

Pledges of Securities
in the EU

***(Legal Update on EU
Collateral Structures and
their Impact in Cross Border
Transaction)***

CITIBANK, N.A.
September 1999

Voltaire's comment is as true now as it was in pre-Revolution France:-

“Is it not an absurd and terrible thing that which is true in one village is false in another? What kind of barbarism is it that citizens must live under different laws? When you travel in this kingdom you change legal systems as often as you change horses.”

(Oevres de Voltaire VIII (1838) Dialogues p5).

CONTENTS:

- Introduction
- Outline of Major Problem Areas
- Country by Country Analysis
- Country by Country Synthesis
- Practical Experience
- The Finality Directive
- Conclusions and Proposals

INTRODUCTION

- ***Impossibility of standardising pledge over euro securities***
- ***The dematerialisation effect (fungibility)***
- ***Pledge is out of step with the legal and financial reality.***
- ***The Finality Directive as the alternative***

This paper reviews the taking of pledges over securities usually held in clearing systems or in registered form between financial institutions and other major players in seven European countries.

While European retail and wholesale customers are able to purchase and sell a variety of euro-denominated securities through the Internet or other electronic trading systems the taking of pledges is not so simple. Although we have established a common currency in eleven Member States in Europe, taking a pledge of euro-denominated securities is not standardised across Member States. A trader thinks taking a pledge should be as simple as clicking a mouse on a screen, whereas the reality is very different.

The increasing size and speed of cross-border financial dealings in Europe, the need for secure enforceable collateral arrangements and policy makers' desire to create deeper, broader Euro capital markets create the conditions for change.

Accordingly this paper:

- i) reviews the law of pledge (domestic and Private International law) in seven countries: England, Italy, France, Belgium, Germany, Spain and Portugal;
- ii) discusses market experience in the subject; and
- iii) suggests some tentative conclusions on uniformity, proposing next steps, with special reference to the Finality Directive.

Securities collateral is a key issue in the 90s and we have seen moves by Major Financial Institutions (MFIs) towards the collateralisation of financial exposures. MFIs have become much more concerned to manage their credit exposures, particularly after the market turbulence of the last year. Obviously the more an institution's exposure is collateralised the more business it can undertake. Major trade associations such as ISDA with its standard collateral documentation and the pan-European collateral delivery systems developed by ECSDA are clear examples of this new tendency towards collateralisation.

Recent developments in clearing systems have speeded up settlement; however dematerialization and the use of CSDs and custodians have in some cases fundamentally changed the legal nature of securities and therefore collateralisation. Interests in securities are often held on a fungible basis and the securities are commingled with the interests of other participants. This has important implications for collateralisation.

Why do MFIs wish to collateralise financial exposures? Counterparties may fail to pay, and debt, as a mere personal right, may potentially lose all its value if the debtor becomes insolvent. With the use of collateral MFIs obtain support for this personal right in the hope of a proprietary right in the securities. Taking collateral is therefore about reducing exposure and the legal challenge is to ensure that no aspect of the collateral is vulnerable in the event of a counterparty's insolvency.

The traditional method of taking collateral, the "pledge" (creation of a security interest), is subject to many limitations and uncertainties, as this paper will show. It is increasingly in the markets replaced by transfer of title.

Collateralisation requires a perfected security interest and the creation of the security interest and its perfection must be done in accordance with the law of the place where the collateral assets are located (*lex situs*).

The concept of *lex situs* is simpler in the case of land and chattels (historically the most important assets over which pledges were taken), since these are tangible, and their location is obvious to everyone. Now with fungible securities held through electronic settlement systems, the assets are intangible blips on computer screens and determining the *lex situs* is not so easy.

This paper shows that in all jurisdictions the old rules are difficult if not impossible to apply to cross border securities settlement arena. The Finality Directive seems to offer an alternative and this paper will discuss its implementation.

Notes:

- (1) The main object of this paper is to ascertain the domestic and conflicts of law aspects of the taking of pledges over investment securities in some of the jurisdictions of the European members. A short discussion of the transfer of title in the jurisdictions in which it may be applicable will compare it with the pledge.
- (2) The terms used in this paper may not have the same meaning from jurisdiction to jurisdiction, or when translated from English into another language. References to "pledge" in this paper will mean both possessory and non possessory interests in property to secure the performance of an obligation. Such interests may be the potential equivalents of ownership if certain conditions are satisfied.
- (3) The main difference between physical and dematerialized securities is simply the way they are evidenced: securities evidenced by individual physical certificates or by a single jumbo or global certificate are considered as physical securities; any issue of securities that are represented by book entries on the records of the issuer or its agent are treated as dematerialized; whether registered physical securities should be classified as physical or dematerialized or as some other category is not our concern in this paper.

OUTLINE OF MAJOR PROBLEM AREAS

- *legal risk implications*
 - *disparity in the conflicts of law rules among participants (Finality Directive*
 - *collateral as a risk reduction tool*
 - *legal and financing costs*
- solution)*

Although the use of collateral is extremely effective in reducing credit risk it does introduce other risks, including legal, operational and concentration risk. But MFIs are under increasing pressure to reduce risk, to respect credit and exposure limits, maintain liquidity and respect balance sheet constraints. Collateralisation has become the risk reduction method of choice to achieve this.

Collateralisation enables an MFI to expand its customer base by collateralising transactions with institutions outside its credit parameters; by collateralising lower-rated credits, deteriorating credits or unrated counterparties, revenues can be increased too. Collateralisation can also lessen the credit spread that is charged to a counterparty, improving the prices which may result in more trade activity.

The key risk for this paper is legal risk. Legal risk is the risk that it may not be possible to enforce collateral (or, if collateral is enforced, that it may be necessary to return or account for such collateral) due to uncertainty concerning the law applicable to the collateral and its enforcement.

The taking of a pledge where all the relevant elements are governed by the laws of one country is generally not too problematic, although some countries' laws are more flexible than others. The real difficulty arises when there is a cross-border element in the collateral structure, for example where the securities are situated in one country and the counterparty is incorporated in another country. In any such collateral structure it may be impossible to predict with certainty which laws will be applicable. The parties may choose the governing law of the contract of pledge, but the applicability of this law is limited. It serves to set out the terms on which the parties intend the pledge to be enforceable, but other (and perhaps more important) aspects of the pledge are governed by other laws, and these are determined by complex conflicts of law rules rather than the choice of the parties.

Firstly, it is a general rule that the question as to which rights in the collateral are actually created by the pledge is a matter for the law of the place where the collateral is situated. In each jurisdiction, the conflicts of law rules determine which law this is and, as their rules are not the same, different jurisdictions may designate different laws as the *lex situs*. Furthermore, for each different type of security in a given portfolio, there may be a different *lex situs*.

Collateral takers look for certainty on the *lex situs*. One approach is to look at the location of the underlying securities to answer the question, but this may be difficult to determine. The adoption of the Art 9(2) of the Finality Directive could, in principle, provide a new alternative approach (PRIMA: place of the relevant intermediary), under which one need only satisfy the requirements of one easily determinable law to ensure the enforceability of collateral.

Secondly, the issues of validity of collateral in an insolvency (e.g. “suspect period” questions, issues of preference and transfers at an undervalue, etc), required formalities and method of distribution of assets (including priority of pledges and set-off) are determined by the law which regulates the insolvency proceedings of the counterparty. As a general rule, these proceedings will be regulated by the law where the counterparty is incorporated (although there are exceptions to this).

In the present state of the law, therefore, for any particular counterparty and any particular form of collateral in a cross-border structure, there may be at least three laws applicable to the matter, namely the law of the pledge agreement, the *lex situs* and the law regulating the insolvency proceedings of the counterparty. If there is more than one counterparty and (particularly in the case of pledges over portfolios of securities) more than one type of security, the number of applicable laws may increase greatly.

This makes it a very difficult task to predict the effect of an insolvency of a counterparty on a cross-border collateral structure. Consequently, risk is perceived as being higher than in a purely domestic structure. Not only does this result in much extra legal work (to try to reduce the uncertainty) but it also makes the structure more expensive for the counterparty.

There are initial and ongoing legal expenses for internal and external counsel associated with the negotiation process and the development and maintenance of necessary documentation. The expenses associated with input from credit, business operations and system personnel, should also be taken into account, as well as custodial fees, financing costs and fees for delivery and receipt of collateral.

The following pages of this paper set out a country by country review of the law of pledge for seven jurisdictions and illustrate the difficulties in each law. In particular, it can be seen that the formalities regarding perfection vary in complexity from jurisdiction to jurisdiction.

COUNTRY BY COUNTRY ANALYSIS

***LEGAL UPDATE ON THE
ENGLISH PLEDGE***

English Position:

1. SECTION I:

- 1.1. ***English collateral arrangements Chart I:*** display of the traditional security interest arrangements (general aspects and type of investment securities applicable to these collateral arrangements).
- 1.2. ***English collateral arrangement Chart II:*** display of the English collateral transfer of title as the legal alternative to the security interest (contains main features of this collateral arrangement).
- 1.3. ***English collateral arrangements Chart III:*** display of the relevant aspects to consider in taking security in England (advantages and disadvantages in using each collateral arrangement)

2. SECTION II:

Aspects of English Security Interest Collateral Chart: In order to create a valid and enforceable interest, it is necessary both to form a valid and enforceable agreement for security between the collateral parties and to ensure that the security interest confers proprietary rights in the collateral which are enforceable against third parties. Therefore, it is necessary to consider the following aspects: validity of the contract and attachment, perfection, priorities, enforcement and insolvency in this arrangement. This chart makes a study of these aspects from a domestic and a Private International Law point of view (reference to statutes and case law included).

3. SECTION III:

- 3.1. **Final comments on the English position regarding cross border transactions in modern holding systems:** comments on the favourable arrangement and their implications with cross border transactions in multi-tiered holding systems.
- 3.2. **The implementation of the Finality Directive in England.**

ENGLAND – SECTION I

English Collaterals Chart I

ENGLISH SECURITY INTERESTS			
MORTGAGE		CHARGE	
LEGAL MORTGAGE	EQUITABLE MORTGAGE	FIXED CHARGE	FLOATING CHARGE
<p>*Full legal title is transferred to the collat.taker by way of security; *equity of redemption remains with the collat.giver, the collat. taker cannot transfer assets to third parties (diff.from the outright transfer). *unattractive alternative to outr. Transf.; also due to its formality makes the equitable mortg. more preferable. *for transfer of legal title necessary to amend the register of the issuer. *investment securities which take this security shares (When they are in Crest, their title will be held in the name of the secured party always that the granter of the security and the secured party are members of CREST, to) register a change of ownership instructions need to be passed to CREST; regarding its enforcement because the secured party has title and can sell to third party). note: normally they are share listed with the London Stock Exchange Limited in dematerls. form in CREST.</p>	<p>*similar to the legal mortgage except that only equitable title is transferred to the coll.taker subject to equity of redemption * not necessary to amend register of the issuer; * still some measure of paperwork involved, not being suitable for use where collateral pool changes-so a floating charge may be preferred. * creation over registered securities: by the deposit with the collateral taker of certificates and blank transfer forms. * investment securities which take this security: shares (represented by share certificates; normally taken with a security power of attorney as above for reg. Sec. the company should deposit the share certificates and an executed blank stock transfer form with the secured party and prior to an event of default, voting rights should not be exercised by the secured party; the dividends will go to the chargor (registered owner. Regarding its enforcement: the secured party completes the executed blank stock transf form and transfer shares to self or third party).</p>	<p>*confers right on the chargee to look to the asset for the discharge of the secured obligation. * no transfer of title is involved to create the charge. *relates to ascertained assets, however it is possible to create a fixed charge over a changing class of assets, provided the chargor cannot remove an asset from that charged pool without the chargee's consent * investment securities which take this sec.: stocks, bonds, debt securities (enforcement is by sale and registration may be required at the registrar of Companies within 21 days of creation.</p>	<p>*same first two characteristic to the fixed *relates to a changing pool of assets where chargor retains freedom to deal * it does not attach to any specific asset until is crystallised into fixed charge * it will be a float. Ch. When a charge is given over all securities from time to time in an account of the chargor at a clearing sys leaving the chargor free to remove securities from the account without the chargee's consent * disadvantages: it ranks behind the fixed charge in terms of priority; it is always registrable CA 1985;it takes effect subject to preferential creditors; it will be invalid if made when Company cannot pay its debts within 12 months of liquidity except when new money is advanced. * investment securities which take this sec. stocks, bonds, debt securities (the enforcement will be by appointment of receiver to a third party and registration at the registrar of Companies within 21 days of creation is required).</p>
PLEDGE			
<p>*Possession of tangible assets is given by way of security; so intangible property cannot be pledged bec. they cannot be possessed (all registered sects. are intangible (Harrold v Plenty[1901] 2 Ch 314, where was held that a share cannot be pledged by deposit of the share certificate; so the physical certificate does not constitute a registered security, but merely evidences it. *Most of the bearer securities used as cross-border collateral are held through the internt..clearg. systs and re-presented by global notes in the hands of the local depositaries used by the clearers; so for the participants they are intangible. In short the pledge is not relevant for the modern sects. collateral arrangements(except with the provision of sterling MM instruments as collat. through CMO, however no pledge will come with demater. Sec. in CMO).</p>			

THE ENGLISH COLLATERAL TRANSFER

Alternative way of achieving the economic effect of security but avoiding the legal formalities of a charge; making an outright transfer of title to the collateral to the "secured party" (collat.tak.).

* Validity: involving: a personal or contractual aspect which is the transfer agreement which gives the collat. tak. the right to call for the delivery of the securities and is determined by the system of law governing the contract in a choice of law clause; and a proprietary aspect is the actual transfer of the securities, determined by the lex situs, so the parties to this type of collateral are concerned to make sure that the title to the collateral securities is effectively transferred in accordance with the lex situs. So in the case of securities held: outside clearing systems, the lex situs of bearer securities is the location of the paper instrument constituting the security and for registered securities generally the place of incorporation of the issuer or if different the place where the register is maintained; in the case of securities held in clearing systems, they are normally held through ICSDs on an unallocated basis, so the securities immobilised in the ICSDs are not negotiable instruments and a different approach applies to them: the property is evidenced and transfers take place through the database of the system and not through the local depository; because they are intangibles and unallocated, the immobilised securities are akin to registered securities, having authority (Mc Millan Inc v Bishopsgate Investment Trust) that the lex situs of registered securities will be the location of the register.

*The function of collateral is giving proprietary rights to the collat.tak. In counterparty default; contrary to the securities interest case where the rights are applied by enforcing the securities interest by selling or appropriating the asset object of the charge, the collateral transfer arrangement is given outright ownership of the collateral to the collat. taker before any counterparty default, the recourse of the collat. tak. involves set-off. In acquiring the outright title the collat tak. is assuming the obligation to redeliver not the particular securities which he originally received but securities equivalent in all respects (number, type, amount and so on) with the original ones. The best English example is the 1995 Credit Support Annex Transfer which involves the granting of the collateral taking a credit risk on the holder but relying for the protection on the availability of netting/set off procedures, so the holder's redelivering obligation will be converted if the party defaults, into an obligation to account for the monetary value of the collateral at the time of default, this can be included in the calculation of close out sums due under the related Master Agreement.

*Set-off: following the above example of the Master Agreement, it states the following set-off steps:- the redelivery date is accelerated to coincide with the date of default; -the collat.tak. Redelivering obligation is converted into an obligation to pay a cash amount equal to their market value; -all cash amounts are converted into a base currency and all sums owed by one party to another under the arrangement are set-off against each other, so a net sum is payable and should be equal to the agreed excess of value of the collateral over the exposure of the collateral taker to the counterparty (margin). The collateral giver must sue for margin as an unsecured debt. Contrary to the danger of the securities interest where the collateral taker may be prevented from enforcing, here the collateral taker already owns the collateral. The danger with the outright transfer is that the insolvency official of the collateral giver may argue that set-off is not effective to discharge collateral redelivery rights, so although the collat. tak. is in possession, it may be sued. Whether this set-off is available in counterparty insolvency will depend on the law governing that insolvency. In England it is mandatory (r.4.90 of the Insolvency Rules 1986).

*Recharacterisation risk is the risk that a court would not allow the collateral agreement to take effect according to its terms, and would recharacterise the interest of the collateral taker in the securities as security interest instead of outright title. Potential risks may take place with cross border transactions, even if the governing law is the English one, because in some jurisdictions the structure fails because it does not comply with some formal requirements as registration or notice, necessary to perfect a security interest, making the collateral worthless and the collateral taker an unsecured creditor. Other consequences are: that the enforcement of a security interest may be stayed during administration or similar insolvency proceedings; the collateral giver may not have had power and authority to grant a security interest; and if the parties have contemplated the creation of a security interest different provisions might have been stated in the documentation: further assurance, negative pledges, ... Under English Domestic Law the recharacterisation risk is considered remote, provided that the documentation has been carefully drafted; the Courts know that transactions can be structured in different ways to achieve the same net economic effect, declaring that they will be reluctant to categorize a transaction as something different than that which it purports to be under the documentation by which it is created.

English Collateral Arrangement Chart III

ASPECTS TO CONSIDER IN TAKING SECURITY INTEREST IN ENGLAND	
SECURITY INTEREST	COLLATERAL TRANSFER
<p>* Creation and perfection : to ensure that the lender has valid and enforceable security formalities for the creation and the perfection of that security needs to be checked and observed Principles of law in a number of jurisdictions may take place and conflicts need to be reconciled</p> <p>*Floating charge: we will have to limit any rights of the borrower to substitute securities as this may render it a floating charge over the undertaking of the borrower, being registrable under S395 of the CA 1985 if the borrower is a UK company.</p> <p>*Contractual restrictions: the borrower can be restricted in granting security interests by covenants or negative pledge clauses in 3rd party arrangements.</p> <p>* Restrictions on enforcement: the English insolvency rules can impose a "stay" on enforc. of sect but probably not set-off rights, where administration proceedings have commenced in England against a borrower.</p> <p>*Disadvantages:</p> <ul style="list-style-type: none"> . the secured party cannot freely use the charged securities, having only a partial proprietary interest. The chargor continues to own the securities, subject to this encumbrance. So the secured party cannot sell the sects, re-charge them or dispose of them, since all these would involve the ownership of sects passing from the chargor to a 3rd party. . As mentioned before it might be registrable with the Registrar of Companies under the registration of charges provisions of the Companies Act 1985. S395(which applies to UK companies and is applied to foreign companies in certain circumstances by section 409) requiring the requires the registration of certain types of charge described in section 396 of the Act: for floating charges and charges on book debts. Failure to register within 21 days of its creation will render the charge void (and not merely voidable) against a liquidator, administrator or third party creditor of the chargor. . The law is somewhat unclear regarding aspects of perfection of sects held by a custodian or in a clearing system. These concern characterisation of the nature of the asset in which the secured party has a purported security interest as well as determining the location of that asset for the purpose of determining the applicable lex situs. Priority difficulties may also arise. 	<p>*Advantages:</p> <ul style="list-style-type: none"> . the transferee is free to deal with the sects received under the arrangement bec. is the owner; so the transferor is free to sell, lend and transfer them by way of security to another party. . The parties do not need to concern themselves with the difficult issues associated with taking security over sects held by custodian or any indirect holding system (multi tiered ones) regarding nature and location of collat assets for determining perfection requirements, since the collateral transfer does not create a security interest, no perfection is required. . The documentation tends to be simpler, since there is no need for the elaborate provisions typically used with mortgages and charges on sects. <p>* Disadvantages: the main ones are the following:</p> <ul style="list-style-type: none"> . The transferor always takes credit risk on the transferee. If the transferee defaults, the transferor should be able to set-off or net the value of the credit support originally transferred agst. its net obligation under the related transactions. Depending on the drafting of the relevant document or on insolvency law applicable to the transferee whether the netting or set-off works agst. the transferee. . Because of the foregoing, the use of custodian for the credit support transferred under the arrangement does not confer benefits on the transferor, bec has no interest in any assets held by the transferee, having only a contractual claim for fungible sects agst the transferee. <p>Assuming the sects are fungible/ tradeable, it is very unlikely that the transferor can obtain an order for specific performance to recover the sects from the defaulting transferee. The transferor's entitlement would be contractual (a debt claim) rather than a proprietary claim. It will be irrelevant to the transferor how or with whom the transferee holds the assets.</p> <ul style="list-style-type: none"> .Special considerations in tax aspects: - regarding capital gains or similar taxes, bec it may be viewed as an acquisition or disposal for this purpose; -as to income tax, if the transferee passes back to the transferor income received on securities transferred, but it could be charged to tax on that income as its legal owner. . Enforceability of set-off: relevant to preserve the lender's net exposure. By interposing a 3rd party custodian to hold the securities transferred can result in problems with "mutuality" which do not arise if security interest is used. Some jurisdictions will exclude it for policy reasons for being prejudicial to general creditors. <p>(For Recharacterisation see Chart II)</p>

ENGLAND – SECTION II

ASPECTS OF ENGLISH COLLATERAL	
Validity of the contract and attachment	<p>A) <u>English Private International Law:</u></p> <ul style="list-style-type: none"> . Material validity determined by the governing law of the collateral agreement; . Constitutional power and capacity issues will generally be determined by the law of incorporation, though it may be limited by the governing law of the collateral contract. . A contract will be valid if complies with the formal requirements of its governing law or the law where either party is located (provisions of Art. 9 of the European Convention, implemented by the Contracts Act 1990). . As a proprietary matter, attachment should satisfy the lex situs of the collateral securities' requirements. <p>B) <u>English Domestic Law:</u></p> <ul style="list-style-type: none"> . Requirement of consideration or value for contracts not executed as deeds. . The Memorandum of association will be checked for good practice in cases of counterparties incorporated in the UK. No act by a UK corporate may be called into question for lack of capacity by reason of anything in its memorandum of association (S35 of the CA 1985). . Capacity of the executing individual to bind the company should be confirmed by a board resolution; however, when dealing with the board or an authorised person by the board, a party acting in good faith will be protected in the event that directors exceed their authority (35A and 35B, CA 1985). A company will be contractually bound even if the agent executing it did not have actual authority or did have ostensible authority (principles of agency law). . No special formal requirements for a collateral agreement under English Law. A purchaser or any person acquiring a security interest may assume due execution if the collateral agreement is purported to be signed by either a director and secretary or by two directors (36 A, CA 1985). . Other possible restrictions on the ability to enter into a collateral agreement come from: <ul style="list-style-type: none"> - regulatory provisions (ex. S5 of the Financial Service Act 1986: which declares unenforceable any transaction entered into in breach of the restriction on unauthorised investment business); - company law (the need to show corporate benefit - prior contractual arrangements (existence of negative pledge). . The attachment requirements are: an agreement that the security interest should attach; that the collateral giver has either a present interest in the collateral or power to grant it as security and the existence of a current obligation to be secured.

