SOCIETE GENERALE
(SEGL/JUR/MGM)
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Memo on answers received to the Repo questionnaire submitted to the EFMLG

General view and recommendation :

Regulatory regimes for repos still vary widely in Europe.

We recommend that the group advocate to apply a "maximum harmonisation" approach to national repo regimes.

- [The draft directive on financial collateral dated March 27, 2001 contains a definition of repurchase agreements. This may bring about harmonisation of the legal concepts of repos and ensure that their regulatory regimes are adapted at least insofar as required to protect close-out netting conducted pursuant to repo agreements from insolvency proceedings.

  However this definition has been deleted from the European Presidency's last draft.]

  We however feel that a clarification of the draft directive or new legislation would be necessary in order :

  - to avoid recharacterisation risks (i.e. that repos are viewed as a loan secured by a pledge)

  - to achieve harmonisation as far as issues linked to the capacity of parties to enter into repo agreements.

- From a tax and accounting viewpoint, it would seem appropriate to seek harmonisation at least on tax and accounting neutrality in all member states.

1. Legal definition of repos in Europe

   a) Economic Function

      In most member states, repo are cash driven (i.e. essentially considered as a means to obtain short term financing), secured by securities. It does however in certain countries where securities lending is less commonly used serve as a means to obtain specific securities.

   b) Legal aspects

i) Definition through law or master agreement

Repos are often defined by law. However countries such as Italy and Portugal have no such definition and for Denmark and the U.K., it is only (indirectly) defined.

As far as contractual definitions of repos, only half of the Member States (MS) have such a definition in a local master agreement.

ii) Recharacterisation risks

Apart from Denmark, all MS recognize title transfer and as a consequence, insolvency proceedings will not prevent close-out netting.

The risk of having repos recharacterised as secured loans however arises in many countries. This sometimes is due to the fact that the transaction does not fit in the Member State's definition for repos (e.g. Belgium and Finland).

In comparison, this risk is minimal in the UK [and Greece ?].

iii) various forms of transactions

First we should state that all countries use both repo and securities lending.

As far as repos are concerned, it is interesting to note that distinctions traditionally made by the market between repos, reverse repo, buy and Sell-back, [repos with or without delivery of the securities] are often not relevant under the local laws.

2. Applicable regime

a) Parties to the agreement

A number of limitations to the hability of parties to enter into a repo contract have been identified (capacity issues). On this Member States differ :

- Many countries have provided for no limitations. This is the case for Denmark, Finland, Germany, Portugal, Spain and the UK.

- Other countries have either stated that repos can only be done between undertakings (for instance in France[1]) or between a category of professional investors or some investment service providers.
  This is the case in Belgium, Greece and Italy.

b) Securities

[1] Pursuant to section 432-12 of the Code Monétaire et Financier.

i) Eligible securities

We have identified three approaches to eligible securities :

- France and Belgium have listed eligible Financial instruments

- Denmark, Germany and Portugal have set no limitations

- Other countries may have some form of restrictions, for instance that the articles of association or the relevant issuing documentation does not prevent repos (UK) or a restriction to a list of securities given by a regulator (Portugal) or a limitation to bonds (Spain).

ii) Delivery of the securities

In this regard, the local legislations vary widely.

Indeed, while some countries (Germany, UK and Spain) make delivery of the securities an intrinsic element of a repo transaction, in others, two forms of repos co-exist, this often having consequences as far as the applicable regulatory regime. (e.g. France where delivery is necessary to ensure the repo cannot be challenged by third parties or Belgium where it is the condition required to benefit from the, protected, repo regime).

iii) Coupons and dividends

- Apart from France, the payment of coupons or dividends during the course of a repo will have no impact on the regime applicable to repos,

- Coupons and dividends :
  . remain with the seller of the securities in Belgium, Germany, France and Greece, while,
  . they are paid over to the buyer of the securities in the UK, Italy, Portugal and Spain.

  [For your consideration :
  Should this issue be harmonized through EU legislation or left up to national laws or for the parties to decide ?
  Is it necessarily linked to a harmonisation of the tax and accounting treatment ?]

3. Enforceability of the agreement

a) Formalities and administrative consents

Apart from the requirement for a written contract in Italy and Portugal, no formalities or administrative consents are required to ensure the validity of repos per se.
However, there still remain some obligations such as stamp duty and declaration of transactions in Greece for example.

b) Close-out netting

(i) Netting of sums due and value of the repoed securities

In most of the Member States (with an exception for Spain and restrictions as to Italy), legislation has been enacted granting repos protection from insolvency proceedings. Close-out netting is therefore possible and there is no cherry picking risk.

(ii) collateral

(iii)Cross product netting

Cross product netting is not at present protected under all Member States laws. The UK, France, Finland and Germany however provide such protection.

4. Tax and Accounting

a) Tax

While some countries have provided a more favourable regime for repos involving :
- either complete tax neutrality (UK, France[2]) or;
- simply a more favourable capital gains regime provided that certain conditions are met (Finland).

Others apply the standard general tax regime.

c) Accounting

As a general matter[3] the securities remain on the seller's balance sheet, there is thus a principle of neutrality accounting-wise.

Draft Collateral directive :

- Parties covered Art 2(2) :

  Public authorities
  Central banks, ECB
  Financial institutions
  Investment firms
  UCITS
  "person other than a natural person whose capital exceeds 100 Million EUR
  or whose > EUR 1000 Million
  at the time where financial collateral is actually delivered."

- Collateral : cash
  Financial instruments

[2] If certain conditions are met.
[3] There are uncertainties as to Germany.

- Definition of repurchase agreement was in
  March 27, 2001 version
  But deleted in October 3 2001

Wouldn’t the harmonisation of repo regimes be best achieved by a separate repo directive ?