the other creditors (this covers, inter alia, actions based on fraud or similar avoidance rules which may apply in a prescribed period).

(17) This Directive provides for rapid and non-formalistic enforcement procedures in order to safeguard financial stability and limit contagion effects in case of a default of a party to a financial collateral arrangement. However, this Directive balances the latter objectives with the protection of the collateral-provider and third parties by explicitly confirming the possibility for Member States to keep or introduce in their national legislation an a posteriori control which the Courts can exercise in relation to the realisation or valuation of financial collateral and the calculation of the relevant financial obligations. Such control should allow for the judicial authorities to verify that the realisation or valuation has been conducted in a commercially reasonable manner.

(18) It should be possible to provide cash as collateral under both title transfer and secured structures respectively protected by the recognition of netting or by the pledge of cash collateral. Cash refers only to money which is represented by a credit to an account, or similar claims on repayment of money (such as money market deposits), thus explicitly excluding banknotes.

(19) This Directive provides for a right of use in case of security financial collateral arrangements, which increases liquidity in the financial market stemming from such reuse of 'pledged' securities. This reuse however should be without prejudice to national legislation about separation of assets and unfair treatment of creditors.

(20) This Directive does not prejudice the operation and effect of the contractual terms of financial instruments provided as financial collateral, such as rights and obligations and other conditions contained in the terms of issue and any other rights and obligations and other conditions which apply between the issuers and holders of such instruments.

(21) 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.

(22) Since the objective of the proposed action, namely 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 effects of the action be better achieved at Community level, the Community may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective,

HAVE ADOPTED THIS DIRECTIVE:

Article 1

Subject matter and scope

1. This Directive lays down a Community regime applicable to financial collateral arrangements which satisfy the requirements set out in paragraphs 2 and 5 and to financial collateral in accordance with the conditions set out in paragraphs 4 and 5.

2. The collateral-taker and the collateral-provider must each belong to one of the following categories:

(a) a public authority (excluding publicly guaranteed undertakings unless they fall under points (b) to (e)) including:

(i) public sector bodies of Member States charged with or intervening in the management of public debt, and
(ii) public sector bodies of Member States authorised to hold accounts for customers;

(b) a central bank, the European Central Bank, the Bank for International Settlements, a multilateral development bank as defined in Article 1(19) of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institution (1), the International Monetary Fund and the European Investment Bank;

(c) a financial institution subject to prudential supervision including:

(i) a credit institution as defined in Article 1(1) of Directive 2000/12/EC, including the institutions listed in Article 2(3) of that Directive;

(ii) an investment firm as defined in Article 1(2) of Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (2),

(iii) a financial institution as defined in Article 1(5) of Directive 2000/12/EC;

(iv) an insurance undertaking as defined in Article 1(a) of Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance (3) and a life assurance undertaking as defined in Article 1(a) of Council Directive 92/96/EEC of 10 November 1992 on the coordination of laws, regulations and administrative provisions relating to direct life assurance (4);


(vi) a management company as defined in Article 1a(2) of Directive 85/611/EEC;

(d) a central counterparty, settlement agent or clearing house, as defined respectively in Article 2(c), (d) and (e) of Directive 98/26/EC, including similar institutions regulated under national law acting in the futures, options and derivatives markets to the extent not covered by that Directive, and a person, other than a natural person, who acts in a trust or representative capacity on behalf of any one or more persons that includes any bondholders or holders of other forms of securitisated debt or any institution as defined in points (a) to (d);

(e) a person other than a natural person, including unincorporated firms and partnerships, provided that the other party is an institution as defined in points (a) to (d).

3. Member States may exclude from the scope of this Directive financial collateral arrangements where one of the parties is a person mentioned in paragraph 2(e).

If they make use of this option Member States shall inform the Commission which shall inform the other Member States thereof.

4. (a) The financial collateral to be provided must consist of cash or financial instruments;

(b) Member States may exclude from the scope of this Directive financial collateral consisting of the collateral-provider's own shares, shares in affiliated undertakings within the meaning of the seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts (6), and shares in undertakings whose exclusive purpose is to own means of production that are essential for the collateral-provider's business or to own real estate.