<p>Perfection</p>	<p>A) <u>English private international law:</u></p> <ul style="list-style-type: none"> . Perfection will be governed by the lex situs, although reference to the law of incorporation or branch should be considered. <p>B) <u>English domestic law:</u></p> <ul style="list-style-type: none"> . There few perfection requirements: <ul style="list-style-type: none"> * any physical bearer security should be taken into actual or constructive possession; * where securities are held through intermediaries, they should be notified of the security interest; * in the case of pledges, the CA 1985 imposes registration requirements and the failure to comply with them will avoid a registrable security interest (strictly these do not represent a perfection requirement, as avoidance for want of registration operates against the liquidator or administrator of the counterparty, and not just third parties.
<p>Priorities</p>	<p>A) <u>English private international law:</u></p> <ul style="list-style-type: none"> . The general rule in the case of successive security interests will be to apply the law governing the securities (the law of the forum as an alternative argument). . The uncertainties can be mitigated by holding collateral through the ICSD, ensuring that a first priority security interest is taken in accordance to the Belgium and Luxembourg laws. <p>B) <u>English domestic law:</u></p> <ul style="list-style-type: none"> . The rules for determining priorities are of great complexity: the first interest in time has priority subject to the following: <ul style="list-style-type: none"> * any equitable interest is overridden by a subsequent legal interest which has been acquired in good faith for value without notice of the equitable interest; * a floating charge is overridden by a subsequent fixed charge, except when it prohibited the creation of subsequent fixed charges ranking ahead or together the floating charge, giving the chargee actual notice of the prohibition at the time it took the charge; * in cases of successive assignments of a debt or trust interest, the priority will be determined by the order in which notice of the assignment is given to the debtor.

Enforcement	<p>A) <u>English private international law:</u></p> <ul style="list-style-type: none"> . The English courts will allow the enforcement over English securities arising under a foreign law agreement, so long as the requirements of English law as <i>lex situs</i> have been complied with. <p>B) <u>English domestic law:</u></p> <ul style="list-style-type: none"> . Special consideration with the drafting of the collateral agreement, inappropriate draft will make the collat. taker to rely on limited statutory rights of enforcement arising under the Law of Property Act 1925. . In the particular case of securities collateral given by domestic corporate by way of security interest, the enforcement will be frozen if the collateral giver goes into administration (S 11(3)(c) of the Insolvency Act 1986).
-------------	--

Insolvency	<p>A) <u>English private international law:</u></p> <ul style="list-style-type: none"> . Generally, insolvency is governed by the law of the jurisdiction in which the company is incorporated, although there are important exceptions such as when the Belgium branch of a foreign entity is wound up in Belgium, the Belgium Courts will apply the law of the jurisdiction of incorporation. . English courts have jurisdiction to wind up any English registered or unregistered company when its unable to pay its debts or if it is just and equitable to do so, according to the IA 1986 S 221 (5). . English insolvency relates to assets wherever located (S 144, IA 1986), although in practice enforcement of English insolvency rules against foreign assets may be limited. The English courts may apply foreign law if requested by mainly Commonwealth courts. . Where insolvency proceedings in other jurisdictions are also involved, the English courts will look for some type of co-operation. . Generally questions of priority arising from tracing actions will be governed by <i>lex situs</i> as was held in <i>Macmillan Inv v Bishopsgate Investment Trust plc</i> [1996] 1 WLR 387. <p>B) <u>English domestic law:</u></p> <ul style="list-style-type: none"> . The insolvency laws provide for different ways whereby the benefit of certain transactions such as the security arrangements entered into prior to the onset of insolvency proceedings may be undone or adjusted; clear examples are: <ul style="list-style-type: none"> * undervalue situations (the insolvent party either received no consideration or insignificant consideration in return for the value which it provided (S 238, IA 1986)); * invalidation of security interests which constitute preferences in favour of some creditors (S 239); * invalidation of floating charges in particular circumstances (S 245). . In the case where the collateral securities are beneficially owned by
------------	---

	<p>a third party and their provision as collateral involves a breach of fiduciary duty by the collat. giver or a third party , the collat. taker will face the risk that the collateral securities may be reclaimed by or on behalf of the beneficial owners under a tracing action. Broadly speaking the collat. taker will be protected from the tracing where it advances money against the acquisition of legal title to the collateral securities bona fide and without notice (including constructive notice: the collat. taker is deemed to know what it ought reasonably to have known) of the breach of duty. The knowledge of responsible individuals within the corporation is attributed to the corporation in accordance with some rules.</p>
--	--

ENGLAND – SECTION III

3.1. FINAL COMMENTS ON THE ENGLISH POSITION REGARDING CROSS BORDER TRANSACTIONS IN MODERN HOLDING SYSTEMS

The most suitable English collateral arrangement will vary depending upon the specific circumstances of the parties; they will need to measure the advantages and disadvantages of each arrangement. Initially collateral transfer seems to be the ideal collateral arrangement to follow: its structure does not involve the creation of a security, so issues of perfection of security, registration or notification requirements or similar formalities do not arise and obviously questions as to how to perfect security interest in securities held in a clearing system or other custodian arrangements are side-stepped; however on the other hand if there is a limitation or prohibition on insolvency set-off or netting in the home jurisdictions of one of the parties involved, the security interest may be preferred.

The vast majority of securities are now held, transferred and pledged by book entry on the records of financial intermediaries, and not by physical delivery or registered pledge on the books of the issuer or its official record holder; the CSD will act as centralised holder of the securities issued in or for its domestic markets. The UK has centralised certain functions through a CSD that arranges to have transfers effected directly on the books of issuers or their transfer agents.

In respect of the intermediary insolvency risk we have to consider that if the investor's chain of intermediaries consists of well managed and capitalised intermediaries, there will be few insolvency risks. However if the cost of obtaining the protection against that insolvency is not covered by the market then enterprising direct participants of those systems can be found which offer cheaper and non issuer direct services on their books; thereby becoming an intermediary between the issuer-direct system and the market.

Treaties do not discuss what *lex rei sitae* applies for book entry pledges of physical or dematerialised securities held through financial intermediaries in the modern international securities holding system.

This creates problems in the modern international holding system which has a large number of local and international central depositories (CSDs and ICSD) where large pools of securities are immobilised or otherwise concentrated; it also has a large number of banks, brokers and other financial international holding positions through CSDS and other financial intermediaries in a complex network of relationships ("multi-tiered" holding systems)

If someone explains the mechanism of the pledge with an intermediary, it will say that the credit seeker (pledgor): first, will instruct its financial intermediary to debit its account and credit a pledged account held for the benefit of the pledgee or will grant the credit giver control over a certain amount and type of securities credited to the credit seeker's account with the financial intermediary by authorising the financial intermediary to follow the credit giver's instructions to liquidate or transfer the pledge of securities in the event of default by the pledgor. This basically is the valid,

enforceable and perfected security interest in charge over or pledge of interests in securities enforceable against the credit seeker and all adverse claimants.

Three or more intermediaries can often stand between an ultimate investor and the individual physical or dematerialised sec. For instance at a tier below the CSD we can have professional investors, brokers or other financial intermediaries (*participants*) with direct contractual relationships with the CSD which hold their interests in securities in book entry accounts with the CSD. These financial intermediaries in turn may hold interests in securities for lower tier investors, brokers and other financial intermediaries which they will be “their customers”.

When *pledge* or *transfer* is made between two customers of a single intermediary in a multi-tiered structure the only thing which will happen is that *accounting entries are made on the books of the intermediary* (so no physical movements and no accounting entries on the books of the upper-tier intermediaries or the issuer will take place).

CSD and intermediaries normally hold their participants or customers securities in fungible form so that a participant or customer does not hold a right to any particular individual securities but rather a package of rights against the CSD or intermediaries or with respect to securities of the same type or number as those deposited with the CSD or intermediary which holds in an account with another intermediary at a higher-tier. The rights may be conferred by contract or by law, although in many jurisdictions with no modernised laws the law conferring such rights is not clear, leaving many gaps.

So the transfer and pledge of interests in securities by accounting entries on the books of one or more intermediaries without any movement of physical secs. or accounting entries on the books of the issuer or its agent, allows the rapid and efficient mobilisation of those interests.

The advantages of these holding systems are that:

*efficiency through the book-entry method of transfer, by simple debits and credits on the CSDs' books and other intermediaries holding positions through CSDs and by the economies of scale offered by the centralisation of large number of securities.

*low risk transaction settlement because CSDs and other intermediaries holding positions through CSDs can offer “delivery versus payment” settlement which ensures that final delivery takes place if final payment occurs, for participants and customers by a CSD or other intermediary that is bank holding cash accounts for its participants or by a close linkage between a CSD or other intermediary and the domestic payment system of its country.

*CSDs and other intermediaries also lower the total outstanding credit exposure of global market participants by favouring large scale netting systems.

3.2. IMPLEMENTATION OF THE FINALITY DIRECTIVE IN ENGLAND:

Her Majesty's Treasury is currently considering the implementation on a confidential basis and is working on the comments made out of the Draft "The Financial Markets and Insolvency (Settlement Finality) Regulations 1999", by main financial institutions which was handed to them in April.

Previously, in April of this year, 100 representatives from financial and legal communities and various government departments met at the British Institute of International and Comparative Law to discuss cross-border collateralisation and the implementation of the Artc. 9 (2) of the Finality Directive in the UK. The workshop ("The Oxford Colloquium") discussed aspects as to the importance of the adoption of the PRIMA approach, the interpretation of art. (narrow or broad) and its impact in the exposure in collateralised arrangements in cross border transactions, as well as if there were any compelling legal factors making inappropriate for PRIMA to be incorporated into Law in the UK by legal reform.

The general feeling was that the statutory recognition of PRIMA is extremely important and that the incorporation of a narrow view would be inadequate, leading to inconsistencies in application. However other participants made clear that the adoption of the PRIMA approach is unlikely to solve all of the problems that arise when there is a provision of securities as collateral in cross border transactions and that additional substantive law reform may well be necessary.

Now we are in a waiting period in the implementation, although the Treasury clearly stated that the British implementation procedures of European Directives make it impossible to adopt a broad interpretation. This does not mean that they are closing doors to the possibility of this interpretation in the English Law. However, they consider that this interpretation is beyond the scope of the Directive.

In CREST, one of the reasons why the assured payment system only provides "effective" DVP ("delivery versus payment link") and why an RTGS system would not by itself wholly eradicate intra-day insolvency exposures is that any transfer or payment made by the systems operated by CREST Co may potentially be set aside by the so-called zero-hour rules (insolvency of the transferring or paying party may have a retroactive invalidating effect on completed transfers or payments made by or on behalf of the insolvent party.) of English or other insolvency laws. The zero-hour rule under English Insolvency Law might affect transfers or payments made by the collateral giver with the presentation of a petition to wind up that party or its settlement bank. Under S 127 of the IA 1986; in a winding up by the court any disposition of the company's property made after the "commencement of the winding up" is void, unless the court otherwise orders. Furthermore another zero-hour rule might affect a payment in the systems operated by CREST Co at an earlier stage to the actual debit to a bank account (see Art. 4.90 (3) of the IA 1986). So, after commencement of the winding up of the collateral giver or its settlement bank its security or the realisation proceedings will be at risk in the event of a winding up order being subsequently made against, or resolution for winding up being passed in respect of the borrower or purchaser or its settlement bank. The Finality Directive will reduce many of the adverse effects of these zero-hour rules. The Regulations can be expected to give substantial protection to collateral takers and collateral givers.

Further, where the relationship between the issuer and the holder has been broken by the intervention of the depositary or other intermediary, the implementation of Art. 9 (2) of the Finality Directive should establish that the location of the collateral giver's entitlement is the place where the relevant register or account on which the entitlement is credited is located. The ad hoc group of leading practitioners and academics dealing with this problem hopes that the provisions of the 1999 Regulations implementing Art. 9 (2) will be further supported by primary legislation, perhaps in the form of an additional clause to be included in the Financial Services and Markets Bill.

COUNTRY BY COUNTRY ANALYSIS

***LEGAL UPDATE ON THE
BELGIAN PLEDGE***

Belgian Position:

1. **SECTION I:**

- 1.1 ***Belgian collateral arrangement Chart I:*** display of the type of investment securities which can be pledged and their general characteristics.
- 1.2. ***Belgian collateral arrangement Chart II:*** display of the relevant factors to consider in taking security by pledge and transfer of title in Belgium.

2. **SECTION II:**

Aspects of Belgian Security Interest Collateral Chart.: Detailed description of the proprietary aspects of the Belgian pledge, with reference to Euroclear position .

3. **SECTION III:**

Final comments to the Belgian position regarding cross border transactions in modern holding systems: comments on one of the most flexible mechanisms of taking collateral in the EU.

BELGIAN PLEDGE

**** Creation: a commercial pledge is created and perfected by way of a simple written or even oral agreement as soon as the pledgor is dispossessed of the collateral.***

Fungible securities: can be either bearer or registered securities held under a particular custodian arrangement with the C.I.K.; the relevant pledge asset with this fungibility regime, will be the pledgee's undivided, notional interest in the pool of securities held by the CSD involved; these interests represented by book entries in the books of the CSD, will to the extent that the CSD is governed by Belgian law. So all securities deposited with CIK are fungible securities, as well as the securities deposited with any affiliated member of CIK. In practice virtually all Belgian based banks and securities firms are CIK affiliates.

Dematerialized: the dispossession is done by crediting the amount of the securities to be pledged to a special account in the books of the relevant account keeping institution or with the appointed operator of the applicable clearing system (the National Bank of Belgium). With respect to dematerialised bonds and shares issued by private companies, the competent account keeping institution has not yet been designated.

*Type of investment securities which can be pledged:

. Shares: the most frequent method of taking securities over shares will be the pledge, although they can also be covered by floating charge, but pledge is in almost all cases the preferable perfection method. Regarding voting rights, they do not pass automatically to the Pledgee, usually is retained by the Pledgor. Dividends shall be paid direct to the Pledgee, although in practice it is common to agree that the dividends are paid to the Pledgor until an event of default occurs. Future shares can be pledged but the pledge is not perfected until shares come into the ownership of the Pledgor and perfection requirements are met. Their enforcement will be done by Court supervised sale (public or private auction).

* registered shares: they will be registered in shareholders' register or by giving notice of pledge to the company. No time limit but if registration is delayed more than 15 days after signing security documents and is then made within the pre-bankruptcy risk period, the security will be voidable; *bearer shares: no registration requirements; they will be perfected by delivery of the share certificates to pledgee or agreed third party holder; * Belgian dematerialised shares: not yet in existence and special rules will apply requiring shares to be credited to special collateral account; * shares or other securities held in Euroclear: special rules apply but in general we can say that the shares will be credited to a special collateral account held in Euroclear (go to Section II for more details).

.other investment securities: Considering the two regimes available for the perfection requirements of the investment securities, we have to identify first what type of categories fall into each regime: so for the regime of the law of 2nd of January 1991:A) OLO bonds and Treasury Bills issued in dematerialised form by the Belgian government; B) MTNs, CPs or CDs issued in dematerialised form by the following public sector entities: the Belgian Government, Belgian government agencies and government-owned organisation; foreign governments and agencies;

European and other international institutions; central banks and any other entities that may be identified for these purposes by royal decree.(The requirements for perfection of pledge are displayed in SectionII in the perfection part) Among the conditions set out in Artc7: the fact that the teneur de comptes must act as beneficiary or third party holder of the collateral (except when it is acting as a pledgor in which case a sub-account 51 will be opened in the central bank's clearing system), unless is itself the beneficiary in which case it must act as third party holder (if the special account is directly opened at the central bank in the clearing system the central bank will always act as third party holder of the collateral), implies that it must expressly consent to hold the securities as collateral for the account of the beneficiary and that it must be aware of the fact that the securities are held as collateral; this requirement makes the perfection of a collateral over OLO bonds and other sects falling under the regime of the law of 2nd of January more difficult than over the private sector sects held in Euroclear under the regime of the Royal Decree; for the regime of the Royal Decree No 62 and company law will cover: a) securities issued in dematerialised form by Belgian companies under articles 52 octies/1sq.Company Law; b) MTNs, CPs or CDs issued in dematerialised form under the law of 22nd of July 1991 by private companies or any issuers other than the public sector entities listed under B) above; c) all other securities deposited on fungible basis in a securities account held with a qualifying institution (the perfection requirements will be fully described in SECTION II with reference to Euroclear position.

Belgian Collateral Arrangements Chart II

ASPECTS TO CONSIDER IN TAKING BELGIAN COLLATERAL ARRANGEMENTS	
PLEDGE	TRANSFER OF TITLE
<p>*Future collateral: the Supreme Court has recognized the validity of a pledge granted by a customer to its bank as a security for any and all amounts which are or would still become due in the future by that customer to its bank. As a matter of contract a security interest in respect to future collateral can validly be created provided that the collateral is determined at the time of entry. A pledge will be validly perfected upon the pledgor's dispossession of the pledged asset.</p> <p>*Overcollateralisation: no restriction with respect to the amount of collateral to be pledged in relation to the value of the debt to be secured. In any event, possible abuse by the pledgee is prevented by the invalidity of clauses entered into prior to the debt becoming due providing for a right to appropriate the asset to the pledgee's benefit. General rule: the preferential right of the pledgee is in any event limited to the amount of the secured claim; any excess of the proceeds is to be returned to the debtor.</p> <p>*No action (filing, registration, notification, stamping or notarization or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval required under the Laws of Belgium to establish, perfect, continue or enforce the security interest.</p> <p>*Disadvantages:</p> <p>*Duty of care: apart from the returning of the collateral upon satisfaction of the debt, the pledgee as the holder of the collateral has to preserve the collateral with reasonable care.</p> <p>* Substitution of Collateral: the secured party must take care that the substitution of collateral does not disturb the continuity of the pledge (avoiding invalidation under the bankruptcy rules relating to new securities constituted during the pre-bankruptcy suspect period (art. 17 of the Bankruptcy Law)). The continuity will be subject to the Cour de Cassation's principles that the new collateral does not have a value in excess of the previous collateral; and that the substitution be simultaneous. Meeting both conditions even if the substitution was effected in the suspect period, the pledge will be upheld and preserve its priority. Difficulty in applying the conditions in factual circumstances and general legal uncertainty with this aspect.</p> <p>No possibility to confirm that the substitution of straight bonds with convertible bonds, secured bonds for junk bonds or bonds for shares will be recognized.</p> <p>*Bankruptcy and reorganisation: heavy restrictions upon the pledgee's rights. Plus, there is risk of conflict with claim over the securities by a pledgee of the business assets.</p> <p>* No re-use of the collateral: pledgee not allowed to dispose of the securities it holds</p>	<p>*creation: a transfer in Euroclear is evidenced by transfer of securities from the collateral giver to the collateral taker's account in Euroclear, according to Euroclear operating procedures.</p> <p>No special account needs to be opened; the securities can be transferred into an existing account resulting in full legal and beneficial ownership passing to the collateral taker. Euroclear has no proposed any specific documentation for this collateral. Indeed the Law request reference to the transferee's undertaking to retransfer the securities. The collateral giver and taker will enter into some form of security agreement.</p> <p>* enforcement: no specific enforcement procedure, as the securities are already owned by the collateral taker. It may set off their value against its claim against the collateral giver and a clause permitting it may be agreed at the time the transaction is entered into and included in the documentation.</p> <p>* During the course of the transfer of title, the collateral taker may use the securities transferred and dispose of them, provided that it retransfers equivalent securities. As to the voting power, this one is transferred to the collateral taker along with ownership.</p> <p>*Substitution: The law provides that the transfer of title to securities to effect substitution will be valid and enforceable in a bankruptcy or any other situation of competing creditors' claims and is not subject to Art. 17 of the Bankruptcy Law; so no specific conditions need to be met. It provides more flexibility and legal certainty.</p> <p>*Bankruptcy and Reorganisation: it enjoys substantial advantages over the pledge, avoiding the constraints that apply to the pledge. Also the collateral taker can remit to Art. 2279 of the Civil Code to oppose any claim over the securities by a pledgee of the business assets.</p> <p>*Disadvantages: in light of the advantages which title transfer appears to enjoy over a pledge, it seems that it should nearly always be the collateral arrangement of choice of collateral taker. However there are situations in which the collateral taker may not wish to take title because of unfavourable tax, accounting or regulatory consequences in the collateral taker's jurisdiction.</p> <p>Also for the collateral giver. Is a problem, because the ownership is transferred, and he is taking a bankruptcy risk on the collateral taker, so if the latter defaults on its obligations to return to the collateral giver same or equivalent securities, the collateral giver would be merely an unsecured creditor of the taker, unless it could manage to appropriate collateral it had taken itself, or otherwise effect a set-off, always under the bankruptcy law of the taker.</p>

BELGIUM – SECTION II

ASPECTS OF BELGIAN COLLATERAL	
Validity of the contract and attachment	<p>A) <u>Belgian Private International Law:</u></p> <ul style="list-style-type: none"> . The law chosen by the parties to govern their contract between them will be the “<i>lex contractus</i>” which will govern the constitution and scope, the validity and effectiveness of contractual relationship embodied by the agreement; whether there is a valid agreement will be governed by the “<i>the lex contractus</i>”. . The relationship between the contracting parties is governed by the law of the contract “<i>lex contractus</i>”. . The question as to the pledgor dispossession of the collateral is realized, will be governed by the “<i>lex rei sitae</i>”, irrespective of the law chosen by the parties. <p>B) <u>Belgian Domestic Law:</u></p> <ul style="list-style-type: none"> . For the creation of a valid pledge, a simple written or even oral agreement suffices if the pledge can be qualified as commercial, that is if the pledge secures a commercial debt (the law of 5th of May 1872 on Commercial Pledges, which contains specific rules applicable to these commercial pledges.) . Creation: pledge over securities in Euroclear Is effected by booking the securities into a special pledged account in the books of Euroclear; upon the transfer to this account the pledge is perfected against third parties (including the pledgor's other creditors and bankruptcy trustee. The pledgor, pledgee and MGT CoNY, Brussels branch enter into one of the versions of the Eurocl. Pledged Account Terms and conditions governing aspects of their relationship.
Perfection tegenstelbaar -heid, opposabilite	<p>A) <u>Belgian Private International Law:</u></p> <ul style="list-style-type: none"> . It will depend on the law of the place where the relevant assets are situated (“<i>lex rei sitae</i>”), however different criteria may be used when it comes to determining the location of the assets. . Registered securities will be regarded as located at the place where the registry is held; bearer securities will be regarded as located in Belgium if the bearer certificate is physically held in Belgium. . As to securities kept in Euroclear or any other clearing system: the law of 15th of July 1998 now expressly confirms that they should be treated as being located at the place

where the clearing system is established. The purpose of the **fungibility** regime organised by the Royal Decree n. 62 of 10 November 1967, applicable to Euroclear, breaks the direct link between the owner of the securities and the certificates representing the specific securities; so Euroclear as depositary may discharge its redelivery obligation by delivering any certificates of the same issue, therefore the physical location of certificates becomes irrelevant, because the participants have no specific right to any particular certificate. As long as the securities are fungible, the rights of their owners are represented by book entries in the clearing system much more than by any physical certificate. In short, the location of securities kept in a clearing system should be the place where the clearing system is operated and this has been reinforced with the law of 15th of July 1998. This law will amend art. 2bis of the Royal Decree n.62, providing that Euroclear may redeposit the securities it holds on account with any sub-custodian in Belgium or abroad, and that the rules set out by the Royal Decree with regard perfection of pledges remain applicable in that case. So Belgium law will govern the perfection of a pledge over securities kept in Euroclear, irrespective of a possible reposit of securities by Euroclear with a foreign sub-custodian.

