EUROPEAN CENTRAL BANK

REPO QUESTIONNAIRE – REPOS IN EUROPEAN COUNTRIES

1. Introduction

1.1.1 Background

The use of repos is common throughout the EU inter-bank financial market as a method of achieving short term secured financing. But the expression 'repo' is used to refer more to a category of legal instruments/techniques than to one specific transaction. In consequence, before entering into a discussion of the appropriate regulatory regimes for 'repos', it is useful to define the nature of this instrument.

In the EU there are a variety of forms and associated definitions of 'repo', each developed for a specific purpose. A "repurchase agreement", also referred to as "repo", or "buy back agreement", is a contract whereby one party agrees to sell securities to another with an agreement to subsequently repurchase from the buyer equivalent securities on a later date at a specified price. Repos may fall within one of four maturity categories: intra-day, overnight, open or term. An intra-day repo is one that matures at a later time on the day on which it was entered into. An overnight repo is one that matures on the day following its original transaction date. An open repo has an indefinite term; either party may terminate the transaction. A term repo has a set maturity of more than one day. Finally, a "reverse repo" is a repo viewed from the perspective of the buyer of the securities.

> A "buy/sell back transaction" is an arrangement under which the parties contemporaneously enter into two separate transactions in respect of the same securities: an immediate sale of the securities with normal or same-day settlement, and a forward transaction whereby the seller repurchases the **securities at a set price and on a set date. This transaction is economically equivalent to a repo, but it may be used when law or regulation does not authorise or renders more difficult repo transactions (e.g. hampers their legal validity, tax treatment or regulatory effect)**.

EFMLG project

The continuing progress made towards a fully-harmonised EU financial market suggests that the time may be ripe to investigate whether the existing variances in the definitions of repo are still necessary, or whether a common definition could be proposed.

That the investigation is timely is also evidenced by a couple of overarching developments, which may be mentioned here in order to put the project into context.

- the reverse transaction regime of the ESCB implemented in January 1999 draws attention to the fact that, on the one hand, the use of investment securities as collateral for short term financing in the inter-bank market is now readily accepted throughout the Euro area, while on the other hand, there remains a fairly wide range of open legal issues relating to the Eurosystem's use of collateralisation techniques;
- the tendency towards use of multi-national standard legal agreements has been highlighted recently as the EBF has published its European Master Agreement ("EMA") to offer a market cross-border alternative to the (very recently re-vamped) TBMA/ISMA GMRA 2000;
- the Commission's proposal for a Collateral Directive recognises that, whilst "pledge" and full "title transfer" (such as that effected through repos) have the same economic intent, their legal nature differs and indicates that barriers to collateralisation should be removed.

The annex to this document sets-out some existing repo definitions in Community legislation (Directive 86/635 of December 8, 1986, Directive 93/6 of March 15, 1993 and the draft proposal for a Directive on the cross border use of collateral[1] dated June 15, 2000 which the EFMLG has already discussed).

These three definitions each have a specific limited use. They do not amount to a pan European definition.

The Annex also mentions existing repo definitions used in standard financial market documents.

[1] A further comment could be made as to whether it is advisable to address the issue of repos in a directive on collateral: couldn't this lead to re-characterisation risks (for repo transactions)?

Indeed, although the Directive will cover both the "pledge" and the "title transfer" approaches, repos are legally different from the handing of collateral as security with full transfer of ownership.

The risk of having as many national repo definitions as there are Member States is that firms conducting cross-border business may not know with certain whether:

- repos validly effect a transfer of legal ownership of the securities transferred from seller to buyer;
- what regime applies to repos (type of securities authorised, capacity issues, close-out netting issues, re-characterisation issues, regulatory capital considerations…); and
- what formalities and documentary precautions are required or at least/advisable to ensure validity.

