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NOTE

from:	the Presidency
to:	the Working Party on Financial Services (Collateral)
No. Cion prop.:	7604/01 EF 36 ECOFIN 95 JUSTCIV 58 CODEC 314
Subject:	Proposal for a Directive of the European Parliament and of the Council on financial collateral arrangements

Delegations will find attached the Presidency paper for the text on the above proposal.

Directive on financial collateral arrangements

Article 1 - Subject Matter

This Directive lays down a Community regime in relation to the financial collateral arrangements covered by Article 2.

Article 2 - Scope of application

- (1) This Directive shall apply to financial collateral arrangements which satisfy the requirements set out in paragraph 2, 3 and 4.
- (2) The collateral taker and the collateral provider must each belong to one of the following categories:
 - (i) a public authority including (1) public sector bodies of member states charged with or intervening in the management of public debt and (2) public sector bodies of member states authorised to hold accounts for customers, but excluding publicly guaranteed undertakings, except as they fall under (xiv);
 - (ii) a central bank, the European Central Bank or the Bank of International Settlements;
 - (iii) a credit institution as defined in the first indent of Article 1 of Directive 2000/12/EC, including the institutions set out in the list in Article 2.2. of Directive 2000/12/EC;
 - (iv) an investment firm as defined in the first indent of Article 1 of Directive 93/22/EC;
 - (v) a financial institution as defined in the fifth indent of Article 1 of Directive 2000/12/EC;
 - (vi) a central counterparty as defined in indent (c) of Article 2 of Directive 98/26/EC;
 - (vii) a settlement agent as defined in indent (d) of Article 2 of Directive 98/26/EC;
 - (viii) a clearing house as defined in indent (e) of Article 2 of Directive 98/26/EC;
 - (ix) a insurance undertaking as defined in indent (a) of Article 1 of Directive 92/96/EC and Directive 92/49/EC;
 - (x) an undertaking for collective investment in transferable securities (UCITS) as defined in Article 1.2 of Directive 85/611/EEC;

- (xi) a management company as defined in Article 1a.2 of Directive 85/611/EEC;
 - (xii) a multilateral development bank as defined in the nineteenth indent of Article 1 of Directive 2000/12/EC or the International Monetary Fund;
 - (xiii) the European Investment Bank;
 - (xiv) 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.
- (3) The financial collateral arrangement consist of or include:
- (i) cash collateral; or
 - (ii) financial instruments.
- (4) This Directive only applies to financial collateral once it has been provided under a financial collateral arrangement and if that provision can be evidenced in writing.

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 collateral or financial instruments subject to a financial collateral arrangement;
- (h) "cash collateral" means money in account in any currency;
- (i) "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, claims relating to or rights in or in respect of any of the foregoing;
- (j) “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 ;

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.

- (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) “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;
- (n) “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;

- (o) “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;
- (p) “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;
- (q) “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;
- (r) “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 in this Directive to financial collateral being "provided" 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.
- 3. References in this Directive to "writing" include recording in electronic form.

Article 4 - Formal requirements on financial collateral arrangement

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

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:
 - (b) cash collateral by setting it off against or applying it in discharge of relevant financial obligations.

¹ A recital will confirm Article 4.2 of the Commission Proposal (non exhaustive list of prohibited formal acts).

The above-mentioned manners of realising the financial collateral are without any requirement :

- (i) that prior notice of the intention to realise shall have been given;
 - (ii) that the terms of the realisation be approved by any court, public officer or other person;
 - (iii) that the realisation be conducted by public auction or in any other prescribed manner; or
 - (iv) that any additional time period shall have elapsed.
2. On the occurrence of an enforcement event, it must be possible for an enforcement related provision of a title transfer financial collateral arrangement to take effect in accordance with its terms without any requirement that prior notice shall have been given.
3. Member States shall ensure that a 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.
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.²

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

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 on financial collateral held under the security financial collateral arrangement.

² A recital could confirm that in case of listed financial instruments, the sale on their (regulated) market is in principle to be considered as a sale in a commercially reasonable manner.

Where a collateral taker exercises a right of use, he thereby incurs an obligation to cause 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.

2. The equivalent collateral delivered in discharge of paragraph 1, shall be subject to the same security financial collateral agreement to which the original collateral was subject.³
3. The 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 on the equivalent financial collateral.
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 transfer, subject to an obligation to deliver the collateral or equivalent collateral, Member States shall recognise that, subject to any contractual provision of the financial instrument concerned, ownership of the financial collateral passes to the collateral taker in accordance with the arrangement.

³ A recital should confirm that this paragraph operates both inter partes as erga omnes.

Article 8 - Recognition of close-out netting provisions

1. A close-out netting provision shall be effective in accordance with its terms 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. The Member States shall ensure that financial collateral arrangements, as well as the disposition or transfer of financial collateral under such arrangement, may not be declared invalid or void or be reversed on the basis of the mere fact that the financial collateral arrangement has come into existence, or the financial collateral has been disposed of or transferred:
 - 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 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.

Where a financial collateral arrangement has come into existence, or financial collateral has been disposed of or transferred after the moment of the commencement of winding-up proceedings or reorganisation measures, it shall be legally enforceable and binding on third parties only if the collateral taker can prove that he was not aware, nor should have been aware, of the commencement of such procedures.

2. The Member States shall ensure that the contractual provisions of a financial collateral arrangement conferring:
- (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;

are valid and binding on third parties.

The Member States shall moreover ensure that the provision of the financial collateral, additional financial collateral or substitute or replacement financial collateral according to such contractual provisions shall not be treated as invalid or may be reversed or declared void on the basis of the following grounds:

- the provision of financial collateral, additional financial collateral or substitute or replacement financial collateral is executed in 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;
- no relevant financial obligation exists in relation to the financial collateral, additional financial collateral or substitute or replacement financial collateral;
- the relevant financial obligation has a prior date than the provision of the financial collateral, additional financial collateral or substitute or replacement financial collateral.