- . **Dematerialised** securities have no physical existence and no obvious location; the closest thing to a physical existence of these securities is their representation as an account entry in a **clearing system**, so the location of the clearing system, will be the relevant location of the securities, analysis consistent with the conflicts of laws rule now set out by the law of 15 July 1998 in relation to securities kept in Euroclear (Euroclear treated as "location" of the securities even if they are reposit abroad).

B) Belgian Domestic Law:

- . A commercial pledge is perfected by way of a simple written or even oral agreement as soon as the pledgor is dispossessed of the collateral. An interruption in the dispossession will affect the existence of the pledge.
- . In the case of **pledge** based collateral, the perfection requirements depend on the type of securities concerned and the nature of the issuer. There are two different regimes to take into account:

1. Regime of the royal decree n. 62 and company law:

- the pledgor must have agreed that the securities will be subject to the fungibility regime of this decree (save in the case of securities issued in dematerialized form by Belgian companies under Art. 52 octies/1sq. of the company law). The

	<p>terms and conditions Governing Use of Euroclear provide that Belgian law is applicable, and that the system operates under the fungibility regime set forth by the Belgian royal decree, n.62 of 10th of Nov 1967. An additional provision should be included in the relevant security agreement when the collateral is held in Euroclear.</p> <ul style="list-style-type: none"> - The securities must be booked on a special account opened at a member institution of the applicable clearing system; and this clearing system is that of either in respect of public sector securities the National Bank of Belgium or the CIK in respect of private sector issuers. With regard dematerialised securities issued under Arts. 52octies/1sq. of the company law, the applicable clearing system is still to be determined by a royal decree. The requirement is not that the securities should be redeposited in the clearing system, but simply that they should stand to the credit of an account held at a member of the clearing system. * Euroclear's pledged account service: Eurocl. is a member of the CIK and of the clearing system of the National Bank of Belgium, so by transferring the securities to a special account opened in Euroclear therefore satisfies this requirement. With this service the pledgee must enter into a standard form agreement with Euroclear and pay certain fees. * Separate Euroclear account: when the beneficiary is a Eurocl.'s participant, it just request Euroclear to open an additional account in its name and arrange for the collateral securities to be credited to it. Here the security agreement needs to include provisions as to the special account's nature. Similar arrangements when the beneficiary of the collateral is not participant; a third party custodian member must then be involved. <p>2. Regime of the law of the 2nd of January:</p> <ul style="list-style-type: none"> - the requirements are set out in Art. 7 of this law, which sets out some conditions: * the securities must be credited to a special account which must be opened at an institution authorised by this law (member of the central bank's clearing system for dematerialized sects; for instance Euroclear, Belgian institutions and investment firms; foreign banks and investments firms, unless they have a branch in Belgium will not be authorized). The special account can be opened directly at the central bank in the securities clearing system. * the teneur de comptes must act as beneficiary or third party holder; - inclusion of an additional provision reflecting the perfection requirements. should be included in the security agreement.
Priorities	A) <u>Belgian Private International Law:</u>

- . Priority aspects will be governed by the Lex rei sitae.

B) Belgian Domestic Law:

- . A pledge confers upon the beneficiary pledgee a “preference” over the asset pledged, in the sense that the pledgee may in case of the debtor’s bankruptcy or insolvency be paid out of the proceeds of realisation of the asset in priority to all other unsecured or junior ranking creditors of the debtor; this preference right also implies the right to retain the asset until the secured claim is fully repaid.
- . A pledge may suffer from the risk of conflict with a pledge granted to another creditor over the general business assets of the debtor (similar to a floating charge) which cover the pledged securities. Here the first pledge constituted would have priority.
- . The general rule is that all creditors are to be treated equally; this rule got a public policy character and is subject to validly created security interest. Only security interest provided for by law can constitute a valid and enforceable priority right.
- . In the absence of any senior pledges, a pledge confers upon the beneficiary a first priority right to be paid out of the proceeds of the realisation of the asset against all other creditors of the debtor, provided that the pledge was not created during the “suspect period” to secure a pre-existing claim or the pledge has not otherwise been nullified under the applicable bankruptcy rules.
- . Priority between different pledges as to the same collateral: the priority will be determined in accordance with the date of creation “prior tempore”: the oldest pledge will have priority over all subsequent created pledges.

<p>Enforcement</p>	<p><u>A) Belgian Private International Law:</u></p> <ul style="list-style-type: none"> . Upon default of the counterparty, the enforcement is governed by the law of the location of the assets. Belgian law will be relevant in the various situations described above, and in particular when the collateral is deposited in Euroclear. . The most common conflict of laws rule for determining the law governing the enforceability against third parties will be also the law of the location of the collateral ("<i>lex rei sitae</i> or <i>lex situs</i>"); so the key issue is to resolve where is the collateral <p><u>B) Belgian Domestic Law:</u></p> <ul style="list-style-type: none"> . When the collateral is created by way of a pledge, the Belgian law sets out very simple requirements and again depending on the type of regime involved: <p>1. for securities falling under the law of the 2nd of January 1991:</p> <ul style="list-style-type: none"> - no prior court authorisation is necessary; - upon default of the counterparty the recipient may sell the collateral on its own initiative; - the enforcing party must give prior notice to counterparty, then sell it within the shortest period of time and refund to the counterparty any excess proceeds. <p>2. for securities falling under the royal decree or company law:</p> <ul style="list-style-type: none"> - the requirements above will apply if the securities are admitted to listing on stock exchange or dealt in another regulated market, recognized and open to the public or transferables and liquid debt instruments, which can have a value accurately determined at any time or at least twice a month; - if the criteria is not satisfied then for securities which are unlisted, the enforcement will be subject to the procedures set out in the law of the 5th of May 1872: service of demand (by bailiff) on the debtor, application to the president of the commercial court, service (by bailiff) of a copy of the application on the debtor, two day waiting period, decision by the president of the commercial court, service (by bailiff) of a copy of the decision on the debtor, and sale on the exchange (if the securities are listed) or at the stock exchange's weekly auctions (if they are not listed). . Enforcement: it must comply with the <i>mandatory requirements</i> of the commercial pledge law: ((Law 5th of May 1872) requiring <i>prior notice to the debtor</i>, application to the <i>competent commercial court, which will authorized the public auction or private sale of the securities by a person appointed by the court</i>, unless the sects. are traded on a regulated
---------------------------	---

	<p>exchange, regularly functioning, recognised and open to the public (Art.5,2 of the Royal Decree n.62). The pledgee may then sell the sects. after notification to the pledgor, provided that the sale is made promptly, considering the volume of the transactions. Pledgor and Pledgee may agree to depart from these rules (i.e. agree that sects will be appropriated by the pledgee and their value set-off against its claim against the pledgor), provided that this is decided in <i>tempore non suspecto</i> after the execution of the pledge agreement. No agreement when entering into the pledge agreement, thus subject to the consent of the pledgor. During the course of the pledge, this remains subject to the traditional rules of commercial pledges, including the prohibitions of using or disposing the pledged assets by the pledgee. Also according to most Company laws, the voting power linked to the sects remains with the pledgor, unless proxy (a specific one, granted for a limited time and meetings) is given by the pledgor to the pledgee.</p>
<p>Insolvency</p>	<p>A) <u>Belgian Private International Law</u></p> <ul style="list-style-type: none"> . The <i>lex contractus</i> and the <i>lex rei sitae</i> may be set aside by the relevant bankruptcy laws "<i>lex concursus creditorum</i>"; this will be normally be Belgian law if the bankrupt company is incorporated in Belgium. . Where Belgian Law is applicable as the <i>lex concursus creditorum</i>, the validity and effectiveness of the security interest are determined by the <i>lex rei sitae</i>; however the question as to whether a certain transaction is enforceable upon the debtor's bankruptcy, e.g. because the transaction was entered into during the "suspect period", may be determined in accordance with the <i>lex concursus creditorum</i>. <p>B) <u>Belgian Domestic Law:</u></p> <p>The transfer of title enjoys substantial advantages over the pledge. The Bankruptcy Law impose heavy restrictions upon the rights of the pledgee, which do not apply in case of transfer of title where the collateral taker should not be seen as a secured creditor and the transferred assets are his and he has the title to them.</p> <ul style="list-style-type: none"> . Even after the closing of the claims verification procedure, the court upon application of the trustee, can suspend the right of the pledgee to enforce the pledge for a maximum of one year from the declaration of bankruptcy, if certain conditions are met. . Relevant to mention the Judicial Composition aspects: a pledgee may not enforce the pledge during the period from the filing of a petition for judicial composition until the decision of the court (within 15 days of the filing); during the

	<p><i>“temporary stay”</i> that the court may grant (Art. 15 of the Judicial Composition Law), the pledgee may not enforce the pledge, if the interest and charges on the debt are paid to it; and during the <i>“definitive stay”</i> the pledgee may enforce its rights, except if it has agreed to the contrary or the court has made such stay compulsory.</p> <p>The Court may only do that if the reorganisation plan approved by the court provides for the payment of interest</p>
--	--

BELGIUM – SECTION III

3.1. Final comments to the Belgium position regarding cross border transactions in modern holding systems.

Belgium has been the first jurisdiction in creating a new legal category by statute to prevail over the rule that depositories lose their property rights in the individual securities deposited with the intermediaries and commingled in fungible goods.

The Belgian Royal Decree transformed the personal or contractual claims against Belgian financial intermediaries into co-property rights in notional pools of securities evidenced solely by accounting entries on the records of the financial intermediary, regardless of where the individual securities or actual pools of fungible securities are located; here the securities held through a securities intermediary subject to these laws cannot be used by the intermediary for its own profit without the consent of the depositors.

When taking collateral over securities held in Euroclear, the following points should be considered: a foreign law may be chosen to govern the security agreement, but the Belgian law is relevant with regard to the perfection of formalities and the enforcement methods; the Belgian law is not necessarily the only law may apply to the security's perfection; perfection requires that the pledged securities be transferred to a special collateral account in Euroclear which may be set up through Euroclear's own "pledged account" service, but this is not always necessary; when the pledged securities held in Euroclear consist in Belgian OLO bonds or similar securities, it is necessary to use Euroclear's "pledged account" service or custodian which is both a participant in Euroclear and a member of the National Bank of Belgium's clearing system; the security agreement always needs to contain certain provisions to ensure perfection in accordance with the Belgian law requirements and in most circumstances, enforcement upon default is not subject to any court approval.

In short this is the model type of law which has contributed to increased certainty in international marketplace by permitting a modern approach to conflicts of laws which allows investors and secured creditors to determine in advance, with certainty and without undue cost, the substantive law that will govern their rights and obligations.

3.2 IMPLEMENTATION OF THE FINALITY DIRECTIVE IN BELGIUM:

The theory that securities held in Euroclear must be regarded as located in Belgium has been reinforced by the Law of 15th of July 1998. Artc. 2bis of the Royal Decree No. 62, as amended by that law, now provides that Euroclear may re-deposit the securities it holds on account with any sub-custodian in Belgium or abroad, and that the rules set out by the Royal Decree with regard to the perfection of pledges remain applicable in that case. This implies that Belgian law will govern the perfection and enforcement of a pledge over securities kept in Euroclear, irrespective of a possible re-deposit of the securities by Euroclear with a foreign sub-custodian.

A further argument to support this analysis can be found in the recent European Finality Directive, which seeks to ensure that payment and settlement systems are protected against systematic risk, in particular through the effective use of collateral. The Artc.9 (2) of the Directive will provide that when securities held in a deposit system are delivered as collateral, “the determination of the rights of the beneficiaries as holders of collateral security in relation to those securities shall be governed by the law of that Member State. Although technically it may be that the directive only applies in the case of collateral delivered to central banks or participants in a settlement system and in the context of that system, it creates a strong consistency argument to the effect that the perfection of collateral in Euroclear generally should also be governed by Belgian Law.

The Belgian position definitely is taking a broad view, eliminating the legal risk for all participants in a European Union Settlement System, considering to apply the artc 9 (2) to direct and indirect participants of all payment and securities systems, whether they are European Union systems or not.

COUNTRY BY COUNTRY ANALYSIS

***LEGAL UPDATE ON THE
FRENCH PLEDGE***

French Position:

1. SECTION 1:

- 1.1 ***French collateral arrangement Chart I:*** here we will provide with general information relating to the collateral arrangements available under French Law: pledge and transfer of title, outlining the type of investment securities which can be pledged and how they are perfected and enforced.
- 1.2 ***French collateral arrangement Chart II:*** it provides the relevant recommendations for parties taking a pledge: its advantages and disadvantages (aspects such as retention, re-use, substitution).

2. SECTION II:

Aspects of French security interest Chart I: The Chart outlines the main aspects of the proprietary aspects (validity of the contract, creation or attachment, perfection, priority, enforcement and insolvency) of the security interest from a domestic and Private International Law point of view.

3. SECTION III:

- 3.1 ***Final comments to the French position regarding cross border transactions in modern holding systems:*** comments as to what type of lex rei sitae regime applies France in the modern indirect holding systems.
- 3.2 ***The implementation of the Finality Directive in France.***

FRENCH COLLATERAL ARRANGEMENTS	
PLEDGE	TRANSFER OF TITLE BY SECURITY
<p>*Perfection of a Securities Account Pledge: by the filing of the "Declaration" document, the Decree No. 97-509, 21st of May, 1997 stating what it is needed (see country by country analysis). No registration or notarisation of the Declaration is required, being signed by the holder and notified to the account holder of the sects being pledged; finally the pledgee receives a pledge certificate denoting the pledge. So technically the pledge is perfected as of the date of execution of the Declaration; common practice to have the Declartn. registered with the local tax authority because the stamp affixed by this authority contains the date of registration providing certainty as to that date.</p> <p>*Realisation:* The artc 29 significantly simplifies the enforcement process allowing Secured Party to enforce its rights without a court decision for pledged assets which may be valued objectively. Prerequisite: the Secured Party's claim against the pledgor should be certain in its principle, determined in its amount and due and payable. The Decree's steps: a formal written demand, delivered in person or by registered mail with French or foreign securities traded in a regulated market, the Secured Party is allowed to sale the sects in regulated market or appropriate an adequate amount of such sects to cover the secured liability with the last available closing price for sects on the relevant regulated market.</p> <p>*Type of investment securities which can be pledged: for shares we have to distinguish between pledge over shares ("Declaration de gage") for shares in most types of companies or pledge over account for shares in a societe anonyme: their enforcement can take place if they are publicly listed shares by public auction in court or before notary or by court order vesting shares in pledgee. If the pledgee is not resident in France we need to take advice on enforcement if listed shares, enforced on expiry of 8 days after order to pay sent to pledgor; if the debt is not paid, the shares are sold at last available quotation price or ownership transferred to pledgee; as to their registration: it will be required at Commercial and Companies Registry for pledge over shares in Societe Civil only; shareholders register of each company whose shares are pledged, French tax authorities, and the Direction du Tresor on enforcement, specifying owner and number of shares. Apparently shares in the following French Companies (SARL, SNC, GIE and Societe Civiles are not freely transferable and negotiable, you can take pledge over them, but their enforcement will be very complex. Also rights to dividends are automatically pledged and the pledgee is entitled to dividends on default. We need to state in the Pledge document that voting right of pledgor must be exercised on instructions of secured party once an event of default has occurred. For other investments: they will be pledged over account into which financial instruments are credited: covering sects or shares with direct access to equity or voting rights, loan notes, debt securities (other than trade bills, futures, units in collective investment scheme), as to their enforcement: for listed sects we need to serve notice of default or the debtor has to give notice of enforcement, then sold on market or attributed to secured party; for unlisted ones: same notice of default or the enforcement one, then seek court order to sell at auction. No registr.</p>	<p>*The creditor's position of an absolute and sole owner of an asset entitles it to act as such vis a vis third parties, however the creditor's proprietary interest only exists for security purposes and is essentially temporary; the creditor must account to the debtor for the transferred collateral *Artc 52 (4) creates this new method of collateralisation, permitting the setting off of reciprocal debts, relating to collateral. In order to benefit from the artc, favourable regime, the transactions need to meet some conditions as to nature of the transactions involving "financial instruments" (artc.1, 1996 Act),(spot transactions not relating to financial instruments if intra-day or settled shortly after their conclusion are not covered); their documentation applying only to transactions governed by a master agreement, complying with the general principles of a domestic or international market master agreement; and the status of the parties: an entity listed in Artc 25 or a non-resident institution having a comparable status. If the conditions are met, then termination of outstanding contracts and close-out netting in insolvency will be allowed, notwithstanding the provisions of artcs 37 and 56 of IA.</p> <p>* The above artc is not limited to agreements governed by French Law; so in dealing with foreign investment sects, we can rely on art. to enter into a Transfer Annex governed by English Law; also the Transfer Annex can benefit from the set-off regime of art.</p> <p>*Set-off: the parties should remain free to perfect their rights pursuant to privately negotiated collateral arrangement, provided that the conditions above are met, the enforcement of the secured party's right should benefit from art. 52.</p> <p>*Recharacterisation: in avoiding any recharacterisation of the collateral convenient to clarify the parties' intention as giving creation to a remise, en pleine propriete, a titre de garantie according to artc52,(4), and not creating any gage or nantissement.</p>

ASPECTS TO CONSIDER IN TAKING FRENCH PLEDGE (SECURITY INTEREST)

- *Fluctuating liabilities: there is nothing in the French law which may prevent the parties from securing fluctuating liabilities, provided that they are determinable in accordance with Art. 1129 of the Civil Code. However, as regards perfection, it is (save in the case of the Securities Account Pledge) necessary to specify the assets pledged, which in effect renders it almost impossible to take a pledge over a fluctuating pool of assets.
- *Security over future obligations: it will be valid under French Law, so long as the means to be used for the later determination of the secured obligations are, as of the date of perfection of this collateral arrangement, provided in the relevant documentation.
- *Security in future collateral: the general rule is that no security interest in future collateral may be perfected, because perfection requirements need to comply with for specific items of collateral, again the Securities Account Pledge will make the exception as results of creating a security interest in respect of the account where the securities are held; so new securities transferred or deposited in the pledged account will automatically be covered by the Security Interest for the secured party's with no need to perform any further formality.
- *Duty of care: Secured Party's responsibility for loss or deterioration, except with Securities Account Pledge where the duty of care is borne on the relevant custodian.
- *Disadvantages:
- *Substitution: it will imply the release of the security interest in respect of the assets returned to the pledgor and the subsequent perfection of a new security interest; however with Securities Account Pledge transfers to or from the accounts may not require release of the pledge, so substitution has no effect, although in bankruptcy may have adverse effect. (Go to Section II, A) International Private Law, enforcement part, for the enforceability of the substitution of collateral). Also if the substitution took place during the Suspect Period, the Artc.52,4, will not lead to a successful transfer of title by way of security, avoiding recharacterisation.
- *Overcollateralisation: nothing in the French law prevents it, except in the case of Insolvency Proceedings, where art. 107 of the IA provides for an automatic annulment of unbalanced bilateral agreements, for instance when the insolvent party notably exceed the obligations of the other party involved.
- *Retention: once pledgor has surrendered possession of the pledged assets to its secured creditor no possibility to claim repossession of the pledged asset until full payment of the secured obligation; this right is a very important protection for the secured creditor, however gives rise to certain legal difficulties (what about book-entry or other immaterial assets which cannot be physically possessed) and relating to the person actually possessing the pledged assets or when the custodian is not the Secured Party, the retention by the creditor appears difficult; Art 29 that the Secrd. Party of a Securities Account Pledge enjoys of that retention in all circumstances even when it is not the custodian of the account where the collateral is held.
- * No termination on grounds of Insolvency: no contract may be terminated by a contracting party on the sole ground that Insolvency Proceedings are pending against the debtor (arts. 37 to 56 the Insolvency Act); the case law gives interpretation to this provision: any contractual provision enabling one party to terminate the contract because the other party ceases its payments to its creditors has been held unenforceable (even in the absence of bankruptcy at the time of termination).
- *No sell, use or dispose of the pledged assets: The pledgor would generally be required to surrender legal possession of the relevant collateral to the Secured Party or a third party custodian, the pledged assets will remain the pledgor's property, so the pledgee cannot use, sell or dispose of the security investments (object of criminal offence).
- * Art. 2078: of the French Civil Code prohibits any agreement purporting to automatically transfer title to the pledged assets to the pledgee in the event of default
- *Filing of a declaration of claims: recommendation made to secured and unsecured creditors (Art.50 of the IA);failing to make it they will be deemed not to have any rights against the insolvent party; so any security interest provided by the insolvent party to secure its rights will be unenforceable under French and also although Art.29 of the 1983 provides for retention right for the Secured Party of a Securities Account Pledge, this filing of a preliminary claim applies and constitutes condition to the exercise of the right of retention.
- *"Loi Toubon": it is a mandatory provision which certain French entities, in some cases, needs to fulfil in order to enter into agreements drafted only in French language; from Parliamentary discussion it seems that this law is only applicable to agreements which are entered into for the performance of the public service mission by a private entity. So this use will not apply to security interests. Other linguistic problems not related to the Loi Toubon include the case of the Registration with the French tax authorities, which needs to be effected in French.