5. This Directive applies to financial collateral once it has been provided and if that provision can be evidenced in writing.

The evidencing of the provision of financial collateral must allow for the identification of the financial collateral to which it applies. For this purpose, it is sufficient to prove that the book entry securities collateral has been credited to, or forms a credit in, the relevant account and that the cash collateral has been credited to, or forms a credit in, a designated account.


This Directive applies to financial collateral arrangements if that arrangement can be evidenced in writing or in a legally equivalent manner.

Article 2
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 whether or not these are covered by a master agreement or general terms and conditions;

(b) ‘title transfer financial collateral arrangement’ means an arrangement, including repurchase agreements, under which a collateral-provider transfers full ownership of financial collateral to a collateral-taker for the purpose of securing or otherwise covering the performance of relevant financial obligations;

(c) ‘security financial collateral arrangement’ means an arrangement under which a collateral-provider provides financial collateral by way of security in favour of, or to, a collateral-taker, and where the full ownership of the financial collateral remains with the collateral-provider when the security right is established;

(d) ‘cash’ means money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits;

(e) ‘financial instruments’ means shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital market, and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment), including units in collective investment undertakings, money market instruments and claims relating to or in respect of any of the foregoing;

(f) ‘relevant financial obligations’ means the obligations which are secured by a financial collateral arrangement and which give a right to cash settlement and/or delivery of financial instruments.

Relevant financial obligations may consist of or include:

(i) present or future, actual or contingent or prospective obligations (including such obligations arising under a master agreement or similar arrangement);

(ii) obligations owed to the collateral-taker by a person other than the collateral-provider; or

(iii) obligations of a specified class or kind arising from time to time;

(g) ‘book entry securities collateral’ means financial collateral provided under a financial collateral arrangement which consists of financial instruments, title to which is evidenced by entries in a register or account maintained by or on behalf of an intermediary;

(h) ‘relevant account’ means in relation to book entry securities collateral which is subject to a financial collateral arrangement, the register or account, which may be maintained by the collateral-taker, in which the entries are made by which that book entry securities collateral is provided to the collateral-taker;

(i) ‘equivalent collateral’:

(i) in relation to 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 or class 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;

(j) ‘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 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;

(k) ‘reorganisation measures’ means measures which involve any intervention by administrative 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 a suspension of payments, suspension of enforcement measures or reduction of claims;
(l) ‘enforcement event’ means an event of default or any similar event as agreed between the parties on the occurrence of which, under the terms of a financial collateral arrangement or by operation of law, the collateral-taker is entitled to realise or appropriate financial collateral or a close-out netting provision comes into effect;

(m) ‘right of use’ means the right of the collateral-taker to use and dispose of financial collateral provided under a security financial collateral arrangement as the owner of it in accordance with the terms of the security financial collateral arrangement;

(n) ‘close-out netting provision’ means a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or, in the absence of any such provision, any statutory rule by which, on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise:

(i) the obligations of the parties 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; and/or

(ii) an account is taken of what is due from each party to the other in respect of such obligations, and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party.

2. References in this Directive to financial collateral being ‘provided’, or to the ‘provision’ of financial collateral, are to the financial collateral being delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or of a person acting on the collateral-taker’s behalf. Any right of substitution or to withdraw excess financial collateral in favour of the collateral-provider shall not prejudice the financial collateral having been provided to the collateral-taker as mentioned in this Directive.

3. References in this Directive to ‘writing’ include recording by electronic means and any other durable medium.

**Article 3**

**Formal requirements**

1. Member States shall not require that the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement or the provision of financial collateral under a financial collateral arrangement be dependent on the performance of any formal act.

2. Paragraph 1 is without prejudice to the application of this Directive to financial collateral only once it has been provided and if that provision can be evidenced in writing and where the financial collateral arrangement can be evidenced in writing or in a legally equivalent manner.