It seems that the EFMLG investigation may for convenience be divided into four strands, and the issues raised in the questionnaire set out below have been divided accordingly. The four strands are:

(a) some background information on the history of the use of investment securities as collateral for short term financing in the secured inter-bank market in general, and the use of a repurchase mechanism in particular;

(b) the legal nature of a repo-type transaction under each of the EU national legal systems (i.e. the extent to which the law validates the economic intention of the transaction: issues such as re-characterisation, capacity, close-out netting, top-up transfers). For convenience, this may be referred to as "legal" issues relevant to repos;

(c) other "regulatory" issues relevant to repos, in particular the treatment under each of the EU national legal systems relating to accounting, tax and capital requirements in the context of banking supervision;

(d) problems and issues encountered in practice.

2. QUESTIONNAIRE

The following questions refer to your national law. Please type your answers in the box beneath each question.

Strand 1 (background information)

1.1 When were investment securities first regularly used as collateral for short term financing in your country's financial markets, and why? Are these transactions generally cash driven or securities driven?

Country name	Answer
	1.1

1.2 When was the repo first regularly used as the chosen legal instrument for this, and why?

Country name	Answer
	1.2

1.3 Please describe the economic function of repos as they are used in your country (including tax issues).

Country name	Answer
	1.3

1.4 Are both repos and securities lending used in your country? Please state which market developed first? And for which purpose? (N.B: do not discuss the differences in legal regimes which will be developed under question 3.3).

Country name	Answer
	1.4

Strand 2 (“legal issue”)

2.1 Legal definition:

2.1.1 Is there a legal definition (or definitions) of repos in your country (whether statutory or through case law)? If so, please specify what it is.

Country name	Answer
	2.1.1

2.1.2 If your country has a national domestic master-agreement for repos, how does it define: (i) repurchase transactions (ii) reverse repurchase transactions and (iii) buy & sell back transactions

Does it purport to transfer ownership of the securities?

Country name	Answer
	2.1.2

2.1.3 Does your national law recognise the above types of repo contracts and the transfer of title of the securities intended by the repo agreements? If so, is this true with respect to transfers of securities and margin (whether cash or securities) i.e. are they fully protected from the defaulting counterparty’s creditors in case of bankruptcy proceedings?

Would your answer change if the repo agreement is governed by another law?

Country name	Answer
	2.1.3

2.1.4 If transfer of title is not recognised, does your national law treat repos as cash loans secured by securities or securities loans secured by cash collateral (i.e. is there a risk of re-characterisation of the repo as a pledge or into any other form of security interest which unlike transfer of ownership doesn’t exclude the securities or cash from the debtor’s estate in the context of insolvency proceedings?)

Country name	Answer
	2.1.4

2.1.5 What types of repo are there? (e.g. repos with delivery of securities and without delivery of securities…)

Country name	Answer
	2.1.5

2.1.6 Can repos be done on any type of securities (e.g. shares, bonds…)?

Country name	Answer
	2.1.6

2.1.7. Can repos be done on securities for which the interest coupon or dividend is paid after deducting a withholding tax?

Country name	Answer
	2.1.7

2.1.8 Please specify treatment given to coupon payments or dividend due during the lifetime of a repo transaction : are they passed on to the original holder of the securities or do they remain with the current holder of the securities or is another solution provided for (ex. through the central securities depository)?

Country name	Answer
	2.1.8

2.1.9 Is there a difference in the legal analysis 2 (characterisation) and effects of:

- repos
- reverse repos
- buy and sell back
- repos with delivery of securities versus repos without delivery of securities
- open ended vs fixed repo date.

Country name	Answer
	2.1.8

2.1.10 Is any regulatory or administrative consent or other formality such as notarisation or stamp duty required/advisable when entering into repos with a counterparty in your jurisdiction-under a Master Agreement governed:

- by the law of your jurisdiction;
- by another applicable law but with your courts as competent jurisdiction ?

[2] E.g. transfer of title, fiduciary transfer, secured loan …

What if it's a purely domestic repo as opposed to cross-border?

Country name	Answer
	2.1.9

2.2 Capacity issue

2.2.1 Are all types of investors (undertakings, investment funds, individuals, non-professional investor …) allowed to enter into all types of repos (repos, reverse repos, buy & sell-back…) ?