FRANCE – SECTION II

ASPECTS OF THE FRENCH PLEDGE	
Validity of the contract and attachment	<p>A) French Private International Law:</p> <p>*As regards the constitution of rights on <i>septs</i> it is the <i>lex contractus</i> which provides the regulations that determine the nature of the securities rights, subsequently conferred by the debtor to his creditor.</p> <p>*French Law permits the parties involved to a contract to freely elect the law which will govern their agreement, so long as : the agreement is an international contract and such choice is not made with the intention of avoiding application of any mandatory provisions of French Law which would have been applied to the agreement.</p> <p>B) French Domestic Law:</p> <p>*The validity of the pledge agreement requires <i>both the pledgor and the pledgee to have the capacity to contract, the pledgor needs to have the ownership of the septs to be pledged</i>; the existence of a <i>valid debt to be guaranteed and a transferable property state</i>.</p> <p>* In general, for the creation of a pledge <i>a written agreement is necessary which shall be notified to the debtor by a bailiff or be signed by the debtor before a public notary</i>.</p> <p><i>In addition a pledge implies the dispossession of the items to be pledged and their transfer to either the pledgee or a third party acting on behalf of the pledgee (note that the term “transfer” is not related to a transfer of ownership, it’s rather a “physical transfer”).</i></p> <p>* <i>With the Law of July 2, 1996, and its provision amending the pledge of securities and creating a new kind of security device “the pledge of financial instruments accounts”, new technical aspects of the creation of the security interest need to be considered; so it is no longer necessary to undertake the previous formalities of delivery of a declaration of pledge to the account holder; the transfer of the pledged securities to a special account and the issue of an affidavit of pledge by the account holder. The main cornerstone of the new regulation is the delivery of the declaration of pledge to the account holder. The issue of the document is the formality which renders the <i>sext</i> interest enforceable in respect of the parties and third parties.</i></p> <p><i>The format of the declaration of pledge is set out in artc 1 of the Decree, which includes: the value of the secured obligations or, failing such, any information allowing such valuation; a description and number of financial instruments registered in the pledged account at the date of the issue of the declaration of pledge and the elements which allowed the pledge account to be identified.</i></p>

	<p><i>The nature of the declaration of pledge has been changed, in the sense that the collateral is no longer constituted by the financial instruments held in the account, but by the account itself. The transfer of financial instruments must take place on or before the date of issue of the declaration of pledge. In such case it is advisable for the pledgee to ask the account holder to issue a representation and warranty as to the effective registration of the financial instruments in the pledged account.</i></p> <p><i>*It should also be noted that a pledge created during the "suspect period" (as such period may be determined by the judge when insolvency proceedings begin against the pledgor) would be declared <i>invalid</i> (see below).</i></p>
<p>Perfection</p>	<p>A) French private international law:</p> <p>*The Law of the jurisdiction of location of the assets (<i>lex rei sitae</i>) governs the aspects regarding perfection; for instance the definition of the rights that may exist over a particular investment security depends on the classification of the asset and rights <i>in rem</i> in respect of such assets which exist in the legal system of the jurisdiction of location of the assets. The case law also supports for the law of the location of the collateral as the governing this aspect of security interest in collateral located in France.</p> <p>*So French Law will not apply to a security interest in foreign collateral, however it will apply for the ones located in France.</p> <p>B) French domestic law:</p> <p>*Since November 3, 1984, all securities issued on French territory and subject to French Law, whatever the form, registered or bearer, may no longer be materially represented by printed means. The securities must be registered in an account. The Law n. 81-1160 of 1981 regarding dematerialisation held that all securities issued in France and governed by French Law, whether bearer or registered, whether issued by public or private companies or governmental entities must be represented by book-entries in securities accounts</p> <p>*Perfection of a Securities Account Pledge: by the filing of the "Declaration" document, the form of which is set out in <i>implementing decree No. 97-509, 21st of May, 1997</i> stating that it is needed : <i>the title "Declaration de gage de compte d'instruments financiers"; a reference to Artc. 29; the name and address of the pledgor and pledgee; the amount and its identification details of the secured liability; identification details of the pledge account, where it is located and the nature and number of financial instrument initially held in the pledge account. No registration or notarisation of the Declaration is required, being signed by the holder and notified to the account holder of the securities being pledged; finally the pledgee receives a pledge certificate evidencing the pledge. So technically the pledge is perfected as of the date of execution of the</i></p>

	<p>Declaration which it cannot be challenged; for this reason it is <i>common practice</i> to have the <i>Declaration</i> registered with the local tax authority because the stamp affixed by the tax authority contains the date of registration and provides certainty as to that date.</p> <p>* Pursuant <i>Artc 57 of the Insolvency Act</i>, regarding security interests whose effectiveness vis –a-vis third parties is subject to publicity or registration, no such formality may be effected after the date of the Initial Judgement. For the Securities Account Pledge, because the pledge is perfected as of the date of execution of the Declaration, registration of the Declaration is not necessary to perfect the security interest vis –a –vis third parties; so the Registration can be effected after the date of an Initial Judgement.</p>
<p>Priorities</p>	<p>A) French private international law: * All priority aspects will be governed by <i>lex rei sitae</i>.</p> <p>B) French domestic law: *The Insolvency Act, establish a hierarchy in the priorities between “super senior” creditors to all other creditors: which are :</p> <ul style="list-style-type: none"> -employees who enjoy a so –called “super privilege” which has priority over all other privileges; - creditors with legal privilege on the basis that their claims arose during the Observation period (see Insolvency part, below); - The Treasury or the social security administration as regards their respective claims. <p>Under certain circumstances, secured creditors enjoy a retention right which allows them to defeat the priorities set forth; in this case the retention right will prevent the sale of a pledged asset by another creditor even if such creditor enjoys one of the above privileges or even if the creditor has retained title to the pledged asset pursuant to a retention of title contractual provision.</p> <p>* During the Observation period and despite the strict prohibition imposed upon the Administrator by <i>Artc. 33 of the IA</i> to pay antecedent debt, the Administrator or the insolvent party, may be allowed by the court to pay an antecedent debt to obtain the release of a pledge over assets which may be required for the continuation of the insolvent party’s business. This payment is the only exception to the priorities laid down by the Insolvency Act in favour of the Treasury or <i>Artc 40</i> creditors.</p>
<p>Enforcement</p>	<p>A) French private international law: *The effect of a bankruptcy on the enforceability of the substitution of collateral held outside France will depend on the treatment of such substitution by the <i>lex rei sitae</i>. If the <i>lex rei sitae</i> requires the perfection of a new security interest over the</p>

substituted assets upon each substitution , there is the risk that the new security interest would be deemed by a French Court to have been perfected during the Suspect Period; as to the date of this perfection , the French Court will refer to the law of the jurisdiction where the relevant assets are located. The French Court would then consider whether that date falls within the Suspect Period and if so, could declare void and null the security interest perfected at that time.

B) French domestic law:

*Under **artc 2078 of the French Civil Code**, the *pledgee may, in the case of a default of the pledgor in the payment of the secured obligation, **apply to a court*** in order to either :

- obtain title to the pledged assets as partial or full payment for the secure obligation, after appraisal of the assets has been made by an expert;**
- or request that the pledged assets be sold in a public auction.**

If the security interest is granted by an entity incorporated as a Commercial Company or person carrying a commercial activity, including a Bank, the secured Party will benefit, in enforcing its rights, from the favourable regime of the French Commercial Code. Under *artc 93 of the French Commercial Code*, the *Secured Party may after eight days following a formal notification addressed to the pledgor and the custodian, directly procure the sale by public auction of the pledged securities without being required to first obtain a court decision to approve such sale.*

*The enforcement procedures have also been simplified. The former *artc 29* contained no provision as to the action to be taken in the event of non-performance of the secured obligations by the pledgor. The new regime of the **Decree of May 1997** states the following in the **artcs 2 and 3**:

-the realisation needs the **sending of a notice to the debtor**, being void where it does not indicate that in the absence of payment the pledge can be enforced by the creditor within eight days or at the expiration of any other deadline previously agreed with the pledgor ; and the pledgor may inform the account holder of the order in which the sums of money or sects are to be fully assigned or sold, as the creditor so chooses.

-according to *artc 3 of the Decree*, the realization of the pledge shall **occur within the limits of the secured obligation** and where appropriate, **regarding the order indicated by the pledgor. for all sums of money figuring in the pledged account, by direct transfer of ownership title to the pledgee; for both French and non-French sects traded in regulated markets or by allotment of the quantity determined by the pledgee** (the quantity is determined by the pledgee on the basis of the last closing price available on a regulated market); *and for shares in*

collective investment undertakings, which the pledgor or, failing it, the pledgee has designated, by presentation for buy-back or by allotment of the quantity determined by the pledgee (quantity is to be determined by the pledgee on the basis of the last valuation available for the said shares)

*Where the pledgee is not the account holder and when it considers the conditions of realisation of the pledge to be fulfilled, it must in writing, request the account holder to proceed with the realisation under the conditions set out above. The account holder shall execute the instructions received, all charges to be met by the pledgee.

The pledgor shall bear the cost of all charges resulting from the realisation of the pledge. Such charges shall be deducted from the amount resulting from this realisation.

<p>Insolvency</p>	<p>A) French private international law: * In principle French Law applies throughout French territory. The Art. 242, of the French Insolvency Law n.85-98, 1985, states that this Law with the exception of articles 130 to 136 is applicable in the French overseas territories and the administrative domain of Mayotte; since no other territories are specified, the law does not apply elsewhere, not having authority on securities held outside the French territory even when the securities belong to a person who is subject to insolvency proceedings in France.</p> <p>B) French domestic law: *<i>The 1984 Law</i> contains the main provisions of French Law as to <i>Voluntary Arrangements</i> which aim to solve the financial difficulties between the debtor and its main creditors (French tax authorities, social security administrators, main suppliers and banks) by setting up an agreement negotiated under the control of a conciliator, in order to attack the bankruptcy. If a Voluntary Arrangement is sought in respect of the debtor, the competent court may temporarily stay individual proceedings against him for a period not exceeding the term of office of the Conciliator, where any enforcement proceedings initiated by a creditor and any individual judicial proceeding initiated by a creditor whose claim originated before the Court's judgement ordering the stay, will be forbidden.</p> *The Insolvency Act provides a <i>good protection for the secured creditors' rights</i> : the insolvency proceedings would be initiated whenever the debtor cannot meet its debts, so an " <i>Initial Judgement</i> " will be rendered by the competent Court, determining the date as of which the debtor is deemed to have ceased its payments (" <i>Date of Stoppage of Payments</i> ") which may be also set on the same date of the "Initial Judgement" or may be deemed to have take place eighteen months before the date of such judgement. Any period between them will be called " <i>Suspect Period</i> ". The "Initial Judgement" appoints an "Administrator" and "The Creditors' Representative", and initiates an "Observation Period", during which the business of the debtor is continued and certain steps are taken for its recovery and the debtor is managed by, or under the supervision of, the Administrator. If there is no possibility of recovery, the court at any time will appoint a liquidator and proceed with the judicial liquidation of the debtor (which can also be decided by the competent court in the initial Judgement). *Artcs 37 and 56 of the Insolvency Act confirm that <i>no contract may be terminated by a contracting party on grounds that Insolvency Proceedings are pending against the debtor.</i> *Artc47 of the Act states that " <i>individual</i> " proceedings against the debtor are suspended or prohibited as from the " <i>Initial Judgement</i> " date. Regarding proceedings initiated before that
--------------------------	---

	<p>date, the Insolvency Act provides for the suspension of the pending claim and its filing; once the filing is effected, such proceedings are resumed for the sole purpose of establishing the reality of the claim of the creditor against the debtor. The application of these provisions is mandatory independently of any contractual provision to the contrary. The freeze in the proceedings also affects enforcement proceedings with respect to real or personal property of the debtor. Individual creditors will recover their right to obtain enforcement of their claim individually only after a liquidation judgement has rendered against the debtor.</p>
--	---

**Artc. 108 of the IA states that any payment or action for valuable consideration, taken during the Suspect Period by the insolvent party may be cancelled by the court if the party dealing with the insolvent party knew that the latter was already insolvent; this annulment is not automatic and the court has discretion to take into consideration all circumstances of the case.*

FRANCE – SECTION III

3.1. FINAL COMMENTS TO THE FRENCH POSITION REGARDING CROSS BORDER TRANSACTIONS IN MODERN HOLDING SYSTEMS:

France is one of the fully modern jurisdictions which combines both traditional categories of rights into a new category of property rights in order to bring its legal regime into line with the commercial changes resulting from the modern indirect holding systems of multi-tiered international securities. In France the location of the pledgor's intermediary will be relevant when the *lex rei sitae* applies to modern categories of property rights. As a result of the 1996 French law on Modernisation of Financial Activities which states that any security interest created would be on the securities account maintained with a French securities intermediary, and not on the individual securities credited to the account, the *lex rei sitae* of the investment securities pledged should be French Law. The landmark provisions contained in the Artc. 102 will enable any person to pledge a "financial instrument" account in connecting with any type of transaction; once the account is pledged any financial instruments held in the account will be subject to the pledge. The term "financial instrument" is broadly considered, including domestic or foreign securities as long as they are reflected in a book-entry securities account opened with a French custodian entity. Compliance with the traditional procedures for pledging individual securities is no longer necessary; nevertheless artc 102 reflects traditional legal principles governing pledges where the pledgor retains title to the collateral and also it will enable the parties to pledge a portion of a particular securities account by either opening a pledged sub-account into which all the pledged assets would be transferred or by earmarking the relevant assets such that they are deemed to represent the pledged account.

In short, a person who takes a book-entry pledge of such an interest has acquired an interest evidenced by a credit to an account with the pledgor's intermediary and the *lex rei sitae* of the interest is the law of the intermediary's office whose records evidence the interest. This will have also consequences in aspects such as duty of care: with the new Securities Account Pledge, the secured party will not always be given actual possession; now the account in which the securities are held will be deemed to be in the possession of the custodian of such account (Sicovam S.A. as clearing system, a bank acting as "*intermediaire habilite*" for example). Thus the relevant custodian will have the following duties: to preserve the rights of both pledgor and the Secured Party; to comply with the sale and purchase orders given by the Pledgor, provided that they comply with the relevant terms of the security interest; inform the Pledgor of any transactions relating to the investment securities and return the securities to the Pledgor once the underlying liability has been paid.

The broad language and the new direction of the French Laws on this subject should greatly comfort participants, both domestic and foreign, potentially offering a very flexible and new framework for more creative financial engineering in structured financings.

3.2. The implementation of the Finality Directive in France:

There is a high level of confidentiality in terms of the implementation of the Directive to date. The level of secrecy is such that the French Banking Association is not aware of any draft legislation relating to the implementation.

Considering that the purpose of the Artc. 9 (2) of the Directive is to protect the beneficiary of collateral against the insolvency of the party which has constituted such securities in its favour. In order to avoid any uncertainty in the event of an insolvency of the debtor, it would be advisable in the implementing legislation to expressly make reference to the insolvency law and state that the Directive's insolvency provisions will prevail on those of the French Insolvency law. This has been done twice by the Law n.96-597 as of July 2nd, for the purpose of "close out netting" and also in the event that an intermediary acting as account keeper or custodian settles a transaction in lieu of its defaulting customer, by the delivery of financial instrument referred to against a payment in cash.

Considering the already mentioned artc 102 which requires that financial instruments be registered to a pledged account held with an authorised intermediary, a central depository or the issuing entity and also that the French International Private law regarding the implementation of the rights over pledged securities is subject to the *lex rei sitae*. Thus it appears French law already favours a PRIMA approach and a broad interpretation of Art. 9 (2).

COUNTRY BY COUNTRY ANALYSIS

***LEGAL UPDATE ON THE
SPANISH PLEDGE***

Spanish Position

1. SECTION I:

Spanish collateral arrangement Chart I: Display of how the investment securities in Spain are pledged and some relevant aspects related to collateral to be considered in taking pledge in Spain.

2. SECTION II:

Aspects of the Spanish security interest: domestic law and Private International law review, analyzing each of the proprietary aspects of security interest in Spain.

3. SECTION III:

3.1 *Final comments to the Spanish position regarding cross border transactions in modern holding systems.* This section describes the type of category of legal rights in Spain when considering the *lex rei sitae* of investment securities of an interest in securities held through intermediaries.

3.2 *The Spanish implementation of the Finality Directive.*

SPANISH PLEDGE

- * The main type of investment securities in Spain are: (I) shares listed in the Stock Exchange; (II) public debt fixed income securities, traded in the Debt Market of the Bank of Spain and (iii) private debt fixed income securities, traded in AIAF market.
- * Securities in Spain may be represented in general by either book entry or the traditional categories of registered or bearer securities. Securities must be represented by book entry accounts in order to be listed in the stock exchanges.
- *Shares: The execution of the pledge will be done as a public document, either (I) public deed executed before a notary or (ii) a “poliza intervenida” (“policy”) signed in front of an official stockbroker, which will make it enforceable against third parties. For shares evidenced by certificates, the shares must be delivered to the pledgee and also they need to be endorsed with the details of the pledge. For shares evidenced by book entry the creation must be noted against the entry; their perfection shall be made as soon as the pledge has been filed with the book entry account related to the pledged securities, or the execution date has been stated in the corresponding public deed. Likewise, the pledge shall have to be filed with the relevant company's share registry book in order to exercise the shareholder's rights, as applicable. All the rights attaching to the shares including voting rights, remain with the pledgor. When the debt secured by the pledge becomes due and payable then the pledgee has the right to request the sale of the pledged shares, the pledgee does not take immediate possession and ownership of the shares. Notification is not required to perfect security but to facilitate enforcement. It shall be made by the pledgor to the Company whose shares are pledged. Regarding their enforcement, in the case of listed shares there is a special procedure under the Commercial Code; in the case of unlisted shares, at the choice of the beneficiary, the enforcement will be done by either a judicial or extrajudicial procedures; the latter one is much faster; however the possibility of using it has become doubtful due to a recent ruling of the Supreme Court.
- * The other investment securities: Listed securities will need to provide notice to the Managing Entity "Sociedad Rectora" of the relevant Stock Exchange and to the National securities Market Commission "Comision Nacional del Mercado de valores" is also required for the security's validity. Communications specified above regarding the listed securities must be done within 10 days following the execution of the public document. Bearer securities, their transfer is done by transfer of title; for registered securities: their transfer requires endorsement and in the case of sects represented by book entry, the transfer will take place by registration at the account held with the relevant registry where the securities are registered.
- * In the case of collateral which has been required for general obligations before any securities exchange, market transactions or before the clearing house, the pledge may be created by means of a private document and subsequent filing with the entity in charge of the book entry accounts as long as the consent of the owner and the beneficiary are evidenced or by means of an statement made by the owner. It should be noted that the pledge created by means of a private document shall not have the effects corresponding to an execution by means of a public deed (priority ranking aspect: with respect to private documents which in the event of a bankruptcy or separation rights from the bankruptcy state.
- * Reorganisation: in the case of reorganisation of an insolvent debtor, the pledgor shall have an abstention voting right in the creditors' meeting, which basically means that the result of the agreement reached by the creditor's meeting shall not affect his/her rights, unless the reorganisation officers decide to repay the existing debt in order to collect the the pledged securities.
- *Substitution risk: it will destroy the pledge.

SPAIN – SECTION II

ASPECTS OF THE SPANISH PLEDGE	
Validity of the contract and attachment	<p>A) SPANISH PRIVATE INTERNATIONAL LAW:</p> <p>. The applicable law as to the formation of the agreements, shall be applicable law in the country in which the agreements are signed. Notwithstanding the foregoing, the laws applicable to the content of the agreement shall also be valid, as well as the national law of the executing parties.</p> <p>B) SPANISH DOMESTIC LAW:</p> <p>. The general provisions applicable to the validity of the pledge agreement are set forth in the Spanish Civil Code stating that:</p> <ul style="list-style-type: none"> - the pledge must be created in order to ensure fulfillment of a principal obligation; - the object of the pledge must belong to the pledgee; - the pledgee must have no restrictions in order to enter into a pledge agreement or must be duly authorized and - finally, the object of the pledge must be entrusted to the pledgor or a third person by mutual consent between the pledgor and the pledgee. <p>. Regarding securities held by <i>book entry accounts</i>, this requirement shall be met by <i>filing the pledge with the book entry account</i>.</p>
Perfection	<p>A) SPANISH PRIVATE INTERNATIONAL LAW:</p> <p>. The criteria used shall be typically the <i>lex rei sitae</i>, so long that an effective perfection of a security interest shall be made in the country in which the securities are held.</p> <p>B) SPANISH DOMESTIC LAW:</p> <p>. Of relevant importance will be the Sixth Additional Provision of the Law 37/1998 the Amendment of Law 24//1988 of 28 of July of the Securities Act. This provision states that when <i>pledges are provided as collateral securities over negotiable securities in a Secondary Market and represented by book entry</i>, for the purpose of securing general obligations arising from any Secondary Market and its liquidity and clearing systems or obligations arising from any transaction arranged in these Markets, such pledges can be constituted by <i>intervened policy by stock broker or public document</i>. Likewise these pledges can also be constituted following the wording of the Art. 10 of the Securities Act. by:</p>

	<ul style="list-style-type: none"> • private document, should the institution in charge of the account register practice the corresponding registration when it gets evidence of consent from the holder in that register and the institution in favour of which the pledge has been provided; • unilateral declaration by the holder in the account register, in which case the acceptance by the favored institution will be considered as taken <i>from the moment in which the institution in charge of the account register is aware of the unilateral declaration</i>, whenever this acceptance had been envisaged in the Market regulations or in settlement and clearing systems, or it had been previously and expressly stipulated by the parties involved. <p>. The institution in charge of the <i>account register</i> will <i>inform the favored institution</i> not only of the <i>registration of the pledge</i>, but also of any <i>incidences and circumstances surrounding the pledge</i> which may take place.</p> <p>.The <i>pledge will only be valid against third parties from the date that appears on the account register</i>.</p>
--	---

<p>Priorities</p>	<p>A) SPANISH PRIVATE INTERNATIONAL LAW: . The criteria used shall be the <i>lex rei sitae</i>.</p> <p>B) SPANISH DOMESTIC LAW: . Priority aspects will be determined by : <i>(I) execution before a Notary Public or Official Stockbroker; (ii) filing with the book entry registry and (iii) execution date.</i> . In case of insolvency the Banco de Espana has a privileged position towards other debtors; in the case of bankruptcy, the pledge creditors' rights are unchallengeable unless the relevant agreements fall within the period of retroactivity judicially declared. In the case of "suspension of pagos" , we have to clarify that wages and salaries of the last 30 days would prevail over any credit, including pledge credits, so regarding these wages we have to consider:</p> <ul style="list-style-type: none"> - wage credits are preferred over any other credit other than securities such as a mortgage or pledge; - the wages for the last 30 days worked and for a quantity that cannot be greater than double the minimum interprofessional wage are preferred over any other credit including those guaranteed by pledge or mortgage; - the worker's credits over the goods which they manufactured have preference; <p>the severance pay derived from the termination of the workers' jobs is considered as another wage, so it will have preference.</p>
<p>Enforcement</p>	<p>A) SPANISH PRIVATE INTERNATIONAL LAW: . As a general rule the enforcement shall be made in accordance with the laws of the place in which the securities are held. (<i>lex rei sitae</i>).</p> <p>. On the other hand , and as far as the applicable courts are concerned, the <i>Spanish courts</i> shall be competent in order to solve any controversy regarding the realisation of the pledge in the event the <i>defendant is a Spanish debtor</i>; if the Spanish debtor is not the defendant then the relevant courts shall be the one corresponding to the place in which the securities are located, unless the parties expressly submit to the Spanish courts. This is in the case where we are dealing with a <i>domestic debtor and a foreign collateral</i>. Where there is a <i>foreign debtor and domestic collateral</i> in this event the <i>same rule</i> applies; although we have to add the fact that the foreign courts shall be competent to rule on any controversy, provided that the <i>foreign entity is the defendant</i>. Otherwise, the courts of the place in which the securities are held shall be competent, unless the parties have expressly submitted</p>

to the courts of the defendant. In the case of **foreign debtor and foreign collateral** here the **Spanish laws shall not apply** unless there is a connection with Spain and the parties expressly submit to the Spanish laws. Furthermore, the enforceability of a foreign judgement in Spain is unenforceable in the event that it is incompatible with the Spanish public order.