**Article 4**

**Enforcement of financial collateral arrangements**

1. Member States shall ensure that on the occurrence of an enforcement event, the collateral-taker shall be able to realise in the following manners, any financial collateral provided under, and subject to the terms agreed in, a security financial collateral arrangement:

(a) financial instruments by sale or appropriation and by setting off their value against, or applying their value in discharge of, the relevant financial obligations;

(b) cash by setting off the amount against or applying it in discharge of the relevant financial obligations.

2. Appropriation is possible only if:

(a) this has been agreed by the parties in the security financial collateral arrangement; and

(b) the parties have agreed in the security financial collateral arrangement on the valuation of the financial instruments.

3. Member States which do not allow appropriation on . . . (*) are not obliged to recognise it.

If they make use of this option, Member States shall inform the Commission which in turn shall inform the other Member States thereof.

4. The manners of realising the financial collateral referred to in paragraph 1 shall, subject to the terms agreed in the security financial collateral arrangement, be without any requirement to the effect that:

(a) prior notice of the intention to realise must have been given;

(b) the terms of the realisation be approved by any court, public officer or other person;

(c) the realisation be conducted by public auction or in any other prescribed manner; or

(d) any additional time period must have elapsed.

5. Member States shall ensure that a financial collateral arrangement can take effect in accordance with its terms notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral-provider or collateral-taker.

(*) Date of entry into force of this Directive.
6. This Article and Articles 5, 6 and 7 shall be without prejudice to any requirements under national law to the effect that the realisation or valuation of financial collateral and the calculation of the relevant financial obligations must be conducted in a commercially reasonable manner.

Article 5
Right of use of financial collateral under security financial collateral arrangements

1. If and to the extent that the terms of a security financial collateral arrangement so provide, Member States shall ensure that the collateral-taker is entitled to exercise a right of use in relation to financial collateral provided under the security financial collateral arrangement.

2. Where a collateral-taker exercises a right of use, he thereby incurs an obligation to transfer equivalent collateral to replace the original financial collateral at the latest on the due date for the performance of the relevant financial obligations covered by the security financial collateral arrangement.

Alternatively, the collateral-taker shall, on the due date for the performance of the relevant financial obligations, either transfer equivalent collateral, or, if and to the extent that the terms of a security financial collateral arrangement so provide, set-off the value of the equivalent collateral against or apply it in discharge of the relevant financial obligations.

3. The equivalent collateral transferred in discharge of an obligation as described in paragraph 2, first subparagraph, shall be subject to the same security financial collateral agreement to which the original financial collateral was subject and shall be treated as having been provided under the security financial collateral arrangement at the same time as the original financial collateral was first provided.

4. Member States shall ensure that the use of financial collateral by the collateral-taker according to this Article does not render invalid or unenforceable the rights of the collateral-taker under the security financial collateral arrangement so provide, set-off the value of the equivalent collateral against or apply it in discharge of the relevant financial obligations.

5. If an enforcement event occurs while an obligation as described in paragraph 2, first subparagraph remains outstanding, the obligation may be the subject of a close-out netting provision.

Article 6
Recognition of title transfer financial collateral arrangements

1. Member States shall ensure that a title transfer financial collateral arrangement can take effect in accordance with its terms.

2. If an enforcement event occurs while any obligation of the collateral-taker to transfer equivalent collateral under a title transfer financial collateral arrangement remains outstanding, the obligation may be the subject of a close-out netting provision.

Article 7
Recognition of close-out netting provisions

1. Member States shall ensure that a close-out netting provision can take effect in accordance with its terms:

(a) notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral-provider and/or the collateral-taker; and/or

(b) notwithstanding any purported assignment, judicial or other attachment or other disposition of or in respect of such rights.

2. Member States shall ensure that the operation of a close-out netting provision may not be subject to any of the requirements that are mentioned in Article 4(4), unless otherwise agreed by the parties.

Article 8
Certain insolvency provisions disapplied

1. Member States shall ensure that a financial collateral arrangement, as well as the provision of financial collateral under such arrangement, may not be declared invalid or void or be reversed on the sole basis that the financial collateral arrangement has come into existence, or the financial collateral has been provided:

(a) on the day of the commencement of winding-up proceedings or reorganisation measures, but prior to the order or decree making that commencement; or

(b) in a prescribed period prior to, and defined by reference to, the commencement of such proceedings or 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.

