



## Consultation Contribution

31 March 2006

### Comments from the European Securities Forum on the Implementation of the Directive on Financial Collateral Arrangements

In response to the invitation from the Commission for comments on the implementation of the Directive on Financial Collateral Arrangements ('Directive'), we set out our replies related to the Questionnaire for Industry as follows:

*(1) What are the positive impacts of the Directive?*

In general, the Directive

- has widened the possibilities to use securities in different collateral arrangements or clarified such use from a legal point of view;
- has reduced the number of required legal opinions for parties outside the EU as one legal opinion would confirm that the respective collateral arrangement is valid and enforceable in all EU member states.

*(2) Have those whom the Directive was intended to benefit encountered a reduction of burdens as a result of the new regime?*

Legal and fiscal uncertainties as described in (9) and (10) below adversely affect the intended benefits.

*(3) Have those whom the Directive was intended to benefit encountered favourable effects for their risk management as a result of the new regime?*

Where the benefits of the protections afforded by the Directive are certain to apply this can provide significant benefits to market participants in their assessment of credit risk, legal certainty and to make appropriate determinations of capital requirements where these are based on a high degree of comfort in and robust legal analysis of contractual rights to collateral. However, legal uncertainties as described in (9) below adversely affect the intended benefits.

25-28 Old Burlington Street London W1S 3AN	Telephone: +44 (0)20 7478 4210 Facsimile: +44 (0)20 7734 2253 Email: <a href="mailto:secretariat@eurosf.com">secretariat@eurosf.com</a> Website: <a href="http://www.eurosf.com">www.eurosf.com</a>	Registered Office 30 St. James's Street London SW1A 1HB	European Securities Forum is a limited liability company registered in England and Wales under no. 4011370
---	--	---	---

*(4) Has the use of collateral been increased in the EU?*

It is questionable whether the (world-wide) trend towards increased use of collateral is attributable to the Directive or rather to a general aim of risk reduction.

*(5) Do you have any materials that reveal the extent to which the achievement of the objectives of the Directive may be measured?*

No such materials are available to us.

*(6) Are you aware of any developments or innovations in market practice that would justify reviewing the effectiveness of the Directive?*

No, we are not.

*(7) Are there any negative impacts of the Directive?*

We are not aware of any negative impacts.

*(8) Is there any implementation cost due to the Directive?*

Not as far as we know.

*(9) Specify any major problems of transposition or interpretation that occurred of which you are aware.*

- We have encountered a variety of differing views on the qualification as a 'financial collateral arrangement' depending on how the Directive has been implemented across the EU. For instance in some jurisdictions all arrangements that fall within the scope of the Directive as implemented in a particular country now qualify even where the underlying contracts and collateral held predate the implementation of the Directive. In others determining factors may be that collateral must not have been transferred until after the implementation date and in others no arrangement qualifies unless both the underlying contracts and the transactions they support are dated after the relevant implementation date. These discrepancies which result from how the Directive has been implemented are an impediment to the legal certainty and the harmonised regime the Directive sought to institute.
- In some jurisdictions there is debate on whether the benefits of the Directive will apply if collateral is not actually held at the critical point in time. Where the

25-28 Old Burlington Street London W1S 3AN	Telephone: +44 (0)20 7478 4210 Facsimile: +44 (0)20 7734 2253 Email: <a href="mailto:secretariat@eurosf.com">secretariat@eurosf.com</a> Website: <a href="http://www.eurosf.com">www.eurosf.com</a>	Registered Office 30 St. James's Street London SW1A 1HB	European Securities Forum is a limited liability company registered in England and Wales under no. 4011370
---	--	---	---

certainty that an arrangement was a financial collateral arrangement gives benefit over and above the rights to the collateral itself eg by Article 7 in the recognition of close out netting provisions this could prove problematic. It is the essence of a commercial arrangement that there is volatility in the exposure of the parties to a bilateral arrangement over time depending on a wide variety of factors and there may be times when credit lines alone are sufficient to permit one party to take a degree of exposure to the other. Provided that arrangements are not set up seeking to rely on the benefits of the Directive where there is never any intention to hold collateral then the arrangement should not suffer if the amount of collateral fluctuates over time.

- The requirement for financial collateral to be in the possession or under the control of the collateral taker poses particular problem for floating charges in the common law jurisdictions.
- One barrier for increased use of transfer of title is the unfavourable, or at least unclear, tax position of the collateral provider. In connection with the implementation necessary changes were not made in the tax legislation, which means that when collateral is provided in the form of transfer of title, the collateral provider may be exposed to capital gains tax.

*(10) Do you have any suggestions for specific revisions of the Directive? If so, please explain what they are.*

- The conflicts provision in Article 9 of the Directive is not the same as that in the Hague Convention. Whilst in some instances the differing rules will lead to the same result this is not always the case. In the interests of promoting legal certainty and facilitating compliance for the financial services industry with the requirements of the Capital Requirements Directive and the legal certainty standards that must be met to benefit from reduced capital requirements it would be beneficial if the conflicts provisions of these two measures were aligned. Since the scope of the Hague is broader than the Directive our view is that this is the model that should be followed.
- The requirement to return "equivalent collateral" which in relation to financial instruments means instruments of the same issuer, same class, same nominal amount and currency etc is inconsistent with how substitution rights usually work where, in general, collateral must be of equivalent value but may not necessarily be "equivalent" as currently defined.

25-28 Old Burlington Street London W1S 3AN	Telephone: +44 (0)20 7478 4210 Facsimile: +44 (0)20 7734 2253 Email: <a href="mailto:secretariat@eurosf.com">secretariat@eurosf.com</a> Website: <a href="http://www.eurosf.com">www.eurosf.com</a>	Registered Office 30 St. James's Street London SW1A 1HB	European Securities Forum is a limited liability company registered in England and Wales under no. 4011370
---	--	---	---

## european securities forum

*(11) Article 10 of Directive 2002/47/EC on Financial Collateral Arrangements stipulates that the Commission's report on the application of the Directive should deal in particular with the application of Article 1(3), Article 4(3) and Article 5. Please make any comments you think it would be helpful for the Commission to receive about these provisions.*

No comments.

European Securities Forum

Dr. Werner Frey, CEO

25-28 Old Burlington Street London W1S 3AN	Telephone: +44 (0)20 7478 4210 Facsimile: +44 (0)20 7734 2253 Email: <a href="mailto:secretariat@eurosf.com">secretariat@eurosf.com</a> Website: <a href="http://www.eurosf.com">www.eurosf.com</a>	Registered Office 30 St. James's Street London SW1A 1HB	European Securities Forum is a limited liability company registered in England and Wales under no. 4011370
---	--	---	---