B) SPANISH DOMESTIC LAW:

Regarding its enforceability, we will have to consider the **Commercial Code's** provisions in **Arts. 320 to 324** concerning collateral loan which were given new reading in the Law 24/1988 of the Securities Act in its fourth Additional Disposition (see also the fourth Additional Provision in the Draft Bill of codifying legislation of the Securities Act) however with the accreditation of the documents that envisage the discipline and codified rules of the particular market in the taking of the pledge regulation will be enough to verify the pledge existence and the claimed amount.

Art. 320 states a **priority criteria**: the lender has the right to ensure that its interests in the collateral assets will be enforceable, against any other creditors of the borrower.

Art. 321 establishes that *when payment of the loan is due, the lender*, unless otherwise agreed to the contrary and with no need to call upon the borrower, will be *authorized to transfer the pledged securities*, by handing to the Secondary Market's managing bodies the policy or loan deed, together with the pledge title or the verified certificate of the pledge registration issued by institution in charge of the particular account register.

Once it has completed all the appropriate verifications, the managing body will adopt the necessary measures to transfer the pledged securities on the same day or (if not possible) the following day in which it receives the secured creditor's communication by a member of the particular Secondary Market.

It is also necessary to satisfy the requirements of Art. 1435 of the Ley de Enjuiciamiento Civil (Law of the Civil Procedure).

Art. 324 states that the pledge may retain the pledged securities until the underlying obligation has been satisfied.

	<p>Additionally, there is a special judicial procedure called “<i>Procedimiento Ejecutivo</i>” for realisation purposes. This is an accelerated procedure in comparison with the normal judicial procedures. Furthermore, there is <i>private realisation procedure</i> carried out before a <i>Notary Public</i>, which is very rare in practice and by which public auction of pledged shares take place.</p>
<p>Insolvency</p>	<p>A) SPANISH PRIVATE INTERNATIONAL LAW: . The insolvency procedures affecting a Spanish company, shall be carried out before the relevant court located at the domicile of the Spanish company.</p> <p>B) SPANISH DOMESTIC LAW: . The Bankruptcy laws in Spain confer <i>special protection of the pledgor’s rights</i> e.g. <i>S918 of the Commercial Code</i> generally exempts the pledgor from the obligation to return the pledged securities to the bankruptcy estate. The authorized representatives of the bankruptcy estate shall repay in full the credit or collateralised loan by the pledge. . On the other hand the <i>Civil Code in its S1926 grants special treatment in favour of the pledgor’s rights</i>; those rights need to be valid, effective and binding as long as the pledge is executed before a Notary Public or Official Stockbroker. . In the event of custodian/intermediary’s bankruptcy, for securities represented by book-entry accounts shall be automatically transferred at no charge by the relevant clearing house to a creditworthy custodian or to the third party accounts of Bank of Spain. . <i>SS 879 to 882 of the Commercial Code</i> set forth different rules under which certain <i>transactions made by the bankruptcy entity before the bankruptcy is effective, may be held invalid</i>. Furthermore, a Court order may declare the invalidity of any agreement executed during the previous two years, provided that they may prove that fraudulent actions were taken against the creditors.</p>

SPAIN – SECTION III

3.1. Final comments to the Spanish position regarding cross border transactions in modern holding systems:

Spain is one of the jurisdictions which has followed traditional categories of legal rights where there are two possibilities: 1) if any financial intermediary is allowed to commingle the securities with its own assets, the person generally loses its property rights in the individual securities and is deemed to have a personal or contractual claim for the return of the same amount and type of securities as those deposited, with title in the individual securities having passed to the financial intermediary. Here the location of the intermediary becomes highly relevant for the purpose of applying the *lex rei sitae* rule. So if a person takes a book entry pledge of such an interest, it will acquire an interest in the personal right against the intermediary; the intermediary is free to sell, pledge or transfer or use the underlying securities, because it has full title to them.; 2) if the interest pledged falls within the traceable property rights category, the intermediary will play an irrelevant function for the purpose of applying the *lex rei sitae*.

3.2. THE SPANISH IMPLEMENTATION OF THE FINALITY DIRECTIVE:

Spain was the first of the member states in giving signs of implementation with the Draft Bill “Sistemas de pagos y liquidacion de valores” with date 5th of May 1999 in the Spanish Congress. It is awaiting senate approval. The relevant artcs of the Draft will be Art. 14 and 15, which state that the participants of a designated system will be entitled to insulate the collateral from insolvency proceedings; its sections 2 and 3 will give indication of the type of interpretation that the Spanish legislation gives to the question of “participants” which will have this particular right, which include apart from the participant, its managing entity, its clearing systems, the Banco de Espana in support of its credit operations and monetary policy operations and in cross border situations to the ECB, the Central Banks of the other Member States and their clearing systems.

Section 4 of Art.14 expressly provide that insolvency proceedings shall not have retroactive effect on the collateral rights given to participants , so the collateral will not be subject to claims under artc 324 of the Commercial Code. This will introduce an exception to the provisions of Section 878 of the Commercial Code which states that certain agreements may be unwound by a Spanish court at the request of the creditors on the basis of the claw-back period .Therefore instructions that have become final before the insolvency proceedings, shall not be included in the claw-back period, and thus, the collateral may not be reclaimed by the bankruptcy officer.

Art. 15 will give implementation to art. 9 (2) and its PRIMA approach of the Finality Directive, but unfortunately Spain has interpreted this in a narrow way. In order to achieve the developments of a broad interpretation, it would be necessary to make an additional substantive law change.

COUNTRY BY COUNTRY ANALYSIS

***LEGAL UPDATE ON THE
ITALIAN PLEDGE***

Italian Position:

1. SECTION I:

Italian collateral arrangement Chart I: a general description of the Italian collateral arrangements available in Italy and the relevant aspects of each as well as which and how investment securities can be pledged in Italy.

2. SECTION II:

Aspects of the Italian security interest: domestic law and Private international detailed review, analyzing the proprietary aspects of this collateral arrangement in Italy.

3. SECTION III:

Final comments to the Italian position regarding cross border transactions in modern holding systems: includes comments as to what type of category of legal rights applies in Italy and some comments as to the new flexible arrangement of the floating lien. Under the new legislation it is now possible to open specific accounts allowing the creation of floating charges.

[This page intentionally left blank]

Italian Collateral Arrangements Chart I

REGULAR AND IRREGULAR PLEDGE	FLOATING LIEN
<p>*Since 1942 Italy has considered two ways of taking security: a regular pledge with no transfer of title involved and irregular pledge with the transfer.</p> <p>* The irregular pledge brings the possibility according to Art.1851 of the Italian Civil Code of an unrestricted right to freely dispose of the collateral, subject only to custodian's obligation to redeliver equivalent collateral in accordance to the terms of the Pledged Agreement. Another aspects of this irregular pledge are as follows; . The pledge will constitute a continuing security for the secured obligation, notwithstanding any intermediate payment or settlement of that obligation.</p> <p>*Substitution: it will imply new registrations and the worry about the collateral's value fluctuation; so a notice of substitution is normally required, stating the particular collateral which will be substituted and the new one which at least must have the same Market Value at the time of service of that notice. In short, substitution will form a new pledge.</p> <p>*Type of investment securities which can be pledged: First, it is important to see what financial instruments fall within the scope of the dematerialization regime:</p> <p>1) Specific instruments (shares or other instruments representing risk capital negotiable on the capital markets); bonds and other debt instruments negotiable on capital markets investment funds' quotas; instruments usually negotiated on the monetary market; any other instruments usually listed permitting to acquire said instruments; as well as State Bonds and the relevant indexes traded or destined to trade in Italian regulated markets.2) Specific instruments shares or other instruments representing risk capital negotiable on the capital markets; bonds and other debt instruments negotiable on capital markets; relevant indexes which are not traded in Italian regulated markets but are issued by issuer with other financial instruments already listed on Italian regulated markets.3) Bonds/ debt instruments negotiable on capital markets, not traded in Italian regulated markets, when issue amount exceeds L300billion.</p> <p>Dematerialization also applies to state bonds even though specific provisions have been set forth in this respect. The Ministry of the Treasury Budget and Economic Planning can apply the dematerialization regime to international bonds of the Republic of Italy governed by Italian law or by a foreign law .</p> <p>Regarding shares: pledge (pegno) must have a specific date of execution, a date certain is normally evidenced by a notarial deed. Voting rights and rights to dividends will transfer to a pledgee by operation of law on granting of the security. Parties may contract for these rights to remain with the pledgor prior to enforcement.</p> <p>Notice is not required to be given to pledgor to create valid pledge but it must be given to the company if the pledgee wishes to exercise voting and dividend rights. Often notice is given after a default has arisen for pledgee to have interest noted on the register. Must endorse and deliver certificates to pledgee. Can also take quotas in "societa a responsabilita limitata".</p> <p>Their enforcement: sale following court order. Registration: must deposit either an original or a certified copy of the pledge with Chamber of Commerce; for quotas of a s.r.l. must be registered in the Company's quota holders books.</p>	<p>* The Legislative Decree n.213 of the 24th June 1998 and the CONSOB Regulation n.11768 of 23rd of December contemplates the possibility of creating this new type of security interest. The collateral will only consist of dematerialized sects.</p> <p>*The pledge is not constituted over specific financial instruments individually identified by their serial number or reference to their type and amount, but rather over a pool of financial instruments held in a specific collateral account.</p> <p>*The value of that pledge may be maintained by means of addition to or substitution of the financial instruments held in the account and this will not result in the creation of a new pledge.</p> <p>* The security agreement can be governed by either Italian Law or foreign Law; and it needs to comply with the perfection requirements stated in Italian law: it must indicate the initially posted collateral, the secured obligation and the secured amount and it must be evidenced by a signed writing bearing a certain date in a notarized document.</p> <p>*The custodian will open a special-purpose collateral account to that effect.</p> <p>*The title can be transferred to the pledgee by way of irregular pledge or the title can be retained by the pledgor.</p> <p>*The intermediary will register the account information, creation date and value of the lien with the register referred under Art.45 of the Consob regltns., upon opening the account. The register of liens will have to be subject to the regltns. of Montetitolì</p> <p>*Substitution: since the value of the collateral is calculated not by reference to specific securities but by reference to such number of securities as are equal in value to the amount to be secured, there is no need for new registrations. The substitution-reconstitution of other financial instruments registered in the same account, for the same value, the date of creation of the lien will be identical to the date of creation of the lien over the substituted or reconstituted collateral.</p> <p>*Continuity: the account holder at the same time of creation will have to give the intermediary written instructions in accordance with any arrangement with the secured party with respect to the maintenance of the collateral integrity of the collateral value and the rights attached to the financial instruments registered in the account.</p> <p>*If transactions are to be effected through an intermediary authorized pursuant to legislative decree other than the intermediary where the account has been opened are registered in the account, the execution of such transaction will be subject to prior authorization by the intermediary where the account has been opened.</p>

ASPECTS OF ITALIAN COLLATERAL

<p>Validity of the contract and attachment</p>	<p>A) Italian Private International Law: *In Italy the Rome Convention is applicable to contractual obligations according to its conflicts of law.</p> <p>*The law chosen by the parties to govern their contract between them will be the “<i>lex contractus</i>” which will govern the constitution and scope, the validity and effectiveness of contractual relationship embodied by the agreement. So whether there is a valid agreement will be governed by the “<i>lex contractus</i>”.</p> <hr/> <p>B) Italian Domestic Law: *In order for a collateral contract to be valid, it is necessary to satisfy all the requirements of a contract, such as the agreement between the parties, the object (security in pledge), the consideration and the legal form (written in case of pledges).</p> <p>*In general, the issue of financial instruments subject to dematerialization must be made through a central custody and administration manager of financial instruments, which should open an account in the name of each issuer and to which the issuer will communicate the global amount of the issue, the date of the placement and the terms and conditions of the specific issue as well as any other relevant information on the issue. The exercise of charges over these dematerialized financial instruments, will be done only through authorised intermediaries, who will keep a record of the charges.</p> <p>Pursuant to Artc. 34 (2) of the Legislative Decree.213, of the 24th of June 1998, the intermediary may open specific accounts for the creation of liens on the aggregate value of the financial instruments registered in such accounts. These accounts will contain:</p> <ul style="list-style-type: none"> - opening date; - type of lien and other additional information; - transaction date and indication of details such as type, amount and value of the financial instrument registered in the account; - the lien’s creation date; - the holder’s name and the secured party’s name and - indication of any arrangement between the parties involved regarding the exercise of the charge and finally, - the expiration date of the lien.
---	--

<p>Perfection</p>	<p>A) Italian private international law:</p> <p>*Considering that with the so-called “dematerialization” of financial investments traded on regulated markets, they can no longer be represented by certificates or other material instruments but must be administered by a Centralized Management Company through a special account, and also considering that the Italian Private International law consider the law governing the perfection of the collateral is the “lex rei sitae”, that it is the place where the relevant assets are situated, in the case of Italian dematerialized securities which no have physical existence and no obvious location, the lex rei sitae will be the location of the intermediary’s account.</p> <p>C) Italian domestic law:</p> <p>*Generally, until the securities have been delivered to the pledgee (by account registration if appropriate), no perfection of pledge takes place and therefore no real guarantee (real from latin Res = Thing, Object) exists on the securities of the pledgor, who has a simple obligation to deliver according to the pignus conventum (agreement to pledge).</p> <p>*For bearer securities, the <i>pignus datum</i> (the perfection of the pledge) takes place by delivery of the security.</p> <p>*For registered securities (titoli nominativi), if not shares, the <i>pignus datum</i> takes place by delivery of the security drawn with the wording "in pledge" on it. If it is a share (not dematerialized) you need also a registration on the books of the issuing corporation if the pledge is to be enforceable against it.</p> <p>*For dematerialized securities, the pignus datum takes place as soon as (i) it is registered in the specific account held by the bank and (ii) it is filed with the register of pledges held by the bank. [The custodian will keep the register of liens in which it records all the liens created with respect to financial instruments held in custody by it according with artc 87 of the Financial Intermediation Act and the Arts. 2215, 2216 and 2219 of the Civil Code.]This is the most flexible way to pledge in Italy. So the only way to perfect security interest is to have the lien recorded in the register of lien held by the custodian.</p>
--------------------------	--

Priorities

A) Italian private international law:

* Priority aspects will be governed by the “lex rei sitae”.

B) Italian domestic law:

*In case of default the pledgee has the right to be paid in preference;

*In the case of failure or liquidation of the debtor, the pledgee may ask to be admitted with preference to the creditors list, and following such admission, may be authorized by the liquidator to sell the collateral.

* Priority is accorded to a third party bona fide purchaser or pledgee of the pledged securities, even if the pledgor is not entitled to pledge, on condition that the third party is in good faith at the moment of the delivery and there is a valid agreement between the pledgor and the pledgee. This principle appears inappropriate now with the dematerialization regime, because, as stated before, the only way to perfect the security interest is to have the lien recorded in the register of liens held by the custodian

Enforcement

A) Italian private international law:

*Upon default of the counterparty, the enforcement is governed by the law of the location of the assets; so the Italian conflict of law rule to determine the law governing the enforceability against third parties is the *lex rei sitae*; the key issue will be where the asset is located.

B) Italian domestic law:

* Major distinction between the regular and the irregular pledge.

- for the ***regular pledge***:

. before proceeding with the sale the creditor shall, *through a process-server*, serve a demand of payment of the debt and charges on the debtor, warning him that if he fails to comply with the request, the item will be sold; the notice shall also be served on the third person pledgor, if any. If no objection is raised within five days from such notice, or the objection is overruled, the creditor can cause the item to be *sold at public auction* or, if it has a market price, he can cause it to be sold at the current price through a person authorized to make such sale, such as a bank. If the debtor does not have his residence or elected domicile in the place in which the creditor has his residence, the time limit for objection is extended. Acting upon the objection of the pledgor, the judge can limit the sale to one of several items pledged whose value is sufficient for payment of the debt. Note that the parties can agree on other procedures for the sale of the item given in pledge.

The *creditor can also petition the judge that the property be awarded to him in payment*, up to the amount of the debt, according to an appraisal to be made by experts, or according to the current price, if the items have a market price.

- for the ***irregular pledge***:

. For irregular pledge the procedure is much quicker and a simple notification to the debtor is considered sufficient. Of course other rules should be taken into consideration (such as Monte Titoli and Consob).

INSOLVENCY	<p>A) Italian private international law:</p> <p>* The basic rule is that a company that has its main business activity abroad and that has been declared insolvent in that country can be declared insolvent in Italy as well. So lex concursus will govern the insolvency proceedings .</p> <p>B) Italian domestic law:</p> <p>* Special consideration must be given to the so-called “zero hour” rule, under which the insolvency of the company may have a retroactive invalidating effect on completed transfers, payments and set-off accounts made by or with the insolvent company. The Finality Directive and, particularly, art 7 will affect this rule, simplifying banks’ dealings with other banks in member states. Art. 7 states that insolvency proceedings shall not have retroactive effect on the rights and obligations of a participant arising from its participation in a system earlier than the moment of opening such proceedings.</p>
-------------------	---

3.1. Final comments on the Italian position regarding collateral in cross border transactions in modern holding systems.

Italy was, until the innovative reform providing for a dematerialization regime enacted by the Legislative Decree n. 213 June 24 1998 (now mandatory for certain financial instruments traded or destined to be traded on regulated markets), one of the jurisdictions followed traditional categories of legal rights where there are two possibilities: 1) if any financial intermediary is allowed to commingle the assets with its own assets, the person generally loses its property rights in the individual securities and is deemed to have a personal or contractual claim for the return of the same amount and type of securities as those deposited, with title in the individual securities having passed to the financial intermediary. Here the location of the intermediary becomes highly relevant for the purpose of applying the *lex rei sitae* rule. So if a person takes a book entry pledge of such an interest, it will acquire an interest in the personal right against the intermediary; the intermediary is free to sell, pledge or transfer or use the underlying securities, because it has full title to them.; 2) if the interest pledged falls within the traceable property rights category, the intermediary will play an irrelevant function for the purpose of applying the *lex rei sitae*.

With the new dematerialization regime the Italian legislation has created a new type of security interest that serves the public policy interests of protecting investors against intermediary insolvency risk, promoting the finality of the security transaction and reducing the costs and risks of cross-border collateral transactions. The new floating lien could be now considered as one of the most flexible collateral mechanisms in the EU collateral arrangements. Here we have the possibility of having the title retained by the pledgor or transferred to the pledgee by irregular pledge; in the latter case the secured party will acquire full title to all the posted collateral, plus the right to immediately dispose of the secured amount. The pledgor can exercise his restitution rights being able to obtain immediate restitution of the posted collateral exceeding the secured amount and, upon fulfillment of the secured obligation the residual portion of the posted collateral. The security agreement is able to provide daily substitution and top-up mechanisms not affecting the initial date of perfection of the security interest, as well as voting instruction clauses and rebate in the particular case that there has been transfer of title by irregular pledge.

With various exceptions such as the zero hour rule, under which the insolvency of the company may have a retroactive invalidating effect on completed transfers, payments and set-off accounts made by or with the insolvent company (n.b. following the implementation of the Finality Directive this will no longer be a problem). The Italian floating pledge is therefore a very attractive mechanism.

3.2. THE IMPLEMENTATION OF THE FINALITY DIRECTIVE IN ITALY.

The Italian Treasury has made an official announcement that they will take the broad interpretation of the artc 9 (2), that means that apart from eliminating legal risk for certain collateral takers:(central banks of Member States; the European Central Bank and those participants that provide liquidity to a European Union payment or securities settlement system to which the Finality Directive applies). It will also eliminate the legal risk for not only all direct or indirect participants in a European Union Settlement system, but also to direct and indirect participants of all payments and securities systems, whether or not they are European Union systems.

The Directive will affect the Italian insolvency proceedings as follows:

- the “zero-hour rule” will need to be abolished. Artc. 7 of the Finality Directive states that insolvency proceedings shall not have retroactive effect on the rights and obligations of a participant arising from its participation in a system earlier than the moment of opening such proceedings.
- Italy will recognize collateral arrangements created in other European jurisdictions, so it will mandate an Italian Bankruptcy judge to respect those collateral arrangement;

COUNTRY BY COUNTRY ANALYSIS

Legal Update on the German Pledge

German Position;

1. SECTION I:

- 1.1 ***German collateral arrangement Charts I and II:*** Outline the collateral arrangements available in Germany and the types of investment securities to which they apply.

2. SECTION II:

Aspects of the German Security Interest Collateral (Pledge) Chart: In order to create a valid and enforceable interest, it is necessary both to form a valid and enforceable agreement for security between the collateral parties and to ensure that the security interest confers proprietary rights in the collateral which are enforceable against third parties. This chart will study the different aspects of the pledge (security interest) in Germany (validity, perfection, priority, enforcement and insolvency) from a domestic and a Private International Law point of view.