2. Member States shall ensure that where a financial collateral arrangement or a relevant financial obligation has come into existence, or financial collateral has been provided on the day of, but after the moment of the commencement of, winding-up proceedings or reorganisation measures, it shall be legally enforceable and binding on third parties if the collateral-taker can prove that he was not aware, nor should have been aware, of the commencement of such proceedings or measures.

3. Where a financial collateral arrangement contains:

(a) 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) a right to withdraw financial collateral on providing, by way of substitution or exchange, financial collateral of substantially the same value.

Member States shall ensure that the provision of financial collateral, additional financial collateral or substitute or replacement financial collateral under such an obligation or right shall not be treated as invalid or reversed or declared void on the sole basis that:

(i) such provision was made on the day of the commencement of winding-up proceedings or reorganisation measures, but prior to the order or decree making that commencement or in a prescribed period prior to, and 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; and/or

(ii) the relevant financial obligations were incurred prior to the date of the provision of the financial collateral, additional financial collateral or substitute or replacement financial collateral.

4. Without prejudice to paragraphs 1, 2 and 3, this Directive leaves unaffected the general rules of national insolvency law in relation to the voidance of transactions entered into during the prescribed period referred to in paragraph 1(b) and in paragraph 3(i).

Article 9

Conflict of laws

1. Any question with respect to any of the matters specified in paragraph 2 arising in relation to book entry securities collateral shall be governed by the law of the country in which the relevant account is maintained. The reference to the law of a country is a reference to its domestic law, disregarding any rule under which, in deciding the relevant question, reference should be made to the law of another country.

2. The matters referred to in paragraph 1 are:

(a) the legal nature and proprietary effects of book-entry securities collateral;

(b) the requirements for perfecting a financial collateral arrangement relating to book-entry securities collateral and the provision of book-entry securities collateral under such an arrangement, and more generally the completion of the steps necessary to render such an arrangement and provision effective against third parties;

(c) whether a person’s title to or interest in such book-entry securities collateral is overridden by or subordinated to a competing title or interest, or a good faith acquisition has occurred;

(d) the steps required for the realisation of book-entry securities collateral following the occurrence of an enforcement event.

Article 10

Report by the Commission

Not later than . . . (*), the Commission shall present a report to the European Parliament and the Council on the application of this Directive, in particular on the application of Article 1(3), Article 4(3) and Article 5, accompanied where appropriate by proposals for its revision.

Article 11

Implementation

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by . . . (***) 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 reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

Article 12

Entry into force

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

Article 13

Addressees

This Directive is addressed to the Member States.

Done at . . .

For the European Parliament

The President

For the Council

The President

(*) Four and a half years after the date of entry into force of this Directive.

(**) Eighteen months after the date of entry into force of this Directive.
STATEMENT OF THE COUNCIL’S REASONS

I. INTRODUCTION


On 5 March 2002, the Council adopted its Common Position pursuant to Article 251 of the Treaty.

II. OBJECTIVE

The aim of the Directive is to create a Community regime for the provision of securities and cash as collateral under both security interest and title transfer structures, including repurchase agreements (repos), in order to increase legal certainty for these arrangements. In order to achieve this objective the Directive requires Member States to ensure that certain provisions of insolvency law do not apply to such arrangements; in particular, those that would inhibit the effective realisation of financial collateral or cast doubt on the validity of current techniques such as bilateral close-out netting, the provision of additional collateral in the form of top-up collateral and substitution of collateral.

The creation of such a regime will contribute to the integration and cost-efficiency of the financial market as well as to the stability of the financial system within the Community, an aim which has been further highlighted by the turbulence in the markets in the autumn of 2001.

The Directive must be seen in the European legal context, comprising, in particular the Directive on settlement finality in payment and securities settlement systems (Directive 98/26/EC) (5) as well as the Directives relating to the reorganisation and winding up of credit institutions (2001/24/EC) (6) and insurance undertakings (2001/17/EC) (7) and Regulation (EC) No 1346/2000 on insolvency proceedings (8). The Directive is in line with the general pattern of these previous legal acts, which it complements and goes beyond on some issues.