If not, what possible consequences could arise from/for a repo contract with an unauthorised entity? (e.g. nullity of contract, tax consequences, netting…)

Country name	Answer
	2.2.1

2.3 Netting regime and transfer of ownership

2.3.1 Do repos benefit from a derogatory favourable netting regime removing them from the scope of Insolvency proceedings (if so, total/partial/subject to conditions?) and actions by the debtor's other creditors? Does this depend on any specific circumstances (such as accounting treatment)?

Country name	Answer
	2.3.1

2.3.2 Are there any limitations or doubts as to the validity of "collateral" transfer mechanisms?

Country name	Answer
	2.3.2

2.3.3 Is there any legal risk linked to "haircut" mechanisms (i.e. providing collateral having a value x % above that of the exposure) through initial margin delivery and top-up collateral margin arrangements? Would such mechanism's validity and enforceability be recognised and could they adversely affect the validity of close-out netting mechanisms in the context of insolvency proceedings?

Country name	Answer
	2.3.3

2.3.4 Please comment any "suspect period" (clawback) issues relating to the delivery of top-up collateral.

Could substitution of the collateral have an impact on the answers given above?
Would the type of collateral (domestic, foreign…) change your answer?

Country name	Answer
	2.3.4

2.3.5 Is there a risk that the administrator of an insolvent party could require the continuation of some transactions and not others (i.e. cherry picking risk)?

Country name	Answer
	2.3.5

2.4 Would your national law recognise the validity of **cross product** netting arrangements for the netting of repos and securities lending (and, potentially, derivatives) such as the EBF's European Master Agreement the ECB's Master Netting Agreement and the TBMA/BBA's Cross Product Master Netting Agreement in the context of insolvency proceedings against a counterparty incorporated in your jurisdiction?

Would there be any conditions to this?

Is domestic netting right form based or substance based (i.e. devolved from right created by a master agreement or due to the nature of the transactions)?

Country name	Answer
	2.4

Strand 3 ("regulatory" issues)

3.1 Specific legal, tax, accounting and regulatory regime

3.1.1 What is the tax regime applicable to each of the following categories? Does regime vary in function of type of securities?

- repos
- reverse repos
- buy and sell back
- repos with delivery of securities versus repos without delivery of securities
- open ended vs fixed repo date.

Country name	Answer
	3.1.1

3.1.2 What is the accounting treatment for each of the categories mentioned in 3.3.1?

Country name	Answer
	3.1.2

3.1.3 What is the prudential treatment given to each of these types of trades (capital adequacy)?

Country name	Answer
	3.1.3

3.1.4 Does the use of clearing systems and Settlement/Delivery systems impact any of your comments above (for all strands of questions)?

Country name	Answer
	3.1.4

3.2 Are there any specific issues related to

-Agency repos?

-cross-border business?

-Please comment

Country name	Answer
	3.2

3.3 Please point out the differences between the regime described above for various forms of repos and the regime applicable to securities lending (such as that conducted pursuant to an OSLA, or 2000 version Global Master Securities Lending Agreement (GMSLA) - sponsored by ISLA – or to a national master agreement for securities lending)./.

Country name	Answer
	3.3

Strand 4 (problems and issues encountered in practice + proposals)

4.1 Are there any problems and issues you have encountered in practice that are not already covered by your answers to the above questions?

Country name	Answer
	4.1

4.2 **What proposals** would **you make for a new harmonised repo regime in Europe**, i.e. what are the concrete effects we are looking to achieve (e.g. recognition of netting, pursuant to a master-agreement, full risk reduction through margining, similar tax treatment across borders…)

Country name	Answer
	4.2

Please opine on whether the proposed definition of repo in article 3 (1) (d) of the March 2001 proposal for a European directive on financial collateral arrangements (2001/0086 (cod)) is satisfactory in its present state.