3. SECTION III:

- 3.1 ***Final comments to the German position in cross-border transactions in modern holding systems:*** Conclusions to the current German position in the subject oriented to cross border transactions and modern holding systems.
- 3.2. ***Implementation of the Finality Directive in Germany.***

German Collateral Arrangements Chart I

GERMAN PLEDGE	GERMAN TRANSFER
<p>*It does not result in a transfer of full legal title. *Normally does not require a written agreement, a registration or public filing. *Type of investment securities which can be pledged: #Regarding its creation, validity and perfection, we will have to distinguish between: A) Sects held physically apart from the assets of the depositary or third parties: Bearer and Order Papers: The creation, validity and perfection of a pledge of bearer sects governed by S1293 of the German Civil code and 1204: pledgor and pledgee must agree on the pledge and the pledge itself have to be delivered to the pledgee (except when it is in pledgee's possession already). If sects are located in another bank, the pledgor has to assign its claims for return and supply against the depositary (Ss870, 1205.2 of the Civil Code, the depositary needs to be notified of the pledge (S1280 Civil Code); for Order Papers (S1292Civ) in addition to the agreemnt. and deliv., they need to be endorsed. Registered Papers: any pledge follows the applicable rules of assignment of the respective right, agreement it is also necessary and the debtor has to be notified of the pledge. Einzelschuldbuchforderungen: will be pledged like Registered Papers; not necessary registration of the debt register, however a respective entry is advisable to avoid acquisition in good faith. B) Sects held in collective safe custody: For Bearer, Order and Registered Papers; they can be pledged according Ss1204 et seq., 1258,747,1008 of the Civil Cod (delivery and agreement. This pledge attaches the co-ownership's share). For Wertrechte: subject to Ss1204 et seq.; 1258,747,1008 of the Civil Cod (agreement, delivery and S11 of the Reichsschuldbuchgesetz which states that the pledge has to be entered in the debt register ("Schuldbuch"). #Regarding its realization: Bearer, Order Papers and Wertrechten: they will be realized by selling the respective pledge upon maturity of the claims secured by the pledge (S1288 of the CC) at public auction or by private sale through a recognised broker or auctioneer provided that the seized property has a current market price (S1295 for Order Paper). At any rate the pledgee is not entitled to sell the items without the involvement of an officially authorized broker of an authorized public auctioneer. If the pledgee has an enforceable judgement against the pledgor, the realization can be carried out in accordance with S803 of the Civil Process Act. Registered Papers and Einzelschuldbuchforderungen: upon maturity of secured claims the pledgee is entitled to exercise the creditor's right of terminations (S1283 of the CC); furthermore, the pledgee demand payment or in lieu of payment-assignment of the respective claim (S1282 of the Civil Code).</p>	<p>*Collateral arrangement in the form of an outright, i.e. non-fiduciary, transfer of ownership has been unfamiliar to German law and practice. The concept is fairly novel, brought into Germany by the ISDA Transfer Annex. Transfer of possession may be effected by transfer of physical control or may be substituted by a custodial relationship in respect of the collateral between the transferee and transferor as custodian who retains direct possession. *Like the creation of the pledge the transfer of legal title requires a respective agreement between the transferor and the transferee and the delivery of the assets. Apart from a Bona Fide Acquisition the assignor has to be the owner of the assets. If the transferee is already in possession of the assets, the agreement on the transfer is sufficient (S929), sentence 2 of the Civil Code). If the transferor wants to keep the assets in his possession, transferor and transferee can establish a legal relationship so that the transferee will get constructive possession. If a third party is in possession of the assets, the delivery can be replaced by the assignment of the claims for return against the third party. *In principle, the rights in rem established under the Civil Code are exclusive and any additional rights in rem cannot be created by agreement; one of this rights in rem is ownership, however there is no limitation upon using the existing in rem rights available under the Civil Code to create a collateral arrangement. *No filing or perfection requirements are necessary or advisable. There no other procedures that must be allowed or consents or other governmental or regulatory approvals that must be obtained to establish, enforce or continue such ownership interest.</p>

THE GERMAN PLEDGE

* The pledge is per se a possessory security interest, coming only into existence if the pledgee obtains possession of the asset to be pledged and being strictly accessory to the obligation which it is to secure; if such obligation does not validly arise, the pledge cannot be created, if the obligation ceases to exist the pledge will cease too; a substitution of such obligation for another obligation will result in the nullity of the pledge; if the obligation becomes subject to a permanent defence, the asset must be returned to the pledgor. It is not necessary that the obligation is for a fixed amount or for a fixed maximum amount. A pledge may secure future and conditional obligations.

*The assets must at all times be identifiable; subject to this a pledge can be created over fluctuating pool of assets.

*Creation: requires an agreement between the pledgor and the pledgee to establish the pledge over the collateral for the benefit of the pledgee and the transfer of possession of the collateral.

* Realisation: the enforcement of the pledge may only be made if the claim which it secures has become due and payable. Any realisation prior to the due date of the secured obligation is expressed to be illegal and will be without legal effect; it is not permitted to agree prior to the time at which the secured obligation has become due and payable that ownership in the collateral shall be vested in the pledgee and any such agreement will be null and void. The Civil Code provides realization rules some of which may be waived or changed by agreement between the parties, but others are mandatory, and are considered fundamental for the pledgor's protection, not being subject to the disposition of the parties.

*Disadvantages:

- no right to dispose or use of the securities: a pledge grants an in rem right to realize the collateral at maturity upon the default of the debtor in order to discharge the secured obligation. The Civil Code requires the pledgee to keep the collateral at all times in safe custody, not providing for any right of the pledgee to use or dispose of the collateral prior to maturity of the secured obligation; even at maturity the pledgee cannot use or dispose of them at its discretion, but must liquidate the collateral by way of sale only in order to cover its open position and transfer any remaining balance to the pledgor; appropriation or disposing of parts by the pledgee only under "irregular pledge", which can only be created for the benefit of a German Credit institution which has been authorised under the German Banking Act, to conduct securities custody business. The appropriation rights may also violate S1229 Civil Code: pledgor and pledgee may not agree prior to the time at which the obligation becomes due and payable that ownership in the collateral shall be vested in the pledgee, and any such agreement shall be null and void;
- no right to set-off: as noted before any agreement that the pledgor's ownership of the collateral shall be vested in the pledgee in the event of the pledgor's default at maturity, prior to the maturity of the secured obligation, will not be recognised in German Law, so any agreement on the right to offset or retain, will be declared null and void;
- the non-existence, invalidity or nullity of the secured obligation will affect the validity of the pledge;
- no reinstatement: where the pledge itself has not come into existence or ceased to exist, because of discharge, avoidance or otherwise, it cannot be reinstated;
- the bona fide purchaser's effects: they cannot be expanded or supplemented by contractual provision also the rules of enforcement of the Civil Code will govern the sale of collateral, and according to them, the bona fide purchaser will acquire good title only if the collateral is sold by a licensed broker or licensed auctioneer, so any other sale violating the liquidation rules will be without effect.

GERMANY

ASPECTS OF GERMAN COLLATERAL	
<p>Validity of the contract and attachment</p>	<p>A) German Private International Law:</p> <ul style="list-style-type: none"> . An important principle in German Law is the distinction between contractual agreement (“Verpflichtungsgeschäft”) and any transaction which concerns the legal ownership itself such as a transfer of legal title or the encumbrance on the legal title (“Verfügungsgeschäft”). While the former has solely legal effect between the contractual parties the latter has an absolute effect against everyone. <hr/> <ul style="list-style-type: none"> . Regarding the “Verpflichtungsgeschäft”, the legal situation is as follows: S27 of the German Introductory law to the Civil Code the counterparties of a contract may choose the law which shall govern their agreement. However, dealing only with one jurisdiction the choice of a different law does not release the counterparties from complying with mandatory provisions of that jurisdiction . Also the choice may be limited in cases which deal with consumer credits or labour law. <p>. Establishment of a foreign collateral will be governed by the <i>lex rei sitae</i>; so creation of a collateral is subject to the requirements of the jurisdiction where the respective item is located. Notwithstanding , German Law acknowledges foreign collateral as long as they are not contrary to the German public policy. Furthermore, the foreign collateral has to be transformed in the respective German equivalent.</p> <p>B) German Domestic Law:</p> <ul style="list-style-type: none"> . The creation (Bestellung) of the pledge requires an agreement between the pledgor and the pledgee to establish a pledge over the collateral for the benefit of the pledgee and the transfer of possession of the collateral (SS1205, 1206). In general, possession requires direct or indirect physical control and the intention to possess (<i>animus possidendi</i>) on the transferee side. Subject to certain refinements, effective transfer of possession in the creation of pledge in Bunds and other Qualifying G-10 Government Securities takes place by debiting the account of the pledgor with Clearing AG or an intermediary depositary and crediting the account of the pledgee with Clearing AG or an intermediary depositary, where the pledgor loses indirect possession and the pledgee acquires indirect possession. .The <i>German Law on General Business Conditions</i> (S.3), states that unusual provisions in a contract are void; so provisions requiring the provision of collateral in an unusual way are invalid. .Section 4, Sub-section 1, sentence 4 No 1 g of the <i>Law regarding consumer credits</i>, which stipulates that a consumer

	<p>credit agreement has to specify any collateral to be provided.. .A collateral agreement may be void according to <i>S138 of the German Civil Code</i> if the respective transaction is contrary to <i>k. ("Gute Sitten")</i>; this section may be applicable in the following cases:</p> <ul style="list-style-type: none"> - usury; - granting of collateral by taking advantage of somebody's distressed condition; - granting collateral which affects the economic freedom of the debtor as that it has a "tying" effect; - endangering of the interest of creditors;- "over collateralisation": if the value of the sects significantly exceeds the outstanding obligations to be secured. The permissible limit will depend on the type of collateral and the individual circumstances; however a margin of 20-50% is acceptable based on existing risks of realization. <p>. Need to comply with the mandatory provisions of S 43 et seq. of German Introductory Act to the German Civil Code ("Einführungsgesetz" zum BGB").</p> <p>. The articles of association or the partnership agreement may provide additional requirements to perfect a valid pledge, such as the consent of the company or the other shareholders.</p>
<p>Perfection</p>	<p>A) German private international law:</p> <p>. According to S43 I of the German Introductory Law to the German Civil Code, the pledge of assets is subject to the <i>lex rei sitae</i> (the law of the country where the assets physically are located); however should the issue show closer connections to another jurisdiction than to the law of the respective jurisdiction will apply (S46 of the German Introductory Law to the Civil Code).</p> <p>. Any pledge of bearer sects and order papers is governed by the <i>lex rei sitae</i> (S43 of the GIL to the CC), although different jurisdiction may be applicable according to the already mentioned S46 of the GIL to the CC). For Registered Papers, they will be subject to the law which governs the respective claim (Sub-section 2 of the Artc. 33 of the GIL to the CC). For Wertrechte , they will follow the rules of the Bearer Sects's pledge. For Einzelverbindlichforderungen, governed by the law which governs the respective claim.</p> <p>. In short, the perfection will be generally governed by the <i>lex situs</i>, although reference to the law of incorporation or branch should be considered.</p>

	<p>B) German domestic law:</p> <ul style="list-style-type: none"> . Pledge normally does not require a written agreement, a registration or public filing; should the securities be held with Deutsche Borse Clearing AG, we have to comply with S 43 of the General Business Conditions of that Institution. . As to the pledge of “Anteilsverpfandung”: for interests in a GmbH & Co KG provided as security, it is advisable, but not necessary to give notice to the company to perfect the security; for shares in an AG notice is not required to perfect the security and is not usually given. <p>For issues relating to perfection in each of the investment sects go to German collateral arrangements chart I.</p>
--	--

<p>Priorities</p>	<p>A) German private international law:</p> <ul style="list-style-type: none"> . It is subject to the <i>lex rei sitae</i>. In Germany there is the principle of priority in time (S804 Subsection III of the German Civil Code): any security established before subsequent collateral rank first (except when the priority of rank can be obtained in good faith, see below). <p>B) German domestic law:</p> <ul style="list-style-type: none"> . The ranking of pledges with respect to the same assets is determined by order of creation (even when the pledge has been created for a future or conditional obligation) in accordance with the so-called principle of priority. So the pledge which was created first ranks before the pledges established afterwards; however according to S 1208 of the Civil Code, a priority of ranking can be obtained in good faith (if the pledgee due to a simple negligent lack of knowledge, does not know the existence of an older pledge). . Under certain circumstances, German law recognizes the concept of a <i>bona fide acquisition of pledge</i>, being governed by S 1207 of the Civil Code; this provision refers to Ss 932 et seq. of the Civil Code (Ss 932 to 935 of this Civil Code deals with the acquisition of title in good faith), thus both the Bona Fide Acquisition and the acquisition of title in good faith are governed by the same rules; so any acquisition will require: an agreement between the authorised transferor and the transferee; a delivery or permitted alternatives to delivery of the respective assets and good faith of the assignee. Regarding Bearer Papers a Bona Fide Acquisition of stolen or lost papers is also possible (S 935 II of the Civil Code). If a businessman sells third party’s property in conducting its business, even a lack of the power of disposal may be cured (Ss 366, 367 of the Commercial Act).
--------------------------	---

<p>Enforcement</p>	<p>A) German private international law:</p> <ul style="list-style-type: none"> . Under German Law the enforcement of collateral is subject to the respective German provisions, applying also to securities established abroad; however should such a security be contrary to German public order an enforcement in Germany is not permitted. <p>B) German domestic law:</p> <ul style="list-style-type: none"> . The realization of a pledge is governed by S1228 et seq. of the Civil Code and as an exception in S 803 et seq of the Civil Process Act. <p>The Civil Code provides for a comprehensive rules regarding the manner of realization; many of these rules may be waived or changed by parties' agreement, however other rules are mandatory and fundamental for the pledgor's protection, not being subject to the disposition of the parties. The realization must be by way of sale only. Generally investment securities will be enforced by <i>public auction and collection of claims</i>; enforcement by <i>private sale</i> may be agreed upon after an enforcement event has occurred.</p> <p>If the sale is by public auction, its time and place and also the assets subject to the auction must be publicly announced. An exception will be if the securities has a stock exchange or market price, in such case the asset may be liquidated by sale through a licensed broker or licensed auctioneer. Any violation of these rules will result in the nullity of the enforcement (S1243 (1) Civil Code), except that a bona fide purchaser in enforcement procedures will acquire ownership of the collateral if certain requirements are met (S1244 Civil Code) and may subject the pledgee to a claim for compensation by way of damages.</p> <ul style="list-style-type: none"> . If the pledge shall be sold by public auction or by private sale the <i>pledgee is obliged to give warning of the realization</i> according to S1234 I of the Civil Code. The auction or sale is at the earliest permitted 1 month after the warning was given (S1234, Sub-section II of the Civil Code). In case of a public auction, this one will take place where the pledge is stored (S1236 of the Civil Cod). Place and time of the auction has to be make public according to S 1237 sentence 1 of the CC). The owner and third parties, which hold rights in the pledge have to be notified separately. Should the pledge be sold the pledgee has to inform the owner according to S1241 of the CC. Further provisions with regard auction can be found in S 1238 et seq of the Civil Code. . According to S1245 of the Civil Code pledgor and pledgee can agree on another form of realization as long as they comply with the mandatory provisions of S 1228 et seq. of the Civil Code. . Enforcement measures during bankruptcy proceedings will be invalid according to S89 of the Insolvency Act.
---------------------------	---

	<p>. For enforcement provisions relating to investment securities refer to German collateral arrangement chart I.</p>
<p>INSOLVENCY</p>	<p>A) German private international law:</p> <p>. Insolvency proceedings may be instituted in Germany in respect of the assets of any entity that has its principal office or registered office in Germany. Under the principle of “universality” prevailing in German insolvency law, the insolvency proceedings extend to all domestic assets and subject to recognition by the applicable insolvency laws of the jurisdiction in which the assets are located, foreign assets of such entity, including the assets created, acquired and hold through any foreign branch of the German entity.</p> <p>. According to <i>S102 of the Introductory Law to the Insolvency Act</i>, the German bankruptcy proceedings instituted abroad extends also to assets located in Germany provided that the court which has instituted the proceedings is competent and the results of such proceedings would not be contrary to German public order. The power of the liquidator is determined by foreign law. In order to protect German collateral-takers intervention in German collateral by the foreign liquidator is only allowed if German Law provides the same limitations.</p> <p><i>S102 (3) states that German insolvency proceedings may also be instituted over assets located in Germany of a foreign debtor</i>, however some commentators have considered this scope very limited in the light of the jurisdiction requirements of the S 3 of the Insolvency Code, which establishes first the general rule that the place of jurisdiction of the insolvency court is the debtor’s place of general jurisdiction. In the absence of statutory, the general rule applies in a cross-border context pursuant to German principles of conflicts of law; so the insolvency proceedings of S102 (3) will apply unless the debtor’s principal place of business or registered office is located in Germany. In short, failing a specific statutory provision and in the absence of Court precedents or a prevailing opinion in respect of the place of jurisdiction of German courts in such case, it is uncertain whether the German Courts would have jurisdiction to institute an insolvency proceeding over the assets of an entity the principal place of business or registered office of which is located outside of Germany.</p> <p>B) German domestic law:</p> <p>. If the bankrupt has granted a pledge after the date of institution such a pledge will be void according to S81of the Insolvency Act.</p> <p>. Should the insolvency proceedings have been instituted, any pledgee is entitled to preferential satisfaction. According to Ss 50, 166 of the Insolvency Act the pledgee, and not the liquidator</p>

	<p>can realize the respective pledge in accordance with the provisions outlined above as long as the respective assets are not in the liquidator's possession.</p> <p>According to Ss 129 et seq of Insolvency Act, the liquidator may challenge the validity of such transactions which take place after the date of institution and will affect the rights of the bankrupt's creditors. Some transactions could be regarded as prejudicing the other creditors, for instance: the acceptance of collateral although the situation of the debtor was known to the collateral taker, or although the collateral taker was not entitled or not at that time entitled to demand such a collateral; willful defeat of other creditors' gratuitous services; provision of collateral and credits which are considered as equity and finally other transactions which were took place with the intention to impair other debtors or creditors or if the transaction was done with a relative of the bankrupt.</p> <p>The right of avoidance is subject to the date the collateral was granted and is subject to the collateral taker's knowledge concerning the collateral giver.</p> <p>. If a <i>custodian goes bankrupt</i> two different situations might arise:</p> <p>a) <i>the pledged securities are physically located with the insolvent bank</i>: in case of separate safe custody the custodian is obliged to separate the securities from its own assets and those ones of third parties and to mark them as the customer's property (S2 of the Deposit Act), ensuring that creditors of the custodian cannot execute against the securities of the customer.</p> <p>If a third party attempts to execute against the sects of the customer, the latter counts with the following defence: the owner is entitled to institute third party proceedings against unjustified enforcement measures according to S771 of the Civil Process Code or to demand right of separation from the bankrupt estate in case of bankruptcy proceedings (S50 of the Insolvency Act and S32 of the Custody Act)</p> <p>b) <i>the pledged securities are held in safe custody with a ban; however the sects themselves are located with a central depository such as Deutsche Borse Clearing AG</i>: it is an irrebuttable presumption that all sects given in custody by a custodian are third party property (S4 of the Custody Act). Therefore, the central depository cannot acquire title to the securities by way of Bona Fide; neither central depository nor its creditors can execute against the sects. The above mentioned S4 , in its subsection 1, sentence 2 of the Custody Act states that the dinal custodian is only entitled to enforce a pledge or a right of retention if the underlying claims are caused by the respective sects and not by sects of third parties. Should however somebody try to execute against the sects the owner is entitled to institute third party proceedings or to demand right of separation from the</p>
--	--

	<p>bankrupt estate.</p> <p>. The institution of bankruptcy proceedings results from the order of a competent court, which has to specify the date and hour of the respective decision and all the assets which are part of the debtor 's property at the hour of the proceedings were instituted or which become afterwards part of the property from the bankruptcy estate. All separate measures of execution outside the bankruptcy proceedings and levied after the institution are void according to S89 of the Insolvency Act. Any collateral granted after the institution date is invalid and not enforceable.</p> <p>. According to S 218 of the Insolvency Act the liquidator and the debtor might avert bankruptcy proceedings and a liquidation by initiating special proceedings (S217 of IA) ("Insolvenzplanverfahren"). In the course of these proceedings even preferential creditors might be forced to waive part of their rights, subject to a necessary majority among the creditors.</p>
--	---

3.1 FINAL COMMENTS TO THE GERMAN POSITION IN CROSS BORDER TRANSACTIONS IN MODERN HOLDING SYSTEMS

Cross-border safe custody of securities and settlement of securities transactions have been the subject of detailed study in Germany over a long period. The starting point is perhaps the 1896 special law on safe custody and procurement of ownership of securities, revised in 1937 and commonly named as “Depotgesetz” (Law on Securities Deposits). Further revisions took place in 1972, 1985, 1994 by the Second Law on Improvements of the Financial Market. The most important amendment was enacted on July 1985, amended in 1994 stating that a central securities depository in Germany can establish links with foreign central securities depositories by opening a mutual account relationship that allows a cross-border clearing transactions in securities by book entry. The following catalogue of prerequisites to be fulfilled for such cross-border account relationship demonstrate the importance of the customers’ protection e.g. the foreign custodian in its country has to be central depository bank, subject to state supervision or equal supervision with respect to the investors; protection; the depositor is granted a legal status provided for by the Law; the right of the central depository bank to require the physical delivery of the securities is not subject to any prohibition of the country of domicile of the custodian.

Therefore if the foreign central securities depository goes bankrupt, the customer must be entitled, directly or indirectly through its custodian, to recover its securities; in other words, the customer must be protected against the third party creditors of the depository.

What is the current situation with the modern indirect holding systems and the depositors’ rights? Germany is one of various jurisdictions which have created new legal categories by statute to prevail over the rule that depositories lose their property rights in the individual securities deposited with the intermediaries and commingled in fungible pools.

In Germany, securities are usually held in safe custody with Deutsche Borse Clearing AG, the German Central depository. Fungible securities physically located in Germany are eligible for *collective safe custody*, under which the depository is allowed to hold in a pool all securities of the same class and of different owner. By depositing the securities in collective safe custody the former owner loses its sole property rights in the individual securities and becomes co-owner of the pool on a pro-rata basis. All co-owners form a community of owners holding undivided shares in property and any co-owner is not entitled to request the return of the original individual securities deposited but only to request the return of securities of the same type and amount. Securities may also be held in separate safe custody, so the customer’s securities will be held physically segregated from the holdings of the depository and of third parties. Should the securities be physically located abroad, the depository is not obliged to provide its customers with the ownership of the respective entry in the securities account.

Should the depository go bankrupt, two situations may arise depending on where the securities are held: *if the pledged securities are physically located with the insolvent bank*; the custodian is obliged to separate the securities from its own assets and the third parties' assets and to mark them as the property of the customer according to §2 of the Deposit Act. Should however anyone try to execute them, the customer goes to the following defence: the owner is entitled to institute third party proceedings against unjustified enforcement measure according to §771 of the Civil Process Code or in case of bankruptcy proceedings to demand right of separation from the bankrupt estate according to §50 of the Insolvency Act or §32 of the Customer Act. *If the pledged securities are held in safe custody with a bank, however the securities themselves are located with a central depository such as Deutsche Borse Clearing AG*: here due to irrefutable presumption of law, securities given in custody by a custodian are regarded as the property of third party, therefore the central depository cannot acquire title by Bona Fide; neither the central depository nor its creditors can execute against the securities.

So when applying the *lex rei sitae* rule to the new category of property rights that Germany classifies as collective property interest (fractional or co-property rights traceable to actual pools of individual fungible securities), the person taking a book-entry pledge of a fractional property would be deemed to have acquired constructive possession or record ownership of a fractional portion of the actual pool, although this person does not have actual possession or actual record ownership of any of the pool.

In short, applying the German approach to the modern indirect holdings systems requires one to locate the securities to make sure that all applicable laws are complied with each time a transfer or pledge is effected. Further, where the single pool of fungibles is located in more than one jurisdiction, the *lex rei sitae* will not give a unique answer as to which jurisdiction's law governs the enforceability of a pledge of a traceable property right in an unallocated portion of the actual pool of securities. The normal consequences will be that pledging procedures in each jurisdiction will have to be followed despite the added costs and if the relevant jurisdictions have conflicting pledging procedures it will be impossible to obtain reasonable certainty that the pledge will be enforceable.

3.2 IMPLEMENTATION OF THE FINALITY DIRECTIVE IN GERMANY:

The German Ministry of Justice (Bundesjustizministerium, BMJ) drafted a law for the transformation of the Directive 98/26.EC into German Law. The non official draft was introduced into the cabinet on July 28 of this year, for discussion; on September the 24th, the draft law will be read for the first time in German Federal Council and due to the time constraint the draft will be read for the first time in the Lower House of Parliament (Bundestag) in the end of September. According to the Directive, the law shall be brought into force by December 11.