III. ANALYSIS OF THE COMMON POSITION

1. General issues

The Common Position follows the approach of the Commission proposal, with some amendments to the substance and to the presentation of the text. The main changes to the Commission proposal reflect the amendments proposed by the European Parliament and concern:

— the persons and institutions covered by the scope of the Directive (Article 1(2)),

— the evidencing of a financial collateral arrangement (Article 1(5)),

— the introduction of the legal technique of ‘appropriation’ (Article 4),

— the conflict of laws provision (Article 9).

The changes to each article of the Commission proposal are explained below.

(6) OJ L 125, 5.5.2001, p. 15.
2. **Scope** (Article 1)

Articles 1 and 2 of the Commission proposal have been merged into a new Article 1 to make it clear that the Community regime laid down in the Directive covers only the financial collateral arrangements and the financial collateral included in the scope, which the Article goes on to define. The structure of Article 1, now incorporating the corresponding Article 2 of the Commission proposal has been changed as explained below, in order to set out the relevant provisions in a clearer and more structured manner and to take account of the amendments proposed by the European Parliament. Inter alia, the new structure takes account of the need for precision expressed in amendment 4 of the European Parliament, the spirit of which is thus included.

The scope is defined with respect to the parties to the financial collateral arrangements, Article 1(2), (3) and (5), and with respect to the financial collateral provided under the arrangement, Article 1(4) and (5).

The scope concerning the persons covered closely reflect the approach proposed by the European Parliament in amendments 5, 6, 7, 8 and 9. The substance of amendment 5 has been included, albeit with different wording, in so far as the Common Position stipulates that both the collateral-taker and the collateral-provider must belong to one of the categories listed in the Directive, with the added provision in Article 1(2)(e) that if one of the parties is a person other than a natural person, the other party must belong to one of the categories set out in Article 1(2)(a) to (d). In other words, as long as one of the parties is an institution of a financial nature as set out in subparagraphs (a) to (d), the other party can be either an institution of a financial nature as set out in subparagraphs (a) to (d), or any of the persons set out in subparagraph (e).

Amendments 6, 7, 8 and 9 have all been included with the following changes to the wording:

— in Article 1(2)(a) (amendment 6) it has been made clear that the exclusion of publicly guaranteed undertakings applies to both categories of institutions covered by the provision;

— the wording of subparagraph (c) relating to financial institutions is as proposed by the European Parliament in amendment 8, except that the references to a central counterparty, a settlement agent or a clearing house have been set out in a separate subparagraph (d) since these institutions are not necessarily financial institutions under prudential supervision. A reference to similar institutions acting in the futures, options and derivatives markets has also been added;

— subparagraph (e) relating to all legal persons is included as proposed by the European Parliament in amendment 9, except that the reference to a person other than a natural person acting in trust on behalf of bondholders has been included in subparagraph (d), which was considered a more appropriate place.

In order to strike the right balance between the need not to enlarge the scope of the Directive unduly to the detriment of the other creditors in an insolvency situation on the one hand and, on the other hand, the need to ensure that the aims of the Directive can be achieved, the Council has found it necessary to introduce in Article 1(3) an option for Member States to limit the scope of the special regime laid down by the Directive to financial collateral arrangements where both parties belong to the institutions of a financial nature set out in Article 1(2)(a) to (d). Since the exercising this option will be an exception to the general regime laid down in the Directive, a special notification procedure is provided for in the event of a Member State making use of it.
Article 1(4) sets out what the financial collateral must consist of. Subparagraph (a) corresponds to the definition of financial collateral set out in Article 3(g) of the Commission proposal. Subparagraph (b) has been introduced to make sure that Member States may exclude from the scope certain financial collateral which, although it might fall under the definition of financial instruments, is directly linked to the means of production of the collateral-provider.

