

## **EBF Position on the Review of the Financial Collateral Arrangement Directive**

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*Set up in 1960, the **European Banking Federation (EBF)** is the voice of the European banking sector. It represents the interests of over 5000 European banks, large and small, from 31 national Banking Associations, with assets of more than EUR 20 000 billion and over 2.35 million employees.*

Following the publication of the Commission's Evaluation Report on the Financial Collateral Arrangement Directive of December 2006, and in view of the current drafting of the review of this Directive, the European Banking Federation (EBF) is pleased to provide the Commission with its view on the matter.

### **1) General observations:**

- The EBF has a positive appreciation of the objective of the existing financial collateral arrangement directive (FCD) which is to create a uniform EU legal framework for the domestic cross-border use of financial collateral.
- Banks have already benefitted from the Directive (reduction of risk and administrative burden, improved legal certainty, and removal of obstacles in some EU countries).
- Part of the success of the Directive also depends on national implementation and on tax arrangements (for example, the possibility for the collateral provider to enter into such arrangements without any tax consequences; the incentive or lack of incentive to exercise one's right of use).
- A review of the FCD is welcome as a means to harmonise further the cross-border use of collateral and to address any existing discrepancies compromising such use. Moreover the review is particularly timely in view of the recent financial crisis as, by simplifying the collateral process and improving legal certainty in the use of collateral, the FCD directly contributes to reducing risks for market participants. With this in view, the FCD review should give particular attention to the extension of FCD material scope and to the removal of opt-out provisions.
- The EBF supports the removal of the opt-out provisions (Article 1(3), 1(4) and 4(3)) to ensure a level playing field for the use of financial collateral arrangements.

### **2) Personal scope of Application**

- The EBF supports the removal of the opt-out possibility on the personal scope provided in Article 1(3) of the FCD (Article 1-3) since financial institutions need the possibility of carrying out cross border business with all types of counterparts including non-financial institutions.
- The EBF also agrees with the Commission's intention to maintain the condition under which at least one of the parties in a transaction must be a regulated entity.

### **3) Material Scope of Application**

- The EBF shares the Commission's wish to delete Article 4(3) (which allows Member States to exclude the right of appropriation for the collateral taker in cases of an enforcement event) from the Directive.

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- The EBF supports the Commission's conclusion to consider the extension of the FCD scope to cover "credit claims". This would indeed also maximise the economic impact of the ECB's Decision to include credit claims as an eligible type of collateral for the Eurosystem credit operations as of 1 January 2007.
- The EBF also believes that the review of the FCD should aim to remove any impediment to the use of credit claims as collateral in order to ensure a level playing field. In this respect, we would particularly recommend the Commission to analyse thoroughly the legal issues relating to set-off provisions (close-out netting) when reviewing the FCD.
- Furthermore, the EBF also supports an extension of the scope to other types of assets which are commonly used in the financial markets such as receivables that have arisen under any contract (e.g. loan agreement, purchase or service agreement). This would be in line with the Capital Requirements Directive and the revised Banking Directive which, if certain requirements are met, both recognise the assignment of receivables as eligible credit risk mitigation.
- Finally, the EBF would consider it helpful if the Commission would amend the Directive so as to allow some very specific categories of security interest to be included as 'security financial collateral arrangements' which receive the protection of the Directive (e.g. system-charges and collateral security charges), even though they may not satisfy the possession or control requirement. The description of this category should be wide enough to facilitate its application across the European Union.

#### **4) Right of use (Article 5)**

Although the Commission's Report on the FCD does not see any difficulty on the right of use provided by Article 5.1 of the Directive, EBF members have reported that some national tax regulations, namely on title transfer arrangements, impair the incentive to use a collateral arrangement.

#### **5) Recognition of close-out netting provision (Article 7)**

- Close-out netting arrangements is of paramount importance to financial market participants:
  - o it reduces credit risk, and hence allows an increase in the credit exposures that institutions are able to accept;
  - o the amount of capital legally required for credit institutions to cover their credit exposures could be reduced;
  - o netting can also contribute to reducing settlement and liquidity risk and, as a consequence, systemic risk.

Legal certainty in respect of close-out netting arrangements is therefore of crucial importance to the banking industry and the EBF strongly supports the Commission's project of a single overarching set of amendments to revise Article 7 of the FCD and other relevant EU instruments. In this connection, the introduction of a uniform definition of the term "close-out netting provision", sufficiently comprehensive to cover all relevant types of netting agreements currently used and not limited to netting agreements contained in collateralisation agreements, would be particularly useful and would prevent any misunderstandings on the scope and applicability of the relevant provisions. Such definition could be based on Article 2 lit. (n) of the FCD but would of course have to be extended accordingly.

- Furthermore, the EBF urges the Commission to start swiftly its analysis, aiming at improving the existing framework for close-out netting, and encourages the Commission to involve the financial industry in this exercise as early as possible.
- In the case of cross-border insolvency proceedings, the various applicable national legislations could lead to an additional risk for close-out netting arrangements. The EBF therefore recommends the Commission to (i) broaden the conflict of law provisions of the FCD for close-out netting arrangements and/or (ii) harmonise or at least ensure a better coherence of insolvency laws in order improve the protection of close-out netting arrangements.

#### **6) Conflict of law (Article 9)**

Given the diverging opinions of Members on the matter (cf. discussion on the Hague Convention), the EBF will not assert a position on this issue.