Their understanding of the art 9 (2), will be the protection to participants in a European Union settlement system, the Central Banks of the Member States and the ECB, to collateral security provided to them in connection with a system from the insolvency effects of the provider.

The determination of the collateral takers' rights shall be governed by the law of the Member States, in which the right-with regard to the sects is legally recorded on a register, account or centralised deposit system.

We understand that the legislators want to implement the provisions for all disposals of securities no matter who disposes of the securities. So the German legislation is adopting a "broad view".

The Directive will not have any substantial effect on the German Insolvency proceedings; as stated in the Directive the collateral security will be insulated from the effects of insolvency law. A new Insolvency Law (Insolvenzrecht) was brought into force on January 1st, 1999, which complied with most of the provisions of the Directive, e.g. arty 7 providing that the insolvency proceedings shall not have retroactive affects on the rights and obligations of a participant arising in connection with its participation in a system. This also applies to Art. 3 providing that transfer orders and netting shall be binding on third parties, even in the event of insolvency proceedings against a participant.

The implementation of the PRIMA approach (the place of the relevant intermediary) will certainly reduce legal risks for the holders of collateral sects; this opinion is based on a non-official draft law of the German Ministry of Justice and amendments are still under discussion. The PRIMA approach will provide legal certainty in Europe, limited to EU participants.

COUNTRY BY COUNTRY ANALYSIS

Legal Update on the Portuguese Pledge

PORTUGUESE POSITION

(NOTE: Portuguese law in this area is currently subject to change. A new Securities Market Code has been recently approved and is expected to be in force from March 2000. With the information available we are able to produce a Section II and make some comments on the Finality Directive Implementation in Portugal.)

PORTUGAL

ASPECTS OF THE PORTUGUESE PLEDGE	
Validity of the contract and attachment	<p>A) PORTUGUESE PRIVATE INTERNATIONAL LAW:</p> <p>. There is no particular provision of Portuguese Private International Law dealing with the creation of security interests over securities currently in force. The general rule of conflicts of law which is therefore currently applicable is that all rights existing over assets should be governed by the law where such assets are located "lex rei sitae", pursuant to Art. 46 of the Portuguese Civil Code.</p> <p>. Current Portuguese practice would appear to be that pledges and other security interests over securities issued by Portuguese entities are created in compliance with Portuguese law (even if the relevant securities are held outside Portugal and if the law governing the relevant contract is not Portuguese).</p> <p>Additionally, a new Securities Market Code has very recently been approved (but which is not yet published and which is only expected to be in force from March 2000 onwards), and that article 41. of this new code provides that (i) the creation of security interests on securities integrated in a centralised system should be governed by the law applicable to the jurisdiction of such system; (ii) the creation of security interests to securities held or registered outside such a system should be governed by the law of the jurisdiction where the securities are held/registered; and that (iii) the creation of security interests on securities not so integrated, held or registered shall be governed by the law of incorporation of the relevant issuer.</p> <p>The parties are free to decide on the law governing the relevant contract and its substantive effects, provided there is a relevant element of connection with the law ultimately retained (without prejudice to the provisions of International Conventions or Treaties that Portugal has ratified and which may soften these requirements).</p> <p>B) PORTUGUESE DOMESTIC LAW:</p> <p>Liens, pledges and other security interests and charges on registered securities (in case of dematerialised securities) or on securities represented by certificates which are deposited with duly authorised financial operators (either nominative or bearer), are created by means of registration of the creation of the relevant security interest on the bank accounts where the relevant securities are held.</p>

	<p>Creation of liens, pledges and other security interests and charges on certificates not deposited under the above system, depend on the nature of the underlying securities, being that in general:</p> <ul style="list-style-type: none"> a) liens on nominative shares must be registered in the relevant company's ledger book; b) liens on bearer securities depend on physical delivery of the certificates to the respective beneficiary (or to a commonly appointed third party). <p>In general, the creation of security interests over securities follows formal requirements similar to those that apply to the transfer of same securities.</p>
Perfection	<p>A) PORTUGUESE PRIVATE INTERNATIONAL LAW:</p> <p>. For reasons of perfection of the relevant security interest and in order to make sure that <i>erga homnes</i> effects are produced (and therefore that priority over third party entitlements is obtained) the requirements of the law under which the relevant securities have been issued are also complied with.</p> <p>B) PORTUGUESE DOMESTIC LAW:</p> <p>. Described as above.</p>
Priorities	<p>A) PORTUGUESE PRIVATE INTERNATIONAL LAW:</p> <p>. Priority aspects will be governed by <i>lex rei sitae</i>.</p> <p>B) PORTUGUESE DOMESTIC LAW:</p> <p>. In relation to the priority over third party entitlements, please note that it results either from the registration of the security interests that have been created in the relevant issuer's ledger book or bank account.</p> <p>.For bearer securities which are not dematerialised or deposited at a bank account, the relevant element to grant priority over third party entitlements is physical (<i>bona fide</i>) possession.</p>
Enforcement	<p>A) PORTUGUESE PRIVATE INTERNATIONAL LAW:</p> <p>. <i>Lex rei sitae</i>.</p> <p>B) PORTUGUESE DOMESTIC LAW:</p> <p>. Court enforcement of pledges and other securities is conducted by means of special legal remedies extensively governed by civil procedure laws.</p> <p>. Pledges entitle their beneficiaries to obtain payment of their credits through the proceeds of the forced sale or execution of the</p>

	<p>pledged assets, such forced sale to be conducted by the court where the proceedings have been initiated (namely by means of a public auction or by a direct sale organised by the court).</p> <p>.Portuguese law generally does not allow the foreclosure of pledged assets.</p> <p>.To a limited extent and when that is expressly authorised by the relevant contractual instrument and provided the pledge is enforced by a special procedure entitling the court to determine the value for which the pledged assets are transferred to the pledge beneficiary, a somewhat similar effect may be obtained, but always requiring a court intervention.</p>
<p>Insolvency</p>	<p>A) PORTUGUESE PRIVATE INTERNATIONAL LAW:</p> <p>.The bankruptcy of Portuguese companies is governed by Portuguese law, irrespectively of the location of the bankrupt company's assets.</p> <p>B) PORTUGUESE DOMESTIC LAW:</p> <p>. Bankruptcy of a Portuguese debtor has various consequences regarding the taking/creation/enforcement of security interests.</p> <p>Generally speaking, all acts of the bankrupt company after the declaration of bankruptcy are illegitimate (except when performed on limited circumstances by the bankruptcy administrator).</p> <p>Also for a period of 5 years counting from the dates of the constitution of the security interest, the other creditors of the bankrupt company are entitled to challenge such constitution made by such company which were prejudicial to the creditors interests in case of bad faith of the relevant counterpart. These include: (i) set-offs applied on the 2 years prior to the proceedings that lead to bankruptcy were initiated, if funds not commonly used for such purposes were consumed; (ii) security interests created after the relevant obligations having been undertaken, on the 12 months prior to the proceedings that lead to bankruptcy were initiated, or created on the 90 days prior to same moment, in case of security interests perfected simultaneously with the guaranteed obligations; (iii) acts and contracts of the bankrupt company conducted on the same 2 years where the obligations undertaken are substantially greater than those of the relevant counterpart; and to (iv) credit mandates granted on the same 2 years which were not granted with real interest for the bankrupt company).</p>

. Under Portuguese law all creditors are forced to present their claims on a given debtor's insolvency/bankruptcy proceedings (even those merely directed to a re-organisation of the debtor) once such proceedings are initiated.

Please note as well that all other enforcement actions against the insolvent debtor that may be pending when the bankruptcy proceedings are initiated are legally suspended after the first court decision to accept such proceedings.

Nevertheless, and as general rule, we draw your attention to the fact that credits guaranteed by security interests may not be reduced or waived without the relevant creditor's authorisation.

PORTUGAL DEALING WITH THE IMPLEMENTATION OF THE FINALITY DIRECTIVE:

To our knowledge, no specific draft legislation for the implementation of this Directive has been made public in Portugal.

Please note however that the new Securities Market Code that was referred to before is expected to be in force from March 2000 onwards and that it already contains many rules implementing the provisions of this Directive.

The purpose of this provision seems to be to protect Central Banks and other participants in a given system from any legal uncertainty as to the law that would govern the enforcement of existing pledges in a bankruptcy scenario.

The concept seems to be to place securities held in a given jurisdiction under the law of that jurisdiction, trying thus to facilitate and to speed-up all possible court procedures applicable for continuation of normal trade, in case a given party fails to perform its obligations.

ENGLAND AND WALES

Legal risks relating to pledges (i.e. security interests) over/in securities and investments.

English Security Interests

- Security interests over securities (i.e. shares, stocks, bonds or notes) can be created by

legal mortgage
equitable mortgage
fixed charge
floating charge or
pledge.

- in the case of registered securities **fixed** and **floating charges** and are most commonly used; in the case of fixed charges, the deposit of certificates (if any) representing the securities is made at the same time.
- as dealing in listed securities became increasingly computerised or “dematerialised”, a legal regime was introduced by the Companies Act 1989 to provide a foundation for title to securities to be evidenced and transferred without a written instrument. The Uncertificated Securities Regulations 1995 were introduced and CREST the system for dealing with “dematerialised” listed securities became operational on 15 July 1996. As with other clearance systems charges can be created over the pledgor’s rights against CREST.
- in the case of bearer securities where title passes by delivery a **pledge** is suitable because the security interest conferred by a pledge is created by the actual or constructive delivery of the securities to the pledgee - for example, constructive delivery can be achieved through deliveries to the pledgee’s account in a clearance system or to the account of someone holding the securities on behalf of the pledgee.

Establishment/creation risks

- due authorisation
- due execution
- security transfer/agreement (supported by consideration)
- certainty of identity of securities pledged
- inherent risk in right to substitute securities
- chargor/pledgor owns the securities and can pledge them
- there is a liability to the pledgee to be secured
- clear conditions for enforceability/attachment
- in case of the pledge, actual or constructive possession of the certificates representing bearer securities by pledgee
- perfection
 - by possession
 - by registration
 - by specific notice

Realisation/enforcement risks

- enforceable event (liability due)
 - remedies
 - foreclosure (in which court action)
 - sale (obligation to obtain fair value)
 - invalidation outside insolvency
 - priorities - prior charge or pledge created
 - invalidation/inhibition inside insolvency
 - automatic stay on liquidation and administration inhibits enforcement
 - new security for past consideration; avoidance of floating charge within 12 months of liquidation except to extent of money paid etc after creation of charge (s.245 I.A.)
 - transactions at undervalue - no consideration or for consideration significantly less value provided by debtor (s.238 I.A.)
 - voidable preferences - in the event of insolvent liquidation an act which puts the creditor or other person in a better position than it would have been in absent that act
 - extortionate credit bargain - transaction requiring debtor to make grossly exorbitant payments or otherwise contravenes ordinary principle of fair dealing (s.244 I.A.)
- (all references to "I.A." are to Insolvency Act 1986)

Custodian risks

- transfer of securities in breach of mandate
- insolvency of custodian

Conflict of law risks

- pledge of securities (governed by, created by different legal system) created by local law process not readily recognised by law of place governing securities
- other

Financial Markets and Insolvency

Part VI of the Companies Act 1989 as amended by the Financial Markets and Insolvency Regulations 1991 and SI 1999/1209 made certain provisions in relation to the law of insolvency in relation to members of certain financial markets. The purpose of the provisions was to safeguard the operation of such markets from at least some of the consequences of the insolvency of any or more of their members.

Broadly speaking, the provisions of Part VI can be divided into three parts:

- modification of the law of insolvency when it applies to the insolvency, winding-up or default of a person who is a party to transactions in the market; for example, allowing procedures of an exchange or clearing house to take precedence over insolvency procedures

- “market charges” (whether fixed or floating) are defined as charges in favour of a recognised investment exchange, the London Stock Exchange, a recognised clearing house or in favour of a person who agrees to make payments as a result of a computer based system established by the Bank of England and the London Stock Exchange for the purpose of securing debts. The provisions relating to a stay on enforcement on filing and administration petition and the power of an administrator to deal with charged property and other provisions do not apply in respect of “market charges” provide for exchanges or clearing houses to have priority rights and remedies in relation to certain property provided as cover for margin in relation to transactions in the market or subject to a market charge (“market property”)

BELGIUM

Legal risks relating to pledges (i.e. security interests) over/in securities and investments.

Belgian Security Interests

- Security interests over securities (i.e. shares, stocks, bonds or notes) can be created by
civil pledge (C.C. 2075)
pledges - commercial pledge (law of 5 May 1872)
pledge over securities held on a fungible basis at qualifying financial institutions
(such as Euroclear)

Establishment/creation risks

- due authorisation
- due execution
- security transfer/agreement, written or oral, (supported by consideration)
- certainty of identity of securities pledged
- inherent risk in right to substitute securities
- chargor/pledgor owns the securities and can pledge them
- there is a liability to the pledgee to be secured
- clear conditions for enforceability/attachment
- in the case of civil pledges and commercial pledges created by the law of 5 May 1872, possession of the securities by the pledgee (creditor) or agreed third party
- perfection
 - pledge over securities - as stated above by the transfer of possession of the pledged assets by the pledgor to the pledgee.
 - pledges over “dematerialised” securities including securities in clearing systems under Royal Decree No. 62 of November 10, 1967 and other laws (i.e. January 2, 1991, July 22, 1991 and April 28, 1999) held on a fungible basis are validly perfected when the securities are transferred to a “special” securities account opened at a qualifying financial institution such as Euroclear and C.I.K. in the name of the pledgor or the pledgee (or any third party). Euroclear offers a pledged account facility which qualifies as “special” for the purposes of Decree No. 62. Belgian law governs the perfection of a pledge over securities kept in Euroclear irrespective of whether the securities are actually located in Belgium or with a sub-custodian of Euroclear elsewhere in the world.

Realisation/enforcement risks

- enforceable event (liability due)
- remedies
- pledge
 - in respect of both civil and commercial pledges of securities court authorisation is necessary before the creditor may sell the securities having given prior notice to the pledgor/debtor and the sale must take place within the shortest period of time; the court will appoint a trustee to sell the securities; in the case of a civil pledge a public auction is

required; in the case of commercial pledge the trustee may choose public auction or private sale; in addition the holder of a commercial pledge may apply to the court to take ownership of the pledged securities.

- pledges over dematerialised securities and pledges of securities falling under Decree No. 62 may be sold by the pledgee without authorisation by the court at auction or by private sale at the earliest possible date; this only applies to listed securities; sale of unlisted securities by a pledgee must follow the procedures of law of 5 May, 1872.
- invalidation outside insolvency
- priorities - prior charge or pledge created
 - creditor may attack contracts or instruments of transfer made by debtor with intent to defraud the creditor (**Action Paulienne**, c.c. 1167)
- invalidation/inhibition inside insolvency
- automatic stay/moratorium
 - under Bankruptcy Law of 8 August 1997 and Judicial Corporation Law of 17 July 1997
- under the Bankruptcy Law a secured creditor is not prevented from enforcing security after declaration of bankruptcy
 - under the Judicial Composition Law court can award preliminary suspension of payments for up to 6 months during which creditors (including pledgee of no securities) cannot enforce their rights. Secured creditors can get additional security if they can show significant decrease in value - often difficult in practice because of debtor's poor financial position
- **avoidance and fraudulent transfer law** - the Bankruptcy Act provides that some business transactions within a period (the so-called "suspect period") can be avoided. The period is fixed by the court, but is not to exceed six months and ten days prior to the bankruptcy order. This rule applies to bankruptcy proceedings and not to judicial composition proceedings.

There are three relevant provisions:

- Article 17 provides a list of transactions that are null and void when concluded or performed during the suspect period. These unusual transactions include, among other things, the transfer of property without proper consideration, payment or debts not due, or payments made other than in cash or by negotiable instruments.
- Article 18 provides that any payment made by the debtor may be declared null and void if the creditor was aware that the debtor had ceased making payments.

- Article 20 of the Bankruptcy Act provides, more generally, that any act or payment which defrauds the rights of the creditors may be voided by the Commercial Court. This provision is a mere application in case of bankruptcy of the *actio pauliana* provided by the Civil Code; it is thus not limited to acts made during the suspect period.

The trustee must establish that the following three conditions are met in order to apply Article 20:

- A prejudice for the creditors
- A fraud from the debtor. According to the Supreme Court case law, fraud is defined as intent to procure an advantage for a creditor to the prejudice of the other creditors. The fraud must be accomplished with complicity of the creditor. This means that the creditor must be aware that the act performed by the debtor will benefit him to the prejudice of the other creditors.

FRANCE

Legal risks relating to pledges (i.e. security interests) over/in securities and investments.

French Security Interests

- Security interests over securities (i.e. shares, stocks, bonds or notes) can be created by
pledge. (*gage* or *nantissement*)
- In the case of securities held in book-entry form (the most common form in France), the pledge is governed by Article 29 of Law no.83-1 of 3 January 1983, as amended, regardless of its civil or commercial nature (a **1983 Law pledge**) and must follow the procedures established in that law
- In all other cases, there are two types of pledge, a civil pledge (C.C. 2073 et seq.) and the **commercial pledge** (C.Com 91 et seq). The analysis below concerns the commercial pledge as being the type which would be used to take the security over securities. There are two principal circumstances in which this type of pledge would need to be used, namely (i) where the securities take the form of promissory notes or other instruments negotiable by delivery and (ii) where the securities are shares in civil companies.

Establishment/creation risks

- due authorisation
- due execution
- security agreement/instrument to create pledge
- pre-emption rights (in the case of shares, where the bylaws provide for such rights)
- certain identity of the securities pledged (although in the case of a 1983 Law pledge, the pledge can be taken over a portfolio of securities held in a special account, provided that the securities initially credited to the account are identified in the security instrument)
- pledgor owns the securities and has the right to pledge them
- there is a liability to the pledgee to be secured
- clear conditions for enforceability/attachment
- perfection
 - in the case of a 1983 Law pledge, by noting in the books of the financial intermediary, clearing system or issuing corporation

(depending on which entity maintains the special account in which the securities are recorded) and obtaining a pledge certificate from such entity

- in the case of a commercial pledge of promissory notes or other instruments negotiable by delivery, by transferring possession of the instruments to pledgee or third party
- if corporation is of non commercial type (**Société Civile**), any pledge of its shares must be evidenced either by a notarial deed, or a private agreement notified in accordance with a special procedure on the company, and is subject to specific registration with the registrar (**Grefte**) of Commercial court, failing which the pledgee loses ranking with respect to competing pledgees (C.C. 1866)

Realisation/enforcement

- enforceable event (liability must be liquidated, certain and due and payable)
- remedies
 - in the case of a 1983 Law pledge over **listed securities**, foreclosure 8 days (or such other period as agreed in the security instrument) after a special demand has been served on debtor (and the pledgor, if different from the debtor, and the entity with which the account is maintained, if different from the pledgee) by hand or registered mail **either** (i) by selling the securities on an exchange or other regulated market or (ii) by forfeiting ownership of the securities for a quantity determined by the pledgee on the basis of the last closing price of the securities, **but** pledgor must be given the right to instruct the pledgee, prior to expiry of the notice period for the demand, as to the order in which the securities shall be sold or forfeited
 - in the case of a 1983 Law pledge over **units or shares in French collective investment schemes** (SICAVs and FCPs), foreclosure 8 days (or such other period as agreed in the security instrument) after a special demand has been served on debtor (and the pledgor, if different from the debtor, and the entity with which the account is maintained, if different from the pledgee) by hand or registered mail **either** (i) by requiring the collective investment scheme to purchase the units or shares at the then prevailing liquidation value or (ii) by forfeiting ownership of the units or shares for a quantity determined by the pledgee on the

basis of the last liquidation value, **but** pledgor must be given the right to instruct the pledgee, prior to expiry of the notice period for the demand, as to the order in which the units or shares shall be presented for repurchase or forfeited

- in **all other cases**, foreclosure either (i) by selling at public auction 8 days after demand has been served on debtor (and the pledgor, if another person) by bailiff (**huissier**) if the debtor has not paid within the time specified (C.Com 91 et seq.) or (ii) by requesting the judicial allocation of all or part of the pledged securities to the pledgee on the basis of a court-appointed expert's valuation

➤ invalidation outside insolvency

- priorities - prior pledge created
- creditor may attack contracts or instruments of transfer made by his debtor in forward of his rights (**Action Paulienne**, c.c. 1167)
- if pledgor acquired the securities against deferred consideration, the vendor may rescind the sale in the event of non-payment of the deferred purchase price (in which case the pledgor would be deemed not to have owned the securities ab initio)

➤ invalidation/inhibition inside insolvency

- automatic stay/moratorium
 - under the "**Reglement Amiable**" procedure - a pre-insolvency procedure which provides a framework for negotiations under the supervision of a court-appointed conciliator between the company and its creditors -, the conciliator may request an order from the court staying all creditor action against the company for a maximum period of 4 months. The stay would apply to secured creditors, but would not otherwise impair their security interest
 - under the administration procedure (**Redressement Judiciaire**) if a company facing financial difficulties has a viable business, it will generally benefit from an observation period during which the court appoints a judge to supervise and a judicial administrator to assist the debtor, a creditor representative and, if the attempt to reorganise fails, a liquidator. During the observation period, creditors may not move against the debtor, as they are subject to a stay. The

stay applies to secured creditors, but pledgees in possession (including a pledgee of securities under a 1983 Law pledge, but possibly not a pledgee over shares in a civil company) may not be dispossessed at any time unless against full discharge of the secured liabilities and accordingly, although such pledgees would not be allowed to enforce their security, their security interest would not be impaired during the observation period

- At the outcome of the observation period, the court must opt for one of the following solutions: (i) a continuation plan, (ii) a total sale of the business and (iii) liquidation.
- if a judicial continuation plan is adopted by the court (**Plan de Continuation**), the pledgee is only entitled to enforce its pledge upon the debtor's failure to pay the secured liabilities, as re-scheduled by the plan.
- if a total sale of the business (**Cession Totale de l'Entreprise**) is adopted, then a portion of the proceeds of the sale is allocated to each of the pledged assets and distributed to the secured creditors although subject to certain prior claims, including liabilities incurred during the observation period; however, it is thought that a pledgee in possession (including a pledgee of securities under a 1983 Law pledge, but possibly not a pledgee over shares in a civil company), is entitled to retain possession of the securities until full discharge of the secured liabilities
- the judicial liquidation (**Liquidation Judiciaire**) in theory allows enforcement of the pledge; however, a pledgee in possession (including a pledgee of securities under a 1983 Law pledge, but possibly not a pledgee over shares in a civil company) may prefer not to enforce its pledge at the risk of being outranked by certain preferred liabilities and instead wait until such time as the liquidator disposes of the pledged securities, at which point the pledgee's right of retention would be deemed to apply to the proceeds of sale, thereby conferring absolute priority to the pledgee; alternatively, the pledgee may be entitled to forfeit the securities.
- avoidance and fraudulent transfer law.
- under the French Insolvency Act 1985 a series of transactions and payments are defined which must be

declared void if entered into or made by the company before insolvency proceedings were started and within a so called “suspect period”. This period is fixed by the court and runs from the date when the court determines that the company had ceased to be able to meet its current liabilities out of current assets. However, the court cannot fix a period of more 18 months prior to the commencement of proceedings. The **transactions and payments that can be avoided** include **all gratuitous transactions or transactions at an undervalue, all payments of unmatured debts, certain payments made otherwise and through recognised means, all security interests granted in respect to all old money debts** and certain precautionary arrest procedures introduced during the suspect period. In addition the court has discretion to void all payments and transactions (**including the granting of security**) made during the suspect period, if it determines that the counterparty knew at the times of the payments or the transactions that the company was no longer able to meet its current obligations out of current assets.