The first subparagraph of Article 1(5) makes it clear that the Directive does not apply to financial collateral until it has been provided. Amendment 3 of the European Parliament is included with slightly modified wording, as is amendment 10 proposed by the European Parliament, which deletes Article 2(5) of the Commission proposal. What is covered by the term 'provided' is set out in Article 2(2), see below.

Paragraph 5 also deals with the question of evidence relating to the provision of financial collateral as well as the financial collateral arrangement itself, and covers the same issues as those set out in Article 2(3)(a) of the Commission proposal. The provision of the financial collateral must be evidenced in writing and must allow for the identification of the financial collateral to which it applies. The financial collateral arrangement must be evidenced in writing or in any other legally enforceable manner provided for by the law applicable to the financial collateral arrangement, for example taped telephone conversations.

These latter requirements relating to evidence must not be confused with the requirement set out in Article 3 that a financial collateral arrangement or the provision of financial collateral must not be dependent on the performance of any formal act, see below.

3. Definitions — Article 2 (Article 3 of the Commission proposal)

The definitions in Article 2(1) largely correspond to those proposed by the Commission. The definitions of the terms ‘collateral-provider’, ‘collateral-taker’ and ‘sale and repurchase agreement’ have been deleted as unnecessary. The definition of ‘financial collateral’ has been included in the new wording of Article 1(4)(a). The term ‘securities collateral account’ has been deleted as unnecessary following the recasting of Article 1, and the term ‘relevant intermediary’ has been deleted since it no longer appears in the text following the redrafting of Article 9.

A new definition of ‘cash’ has been introduced, covering money credited to an account and claims on the restitution of money such as money market deposits, but excluding physical notes and coins, which it was thought unnecessary to include in the scope of the Directive.

Some amendments have been made in order to make the text clearer without changing the essential thrust of the definitions. In particular:

— the term ‘relevant financial obligations’ has been amended to include the substance of Article 2(6) of the Commission proposal, which defined what relevant financial obligations could consist of or include,

— the definition of ‘enforcement event’ has been amended to highlight default as an element that may trigger the realisation of financial collateral.

Article 2(2) sets out what is meant by financial collateral being provided, and includes amendment 11 proposed by the European Parliament in almost identical wording. It further makes it clear that any right of substitution and right to withdraw does not prejudice the provision, as such, of the financial collateral. The Council finds that this provision replaces Article 2(2)(c), (d), (e), (f) and (g) of the Commission proposal, which are not maintained in the Common Position.

Article 2(3), which defines the references to ‘writing’, incorporates amendment 12 proposed by the European Parliament.
4. Formal acts — Article 3 (Article 4 of the Commission proposal)

The Common Position preserves the thrust of Article 4 of the Commission proposal, and extends it also to the provision of the financial collateral. It stipulates that Member States shall not require that the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement or the provision of financial collateral under a financial collateral arrangement is dependent on the performance of any formal act.

Examples of what is meant by a formal act are not set out in the enacting provisions, and Article 4(2) of the Commission proposal is deleted. Recital 10, which sets out the reasons behind Article 3, does, however, give some indications, such as the execution of any document in a specific form or in a particular manner, filing with any official or public body or registration in a public register, advertisement in a newspaper or journal, in an official register or publication or in any other manner, notification to a public officer or the provision of evidence in a particular form.

In order to avoid confusion between Article 3(1), the provision relating to evidence set out in Article 1(5) and the definition of 'provided' in Article 2(2), the Common Position introduces a new Article 3(2) which makes it clear that paragraph 1 is without prejudice to these provisions.

In this respect it should be noted that the Common Position aims at providing a balance between market efficiency, which is the reason behind the exclusion of formal acts, and the safety of the parties to the arrangement and third parties, thereby avoiding, inter alia, the risk of fraud. This balance is achieved by the fact that the scope of the Directive only covers those financial collateral arrangements which provide for some form of dispossession, as set out in Articles 1(5) and 2(2), and where the provision of the financial collateral can be evidenced in writing or in a durable medium, as set out in Articles 1(5) and 2(3), ensuring thereby the traceability of that collateral. For the purpose of this Directive, acts required under the law of a Member State as conditions for transferring or creating a security interest on financial instruments other than book entry securities, such as endorsement in the case of instruments to order, or recording on the issuer's register in the case of registered instruments, are not considered as formal acts.