It reads as follow:

3 (1)(d) "sale and repurchase agreement" means an agreement under which a collateral provider sales financial instruments or interests in or in respect of financial instruments to a collateral taker subject to an agreement by the collateral provider to purchase and by the collateral taker to sale equivalent financial instruments at a future date (the "repurchase date") or on demand, and at a price (the "repurchase price"), specified in or determined as provided in the agreement and includes any term of such an agreement under which:

(i) either party is obliged to transfer to the other full ownership of financial collateral in order to remain a specified ratio or margin between the current market value of the equivalent financial instrument due to be purchased at the repurchase date and the repurchase price; or

(ii) the collateral provider is entitled, before the repurchase date, to require the collateral taker to transfer it full ownership of financial instruments equivalent to some or all of those sold in exchange for the transfer to the collateral taker of full ownership of other financial instruments by way of substitution;

III - ANNEX

Existing repo definitions:

1. Community legislation

(a) Repos are mentioned and defined in the EC Directive 86/635 of December 8, 1986 on the annual accounts and consolidated accounts of banks and other financial institutions :

Article 12

1. Sale and repurchase transactions shall mean transactions which involve the transfer from a credit institution or customer (the “transferor”) to another credit institution or customer (the “transferee”) of assets, for example, bills, debts or transferable securities, subject to an agreement that the same assets will subsequently be transferred back to the transferor at a specified price.
2. If the transferee undertakes to return the assets on a date specified or to be specified by the transferor, the transaction in question shall be deemed to be a genuine sale and repurchase transaction.
3. If, however, the transferee is merely entitled to return the assets at the purchase price or for a different amount agreed in advance on a date specified or to be specified, the transaction in question shall be deemed to be a sale with an option to repurchase.
4. In the case of the sale and repurchase transactions referred to in paragraph 2, the assets transferred shall continue to appear in the transferor’s balance sheet; the purchase price received by the transferor shall be shown as an amount owed to the transferee. In addition the value of the assets transferred shall be disclosed in a note in the transferor’s account. The transferee shall not be entitled to show the assets transferred in his balance sheet; the purchase price paid by the transferee shall be shown as an amount owed by the transferor.
5. In the case of the sale and repurchase transactions referred to in paragraph 3, however, the transferor shall not be entitled to show in his balance sheet the assets transferred those items shall be shown as assets in the transferee’s balance sheet. The transferor shall enter under Off-balance sheet item 2 an amount equal to the price agreed in the event of repurchase.
6. No forward exchange transactions, options, transactions involving the issue of debt securities with a commitment to repurchase all or part of the issue before maturity or similar transactions shall be regarded as sale and repurchase transactions within the meaning of this Article.

(b) In the EC Directive 93/6 of March 15, 1993 « on the capital adequacy of investment firms and credit institutions » :

Article 17

Repurchase agreement and reverse repurchase agreement shall mean any agreement in which an institution or its counter-party transfers securities or guaranteed rights relating to title to securities where that guarantee is issued by a recognised exchange which holds the rights to the securities and the agreement does not allow an institution to transfer or pledge a particular security to more than one counter-party at one time, subject to a commitment to repurchase them (or substituted securities of the same description) at a specified price on a future date specified, or to be specified, by the transferor, being a repurchase agreement for the institution selling the securities and a reverse repurchase agreement for the institution buying them. A reverse repurchase agreement shall be considered an interprofessional transaction when the counter-party is subject to prudential co-ordination at Community level or is a Zone A credit institution as defined in Directive 89/647/EEC or is a recognised third-country investment firm or when the agreement is concluded with a recognised clearing house or exchange;

(c) The proposal for a directive on the cross border use of collateral of June 15, 2000 also gives a definition of Repos:

"sale and repurchase agreement" means an agreement under which a collateral provider (the "seller") sells financial instruments or interests in or in respect of financial instruments to a collateral taker (the "buyer") subject to an agreement by the seller to purchase and by the buyer to sell equivalent financial instruments at a future date (the "repurchase date"), and at a price (the "repurchase price"), specified in or determined as provided in the agreement:

(i) either party is obliged to transfer to the other full ownership of financial collateral in order to maintain a specified ratio or margin between the current market value of the equivalent financial instruments due to be purchased at the repurchase date and the repurchase price; or

(ii) the seller is entitled, before the repurchase date, to require the buyer to transfer to it full ownership of financial instruments equivalent to some or all of those sold in exchange for the transfer to the buyer of full ownership of other financial instruments by way of substitution;

2. Existing practice / Master-Agreements

European repo markets usually describe repo transactions by using the following vocabulary:

- Repo transactions (one party sells securities and commits to repurchasing them on a later date);
- Reverse repos (same as above but seen from the position of the party receiving the securities rather than from that of the party giving the securities);
- Buy & Sell Back (here the sale and the repurchase are not constructed as a single deal but as two separate transactions : a spot acquisition and a forward sale).

All of these transactions are usually documented through confirmations referring to a master agreement signed or to be signed between the two parties. The master agreements currently used are the 1995 PSA-ISMA Global Master Repurchase Agreement (GMRA)[3] and the various national master agreements[4] which are used for domestic transactions and some cross-border business.

Work is being done to finalise the legal opinions on a new "European Master Agreement for financial transactions ", ("EMA") which would:

- exist in many of the languages of the member states and could be used under any one of their domestic laws;
- cover both repo transactions and securities lending;
- allow for close-out netting of repos (as do other master agreements), for close-out netting of securities lending transactions and for a set-off of these two close-out amounts to the extent permitted by applicable law[5].

The GMRA and EMA also define repos:

If we refer to the GMRA, repurchase transactions are:

> transactions in which one party, acting through a Designated Office, ("Seller") agrees to sell to the other, acting through a Designated Office, (Buyer") securities and financial instruments ("Securities") (other than equities, U.S. Treasury instruments and Net Paying Securities) against the payment of the purchase price by Buyer to Seller, with a simultaneous agreement by Buyer to sell to Seller Securities equivalent to such Securities at a date certain or on demand against the payment of the purchase price by Seller to Buyer.

In the EMA, repurchase transactions are:

> "Transactions in which one party (the "Seller") sells to the other (the "Buyer") Securities against payment of an agreed price (the "Purchase Price") and in which the Buyer sells to the Seller Securities of the same kind and quantity as such Securities against payment of another agreed price for delivery and payment at a specified later date or on demand.

[In order to avoid confusion and disparities in terminology, in addition to the terms defined above, the following expressions used in the questionnaire are intended to have these meanings:

- Collateral: [definition to be discussed] refers to the securities transferred or delivered by one party to the other under the repo arrangement. It includes the initial delivery of securities and

[3] A 2000 GMRA has been published recently by the Bond Market Association.

[4] Such as AFTB, Deutsche Rahmenvertrag für Repo, …

[5] This new agreement and the introduction of cross product master netting agreements (which refer to existing master agreements and allow for the setting off of their respective close-out amounts) leads us to think that laws of the member states should by amended to provide for a derogation to bankruptcy law to ensure that this cross product netting is enforceable in the case of insolvency proceedings.

any additional margin deliveries intended to cover loss in value of the initial collateral [or, where specified by the parties, a degradation in the creditworthiness of the collateral giver) ;

- Collateral giver : party handing the collateral;
- Collateral receiver : party receiving the collateral;
- Top-up collateral : additional margin deliveries to cover the loss in value of the collateral already held (and, where specified by the parties, a degradation in the creditworthiness of the collateral giver);

In the ‘General Documentation on Eurosystem monetary policy instruments and procedures’ of November 2000, repurchase transactions are defined:

> **Repurchase agreement**: an arrangement whereby an asset is sold while the seller simultaneously obtains the right and obligation to repurchase it at a specific price on a future date or on demand. Such an agreement is similar to collateralised borrowing, with the exception that ownership of the securities is not retained by the seller. The Eurosystem will use repurchase agreements with a fixed maturity in its reverse transactions.