Custodian risks

- transfer of securities in breach of mandate.
- insolvency of custodian.

Conflict of law risks

- pledge of securities (governed by, created by different legal system) credited by local law process not readily recognised by law of place governing securities.

Financial Markets

- specific provisions exist for exchanges or clearing houses or their affiliates to have priority rights and remedies in relation to certain property provided as cover in relation to transactions in the market: such provisions assume that full title to the deposits/margin are transferred to the exchange, clearing house or affiliate, rather than pledged.
- specific provisions exist for clearing systems to have priority rights and remedies in relation to certain property provided as cover by their participants, including by way of a 1983 Law pledge.
- specific provisions apply to collateralisation of derivative instruments if collateral is granted by absolute transfer of title (rather than by way of pledge).

ITALY

Legal risks relating to pledges (i.e. security interests) over/in securities and investments.

Italian Security Interests

- Security interests over securities (i.e. shares, stocks, bonds or notes) can be created by

assignment by contract (C.C. 1261)

pledge

- security interests over securities (i.e. shares, bonds and governmental securities) can be created only by pledge.
- registered securities: pledge over shares (the most important registered securities) shall be created by a deed and a notarised endorsement on the share certificate. The pledge must be registered in the Shareholders' Book and executed by a director of the company. A share pledge by an Italian limited company must be evidenced by a notarial deed and registered in the Companies' Register held by the local Chamber of Commerce and in the Quotaholders' Book of the company.
- bearer securities: pledge over bearer securities (normally, bonds) shall be created by means of a deed and the transfer of the possession of the relevant security from the pledgor to the pledgee.
- clearance systems: pursuant to the recent Italian law, the securities (shares and bonds) listed on the stock exchange and governmental securities are issued in a dematerialized form and the pledge over these dematerialized securities is registered in ad-hoc Roll, called "Registro dei Vincoli", held by one of the intermediaries acting as custodian, which is a member of the Centralised System Monte Titoli

Establishment/creation risks

- due authorisation (by means of a power of attorney)
- due execution
- pledge deed:
 - certainty of identity of the securities assigned
 - date "certain": a date is deemed to be "certain" when the document is certified by a notary public, a judicial clerk, or filed with the tax office, or sent through the "corso particolare" procedure

- certainty of identity of the securities assigned
- assignor owns the securities and can pledge them
- there is a liability to the assignee to be secured
- clear conditions for enforceability/attachment
- in the case of pledge, possession of the securities by pledgee
- perfection
 - if registered securities, by registration in the Shareholders' or Quotaholders' Book of the company
 - if bearer securities, by possession
 - if dematerialised securities, by registration in the "Registro dei Vincoli".

Realisation/enforcement

- enforceable event (liability due)
- remedies
 - by applying to the Court for the assignment
 - by public auction for the sale
- invalidation outside insolvency - priorities:
 - shares (registered securities): the priority is determined according to the date of registration entered with the Shareholders' or Quotaholders' Book of the company.
 - bearer securities (normally, bonds): the priority is determined according to the individual who has the possession of the security.
 - dematerialised securities (shares, bonds and governmental securities): the priority is determined according to the date of registration in the "Registro dei Vincoli".
- invalidation/inhibition inside insolvency
 - automatic stay inhibits enforcement
 - **Preliminary Concordat** - if approved by majority of voting creditors, representing two-thirds of total amount of claims and ratified by tribunal a decision binds every creditor
 - **Controlled Administration** -this procedure consists of a moratorium period, no longer than two years, during which actions against the debtor are stayed whilst the debtor

submits a reorganisation plan to the court. If during the moratorium period it becomes clear that the debtor will not be able to discharge its obligations, the court must revoke the admission to the procedure and, at the same time, declare the company bankrupt

- **Liquidation** - provides for automatic stay of claim
- **Forceful Administrative Liquidation** for insurance companies, banks and certain companies controlled by the state
- **Extraordinary Administration** where debts toward credit and social security institutions exceed a certain level
- avoidance and fraudulent transfer law
- unless the creditor can prove that he was unaware of the debtor's insolvency the competent court may avoid
- all the agreements entered into by the debtor within two years prior to declaration of bankruptcy in which the debtors obligations are disproportionate to obligations of the other party
- all discharge of pecuniary debts made by the debtor within two years prior to bankruptcy using non cash assets
- all security granted by the debtor on non matured debts within two years prior to bankruptcy
- all security granted by debtor on matured debts within one year prior to bankruptcy
- all gratuitous transfers of assets made by the debtor within two years prior to bankruptcy. In this case, the transfers will be revoked also if the creditor can prove that he was unaware of the debtor's insolvency.

GERMANY

Legal risks relating to pledges (i.e. security interests) over/in securities and investments.

German Security Interests

- Security interests over securities (i.e. shares, stocks, bonds or notes) can be created by

pledge and, theory by

transfer by way of security (bearer securities) or assignment by way of security (registered securities).

- a **pledge** is a possessory security, so:
 - The pledgee must either have possession of the securities or (if held by a custodian) the custodian must acknowledge that it holds the securities for the benefit of the pledgee, and segregate them and mark them as belonging to the pledgee. If the securities are registered, the pledgee must be either registered as the holder of the securities in the Issuer's register or have the pledge notified, and the pledgee must take possession of any certificates.
 - The pledgee is required to keep the pledged assets in safe custody.
- a **transfer/assignment by way of security** [Sicherungsübereignung/Sicherungsabtretung] is
 - not possessory, outright transfer
 - transferee becomes legal owner of the securities, therefore issues such as control of voting rights and liability as owner of the securities arise
 - requires a high degree of specificity - description of the assets transferred/assigned.

Establishment/creation risks

- due authorisation
- due execution
 - written agreement not always required for pledge, but common practice
 - notarisation required of agreement creating pledge or transferring security over limited liability company (GmbH) shares
- security transfer/agreement
- certainty of identity of securities pledged

- particularly important for both pledges and transfer assignment by way of security
- transferor/pledgor owns the securities and can pledge/transfer them
- there is a liability to the pledgee to be secured
 - note that a pledge is an “accessory” security. It therefore depends on the continued existence of the original secured claim, and can only be held by the holder of the liability secured. In particular, in the case of syndication by novation, a pledge expires by operation of law and cannot be (re-)executed by the new bank(s).
- in case of the pledge, possession of the securities by pledgee (either directly or indirectly through Custodian)
- perfection
 - by transfer of possession
 - by specific notice (e.g. in case of GmbH shares Notice to GmbH required)

Realisation/enforcement risks

- enforceable event (liability due and payable)
- remedies
 - Pledge - Sale by Public Auction or (but only if agreed after pledge becomes enforceable) Private Sale
 - Assignment by way of security - claim for possession and sale (public/private)
- invalidation outside insolvency
 - priorities - (either prior in time or priority agreement)
 - possibility of attack by creditor on grounds of voidance preference etc. (see below)
- invalidation/inhibition inside insolvency
 - insolvency inhibits individual enforcement
 - new security cannot be perfected
 - voidable preferences (including transactions granting a creditor security or performance within 3 months before debtor’s insolvency (if creditor knew of insolvency))

- fraudulent preferences (including transactions entered into by debtor with the intention of prejudicing creditors)
- extortionate credit bargain

Custodian risks

- transfer of securities in breach of mandate (in theory, but usually booked to specific pledge account)
- insolvency of custodian (risk only if custodian failed to segregate)

Conflict of law risks

- pledge of securities governed by lex situs, no choice of law possible
- Custody Act - co-ownership of collective mass of fungible securities (global securities certificates) possible to pledge co-ownership share, custodian required to keep pledged securities separate

PORTUGAL

Legal risks relating to pledges (i.e. security interests) over/in securities and investments.

Portuguese Security Interests

- Security interests over securities (i.e. shares, stocks, bonds or notes) can be created by

pledge (arts. 666 et seq. c.c.)

the debtor may constitute a pledge over equity and debt securities. The formalities legally required for constitution of a pledge over securities depend on the type of securities. As a general rule, the creation of a pledge over securities is subject to the formalities which are required for the respective assignment

- **certificated shares:** in relation to shares represented by certificates, there is a distinction between registered shares and deposited shares:
pledge over registered shares as a rule are subject to:
 - pledge contractual agreement
 - delivery of certificates to pledgee
 - notation of pledge in official form and in the certificates (if nominal shares)
 - company's certification of pledge (official form, which may require notarised signatures)in relation to deposited shares, the pledge is created by contractual agreement (which may require notarised signatures if bearer shares) and notation of pledge in an official form may also be required
- **dematerialised securities:** pledges over dematerialised shares are constituted by contractual agreement on the basis of which the financial institution where the shares are registered shall effect the corresponding registration
- **other:** there are a number of particular types which may be subject to different/additional requirements, including:
 - bearer shares which are not deposited nor registered (pledge contractual agreement plus delivery of certificates)

- shares represented by certificates which are under the system of control and deposit of the "Securities Central" (mandatory for listed shares but which may be voluntarily adopted for unquoted shares) which become subject to the regime applicable to dematerialised shares.

Establishment/creation risks

- due authorisation
- due execution
- security transfer/agreement
- certainty of identity of securities pledged
- chargor/pledgor owns the securities and can pledge them
- there is a liability to the pledgee to be secured
- clear conditions for enforceability/attachment
- in the case of the pledge, possession of the securities by the pledgee
- perfection - as described above

Realisation/enforcement risks

- enforceable event (liability due)
- remedies
 - as a rule securities pledged must be sold by the court so that the creditor is paid out of the proceeds. The parties may agree that the sale can be effected out of the court or that the subject matter of the pledge be adjudicated to the creditor for a value which the court may establish
- invalidation outside of insolvency
 - priorities
- invalidation/inhibition inside insolvency
 - automatic stay inhibits enforcement
 - Bankruptcy Laws are to be found in Code of Special Proceedings for the Recovery of Enterprises and Bankruptcy as approved by D.L. 132/93 of 23.4.93

Under the Code the following transactions may be challenged:

- transactions made by the bankrupt in the two years preceding the Declaration of Bankruptcy in favour of any

person having a service or employment relationship with the debtor and transactions in favour of companies associated or controlled by it

- any payment or other consideration made for a debt, whether or not due, within the year preceding the Declaration of Bankruptcy if payment or consideration is derived from sources not normally considered for such purpose
- any security interests granted subsequent to the creation of the obligations secured by such interest within the year prior to bankruptcy
- any security interest created simultaneously within such obligation within 90 days prior to bankruptcy
- any transactions entered into by the debtor where the debtors obligations clearly exceed those of the other party
- any guarantee provided by the debtor, within two years prior to bankruptcy, if not given in a transaction where the debtor has an actual interest.

If the debtor entered into an arrangement within two years prior to bankruptcy that resulted in a decrease of the debtors net worth, that transaction may be declared null and void. If the debtor entered into a transaction or transactions with a related party (shareholder, management or companies controlled by the debtor or having the same controlling shareholders), within six months prior to bankruptcy and, that transaction was detrimental to the estate, the transaction may be declared null and void.

Custodian risks

- transfer of securities in breach of mandate
- insolvency of custodian

Conflict of law risks

- pledge of securities (governed by, created by different legal system) created by local law process not readily recognised by law of place governing securities
- other

PRACTICAL EXPERIENCE

- ***Reduction of credit risk on a case-by-case basis and on a programme basis***
- ***Legal issues in lex situs***
- ***Mitigation of credit exposure***
- ***Initial and ongoing legal and financial expenses***
- ***Selection of appropriate documentation***

There are many different product areas where MFIs take collateral in cross-border situations. On the banking side, these include securities lending, securities fails coverage, provisions of specialised forms of credit to certain types of counterparty and one-off financing structures. On the brokerage side, they include securities borrowing and repos. Both sides also take collateral as margin for derivatives trading.

In all these areas, the approach has been similar. Firstly, MFIs have tried to achieve certainty as to the lex situs of the collateral. This is usually done by ensuring that the collateral is held in a manner and in a place that will give certainty (for instance, securities held in Euroclear or securities deposited with a custodian in London) and usually MFIs take appropriate legal opinions on this. Secondly, in order to understand the impact of an insolvency on the collateral structure, MFIs obtain opinions on the insolvency law applicable to the counterparty.

MFIs enter into collateral structures on a program basis (standard opinions being obtained at the outset for a particular type of counterparty but then not being required for each individual counterparty) and also on a case by case basis.

The cost of setting up a cross-border collateral structure is high (although if it is done on a program basis and the program is frequently used, the cost is amortised over time). On a case by case basis, the expense and time involved mean that cross-border collateral structures are only justified in the biggest and most important transactions.

Historically, in order to achieve an acceptable level of certainty as to the lex situs, MFIs have tended to limit the types of security and the manner and place in which they are held. In the market generally, US government securities held in New York have often been the only acceptable collateral, but MFIs are now increasingly willing to accept European government securities held in Euroclear.

Likewise, it has been the practice to accept as counterparties only those institutions which are incorporated in countries whose insolvency laws are generally creditor friendly.

MFIs, as members of trade associations such as ISDA and ISMA, have been developing appropriate documentation. What is appropriate will depend not only on the nature of the counterparties, the type of security, but also the operational capabilities of the parties. The use of industry standard forms is of great assistance because they offer objectivity, consistency and a body of judicial and operational

experience. They also shorten negotiation because they are more easily accepted. However, it is still necessary to take legal advice concerning the best way to hold collateral and to create the property rights required to defeat claims to the collateral by third parties. Overall the taking of cross-border collateral remains a difficult time consuming process.

THE FINALITY DIRECTIVE

- ***Insulation of collateral from insolvency proceedings***
- ***Vague and imprecise terminology definitions***
- ***Inconsistency of Art. 9 (2)***
- ***Narrow or broad interpretation of the Art. 9 (2)***
- ***Insolvency considerations***

Each of the European Member States must implement the Settlement Finality Directive before the 11th of December 1999. The Finality Directive has as its main objective the creation of greater certainty in the payment process and the reduction of systemic risk, focusing on three areas: the application of netting after the commencement of insolvency proceedings; the applicability of insolvency proceedings and the insulation of collateral from insolvency proceedings.

The Directive firstly provides that the situs of an entitlement to securities evidenced by the credit of securities to a register, account or centralised depository system in a Member State shall be the location of the register or account. Secondly the Directive preserves or protects the collateral rights given to participants in the system in support of their credit operations related to the system and the collateral rights given to national central banks and the ECB in support of their monetary policy operations.

Therefore the implementation of the Directive will introduce substantial changes to the local laws of the Member States.

Unfortunately the Directive lacks a statement of principles and in places its terminology is not precise enough. The meanings of certain terms may differ between jurisdictions, so a common understanding of terms among the Member States is necessary. Arts. 1 and 2 of the Directive contain imprecise definitions. More importantly the application of the Directive is limited, on a narrow interpretation of the Directive, to only some of the parties in the chain of security holdings. On this point, Member States will have to decide if they wish, in their implementing legislation, to follow this narrow interpretation or to adopt a broad or very broad approach.

Art. 9(2) and its inconsistency:

This paragraph of the controversial Art. states:

2. *Where securities (including rights in securities) are provided as collateral security to participants and /or central banks of the Member States or the future European Central Bank as described in paragraph 1, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State."*

The legal analysis of the property aspects of securities, such as ownership, transfer and pledging, differs considerably between jurisdictions.

Also we have to consider if the system for dealing with the securities is one which follows a traditional approach which assumes that the securities are in a physical form, but nevertheless permits securities to be traded on a book entry basis or follows a dematerialised approach where the securities exist in an electronic form. To analyse briefly immobilised and dematerialised systems:

- where the physical securities exist in global form or are *immobilised, in a non-fungible* form, the provision is made for the owner's rights to be discussed in terms of possession and delivery. The investors are treated by virtue of having a book entry as having constructive physical possession; where the depositary agrees to hold immobilised securities on a *fungible basis* (here the depositary's obligation will be to deliver securities equivalent to those deposited by the investor) it is more likely to happen. The depositary intervention will break the relationship issuer-investor. The investor rights are replaced by contractual ones (usually proprietary co-ownership) against the depositary and in the pool of securities of the same type that the depositary is holding for the account holders.;
- the dematerialised method differs from the above because there are no certificates which are required to be held on a non-fungible basis; here the fungibility does not break the issuer-investor relationship. With registered securities is the investor which is entered on the register maintained by the issuer.

The differences between systems show the problem of identifying the true nature of an investor's entitlement to securities held in a depository on a fungible basis. Also the breaking of the issuer-investor relationship creates a new type of entitlement to securities, this time against the depository. This complicates the task of locating the investor's entitlement because the security is enforceable against an entity which may be domiciled/incorporated under a different jurisdiction from that of the issuer or its register.

The reason for the late inclusion of this Art. in the Directive was that the Commission wanted to clarify the *situs* of an entitlement to a security which is evidenced by a credit of the securities to a register or account by a depositary, custodian or other intermediary in a Member State. In other words, from a private international law point of view, the *situs* of an entitlement is the principal determinant of the law which governs proprietary rights in or title to the entitlement.

Where securities are held by a depositary or a similar system, the relationship issuer-investor is broken by the intermediation of the depositary. In a further intermediation by custodians and brokers resulting in a chain of entitlements, the Art. will clarify that the *situs* of the entitlement will be the place of the register or account which evidences the relevant entitlement (i.e. of the particular counterparty giving the pledge) and not the law of the location of the books of an intermediary who is higher or lower in the chain of intermediaries.

The limited scope of Art. 9 (2):

Various Recitals in the Directive refer to this Art.:

- Recital 19 states that the Art. should only apply to a register, account or centralised deposit system which evidences the existence of proprietary rights for the delivery or transfer of the securities concerned;

- Recital 20 states that the provisions of the Art. are intended to ensure that if the participant, central bank or the European Central Bank has a valid and effective collateral security according to the local laws of the Member State, where the relevant register account or centralised deposit system is located, then the validity and enforceability of that collateral security as against that system and any third person claiming directly or indirectly through it, should be determined solely under the law of that Member State;

- Recital 21 clarifies that there is no intention to contravene the operation and effect of the law of the Member State under which the securities are constituted or located (including the law concerning the creation, ownership or transfer of that securities or of its rights) and should not be interpreted to mean that any such collateral security will be directly enforceable or capable of being recognised in any such Member State otherwise than in accordance with the law of that Member State.

- Recital 20 suggests that the obligation to be secured by the collateral arrangements is owed by one participant in the system to another participant, the collateral taker which includes entities other than central counterparty, settlement agent and clearing house). Unfortunately, this appears to be too narrow a formulation to cover all the different types of relationship that may arise in the context of clearing systems. For example, collateral may have been provided to the collateral giver by another participant. A failure to extend the effect of Art. 9 (2) to back to back arrangements may mean that the situs of the collateral giver's entitlement is different from the situs of the collateral taker's entitlement. This will have systemic implications because the collateral taker's entitlement derives from the giver's entitlement. So if the collateral giver has not perfected that entitlement, the collateral taker's entitlement might be affected by adverse claims at the collateral giver's level. This result could be avoided if Art. 9 (2) determined the situs of both participants' entitlements.

Art. 9 (2) is only concerned to determine the situs of an entitlement to securities; so the participants in a designated system who are taking collateral over a relevant entitlement to securities cannot ignore the potential effect of any of the following laws on the validity and enforceability of their collateral interest: the law of any higher tier entitlement; the proper law of the contract governing the collateral arrangement and the attachment of the collateral interest as against the collateral giver and the law of the place of incorporation of the collateral giver.

The Finality Directive will also have a major impact on the insolvency law aspects of cross-border collateral structures. Art.7 provides that insolvency proceedings shall not have retroactive effect on the rights and obligations of a participant arising from its participation in a system earlier than the moment of opening such proceedings. This overrules the "zero hour rule" under which the insolvency of a company may have a retroactive invalidating effect on completed transfers, payments or set-offs

made by or with the insolvent company.

By adopting a “narrow view” Art. 9 (2) will only eliminate legal risk for certain collateral takers: central banks of Member States; the ECB and those participants that provide liquidity to a European Union payment or securities settlement system to which the Finality Directive applies. By applying a “broad view”, the Art. 9 (2) should eliminate legal risk for all direct or indirect participants in a European Union settlement system. By applying an even broader interpretation, Art. 9 (2) should apply to direct and indirect participants of all payment and securities systems, whether or not they are European Union systems. The opinions of the Member States as to which is the best approach are mixed, however the broad view is gaining more ground. At present, the positions of the Member States appear to be as follows:

Narrow positions: Spain and Austria, UK, Netherlands, Portugal.

Broad: Germany, Ireland, Luxembourg, Belgium, Denmark, Sweden, Italy.

In conclusion, the Directive has provided a method for achieving at least a partial legal certainty. However, more work needs to be done.

CONCLUSIONS AND PROPOSALS

It is not realistic to expect that legislation will be passed in every relevant country to deal with all the issues raised in this paper. Nor is it desirable for participants in the market to continue to be obliged to obtain multiple legal opinions at great expense and loss of time each time they wish to create a collateral structure.

The lack of a uniform and certain method of taking pledges in cross-border collateral structures is an impediment to the development of a true single financial market in the European Union.

It is clear that the “pledge” is subject to more formalities in its creation and perfection than the title of transfer. These may include registration, filing or other notifications of the pledge and other specific requirements as to the form and content of the document creating the “pledge”. These formalities are necessary to ensure the formal validity and priority over any third party with a purported claim to the collateralised securities and vary in complexity from jurisdiction to jurisdiction. One of the advantages of the transfer of title is the lack of such perfection formalities.

The “pledge” normally impose duties, conditions and restrictions on the collateral taker as to the manner of holding and as to the use of collateral in recognition of the fact that the taker has only a partial and limited interest in the collateral. Under the transfer of title these restrictions do not apply.

The enforcement of a “pledge” is often subject to a judicial procedure imposed by law to ensure an equitable realisation of the collateral securities but this is often time-consuming. The transfer of title is not subject to such procedures.

We therefore have two proposals:

1. In each Member State, interested parties should lobby to ensure that the Finality Directive is implemented with as broad an application as possible. This could solve a number of the issues set out above.
2. There should be further detailed investigation of the suitability of the transfer of title as a form of collateral, as it has many advantages over the pledge and avoids some of the cross-border issues associated with pledges.