5. Enforcement — Article 4 (Article 5 of the Commission proposal)

Article 4 of the Common Position maintains the substance of Article 5 of the Commission proposal, which complements Article 3 by precluding the imposition of formal and procedural requirements on the enforcement of a financial collateral arrangement and ensures enforcement in event of insolvency of the collateral-provider or the collateral-taker. The structure is amended to make the text clearer and in a manner which includes amendments 13 and 14 proposed by the European Parliament.

Article 4(1) follows closely Article 5(1) of the Commission proposal, but the reference to the realisation requirements is set out in a separate paragraph, Article 4(4), and it states that set-off is recognised as a manner of realisation.

The Common Position includes the legal technique of appropriation as proposed by the European Parliament and Article 4(2) incorporates, almost verbatim, amendment 14 proposed by the European Parliament. However, since this technique is unknown in some Member States and it was feared that its introduction solely in respect of financial collateral arrangements could give rise to legal uncertainty in those parts of the Community where it has never been used, the Council has found it necessary to introduce in Article 4(3) of the Common Position an option which allows Member States where appropriation is not permitted on the date this Directive enters into force not to recognise this technique. Since the exercise of this option will be an exception to the general regime laid down in the Directive, provision is made for a special notification procedure where a Member State makes use of it.
Article 4(4) sets out the references to the realisation requirements, which were set out in Article 5(1) of the Commission proposal and includes amendment 13 proposed by the European Parliament. The substance of Article 5(2) of the Commission proposal has been moved to Article 7, which concerns close-out netting. The substance of Article 5(3) of the Commission proposal is set out in Article 4(5) of the Common Position in a clearer form. The Council deemed it unnecessary to include examples of what can constitute an enforcement event since the term ‘enforcement event’ is defined in Article 2.

Article 4(6) corresponds to Article 5(5) of the Commission proposal, but is extended to cover the calculation of the relevant financial obligation.

6. **Right of use — Article 5** (Article 6 of the Commission proposal)

Article 5(1) and (2) of the Common Position fully includes amendment 15 proposed by the European Parliament, in a slightly amended form. Article 5(2) further makes it clear that the collateral-taker may, if the terms of the security financial collateral arrangement so provide, choose to set off the value of the equivalent collateral against the relevant financial obligation or apply it in discharge thereof.

Article 5(3) combines the substance of Article 6 2) and (3) of the Commission proposal, in an amended form which takes account of the new wording of Article 5(1) and (2).

Article 5(4) aims to make it clear that when a collateral-taker exercises the right of reuse he does not thereby lose his rights to the financial collateral under the financial collateral arrangement.

Article 5(5) maintains Article 6(5) as proposed by the Commission in its original proposal.

7. **Title transfer and close-out netting — Articles 6 and 7** (Articles 7 and 8 of the Commission proposal)

Article 6(1) concerning the recognition of title transfer financial collateral arrangements maintains the essence of Article 7 of the Commission proposal. The Council has found it useful to add a second paragraph making it clear that a title transfer arrangement can be terminated by close-out netting if an enforcement event occurs.

Article 7(1) of the Common Position, on the recognition of close-out netting provisions, combines Article 8(1) and (2) of the Commission proposal with more specific wording which does not change the substance of these provisions. Article 7(2) replaces Article 5(2) of the Commission proposal and ensures that Article 4(4) applies to close-out netting as well, unless the parties have explicitly agreed otherwise.

8. **The non-application of certain insolvency provisions — Article 8** (Article 9 of the Commission proposal)

Article 8 of the Common Position maintains the substance of Article 9 of the Commission proposal, but with different wording.

The aim is to protect a financial collateral arrangement, as well as the provision of financial collateral under such an arrangement, against certain automatic avoidance rules which would render an arrangement or the provision of collateral void on the sole basis that the collateral was provided on the day of, but before the commencement of, insolvency proceedings or in a prescribed period prior to such proceedings. This is set out in Article 8(1) of the Common Position.
The Common Position introduces a new rule in Article 8(2), not contained in the Commission proposal, protecting a collateral-taker who has acted in good faith on the day of, but after the opening of, insolvency procedures.

The second aim of this article is to protect the market practices of 'top up', whereby participants in the financial market use top-up financial 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 financial collateral and accordingly ask for top-up financial collateral or return the surplus of financial collateral, and the market practice of substituting other assets of the same value for assets provided as financial collateral. Article 8(3) provides that these two practices should be protected against invalidation on the basis of the sole fact that the collateral was provided on the day of, but before the commencement of, insolvency proceedings or in a prescribed period prior to such proceedings, or on the basis of the sole fact that the relevant financial obligations were incurred prior to the provision of the top-up or substitute collateral.

However, this Article does not prejudice the possibility of questioning the financial collateral arrangement and the provision of financial collateral as part of the initial provision, top-up or substitution of financial collateral, under national law for other reasons, for example where this has been done intentionally to the detriment of the other creditors (this covers, inter alia, actions based on fraud or similar avoidance rules which may apply in a prescribed period).

9. Conflict of laws — Article 9 (Article 10 of the Commission proposal)

Article 9 of the Common Position covers the substance of Article 10 of the Commission proposal and introduces a provision regarding conflict of laws in relation to book entry securities. The Common Position does not include Article 9(2) of the Commission proposal since the question of conflict of laws is currently subject to ongoing international discussions in the Hague Conference, which is negotiating a Convention on the law applicable to certain rights in respect of securities held with an intermediary. In order not to bind the hands of Member States and the Commission in these discussions it is preferable simply to establish the place of the relevant intermediary (PRIMA) principle in the Directive, without going into further details at this stage. The Common Position thus includes amendment 17 proposed by the European Parliament.

The Council takes the view that it is, in principle, desirable that provisions with regard to the applicable law are in line with the ongoing discussions at the Hague Conference, but taking into account the importance of the Directive for the EU financial market, the Council nevertheless finds it impossible to postpone the passing of the Directive until the discussions in the Hague Conference have been completed. Therefore it must be kept in mind that, when the Conference has been finalised, Article 9 may have to be reviewed in the light of the outcome of the Convention.

The wording of Article 9(1) has been amended slightly to take account of the new structure, and the wording of Article 9(2) has been changed from that of Article 10(3) of the Commission proposal, to reflect more closely the current state of negotiations within the framework of the Hague conference.

10. Final provisions — Articles 10, 11, 12 and 13

The Council feels that the new regime introduced by the Directive should be evaluated and has therefore introduced in Article 10 an obligation for the Commission to present a report on the application of the Directive three years after the date of implementation. The report should focus, inter alia, on the use of the option to limit the scope set out in Article 1(3), the option not to introduce the legal technique of appropriation set out in Article 4(3), and the right of reuse of financial collateral laid down in Article 5.

Since the new drafting of Article 1(2) renders Articles 11 and 12 of the Commission proposal redundant, the Common Position incorporates amendments 18 and 19 proposed by the European Parliament, which delete these two articles.
Implementation has been set at 18 months after entry into force, which is the minimum period required in some Member States to implement the new regime laid down by the Directive. The actual date of implementation will thus depend on the final adoption of the Directive. So, while the Council shares the concerns of the European Parliament concerning early implementation of the Directive, the Common Position does not include amendment 20 as proposed by the European Parliament.

11. The recitals

The recitals have been adapted to reflect the amendments to the Commission proposal set out above, and includes amendments 1 and 2 proposed by the European Parliament.

IV. CONCLUSION

The Council considers that all the amendments made to the Commission proposal are fully in line with the objectives of the Directive. The main changes to the text of the Commission have been made following the amendments proposed by the European Parliament, almost all of which are included in the Common Position. While the amendment relating to the date of implementation has not been introduced as proposed by the European Parliament, it cannot be considered to have been rejected either, since early adoption of the Directive would entail a date of implementation close to that proposed by the European Parliament.