



EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 4 August 2004

at the request of the Belgian Ministry of Finance

on a draft law on financial collateral and various tax provisions in relation to *in rem* collateral arrangements and loans for financial instruments

(CON/2004/27)

1. On 22 June 2004 the European Central Bank (ECB) received a request from the Belgian Ministry of Finance for an opinion on a draft law on financial collateral and various tax provisions in relation to *in rem* collateral arrangements and loans for financial instruments (hereinafter the ‘draft law’).
2. The ECB’s competence to deliver an opinion is based on the second indent of Article 105(4) of the Treaty establishing the European Community and on the third, fifth and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions¹, as the draft law relates to (i) the Nationale Bank van België/Banque Nationale de Belgique (NBB/BNB); (ii) settlement institutions and systems; and (iii) the stability of financial institutions and markets. The ECB has no comments on the draft law’s tax provisions since these do not appear to have an impact on the ECB’s fields of competence.
3. The ECB notes that the main purpose of the draft law is to implement Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (hereinafter the ‘Directive’)² in Belgium. As already stated in the past the ECB has an interest in the harmonised implementation of the Directive³ and welcomes the fact that the draft law does not use any of the opt-out possibilities provided in the Directive. The ECB also notes that, while national authorities are not legally obliged to consult the ECB on draft national laws aimed exclusively at implementing EU directives, the draft law contains a substantial number of provisions that go beyond merely implementing the Directive thus justifying the ECB’s competence referred to in paragraph 2. Indeed, the draft law addresses matters directly relevant to the Eurosystem’s core fields of competence and it will have an impact both on the efficient and

¹ OJ L 189, 3.7.1998, p. 42.

² OJ L 168, 27.6.2002, p. 43.

³ See paragraph 2 of ECB Opinion CON/2003/11 (text available on the ECB’s website <http://www.ecb.int>).

safe use of financial collateral arrangements in EU financial markets and on the Eurosystem's collateralised operations.

4. Furthermore, the ECB notes that, as regards both financial collateral and netting arrangements, the draft law's scope is broader than that of the Directive. As regards financial collateral arrangements (see paragraph 11 as regards netting arrangements), the draft law applies, as a rule, to all financial collateral arrangements without restricting the categories of collateral takers or providers and, thus, also includes natural persons (Article 4(1)). The only exception relates to title transfer collateral arrangements, other than repurchase transactions (see paragraph 10). The draft law also establishes uniform rules regarding, *inter alia*, (i) the proof of conclusion of financial collateral arrangements (Article 6); (ii) the enforcement and use of any financial collateral in the form of a pledge, which under Belgian law corresponds to the 'security financial collateral arrangement' referred to in the Directive (Articles 8, 9 and 11); and (iii) any title transfer financial collateral arrangement in the form of a repurchase transaction (Article 13). The ECB emphasises that simple and reliable methods of collateralisation, which include efficient enforcement methods, are of fundamental interest to the Eurosystem, as they help, *inter alia*, to ensure the smooth functioning of the Eurosystem's single monetary policy⁴. The ECB also emphasises that establishing different regimes for the creation and use of the same kind of collateral, depending on the type of parties involved, implies evaluating the status of the parties to an arrangement and tends to disrupt the operation of collateralised transactions⁵. Subject to the statements in paragraph 10, the ECB therefore welcomes the broad scope and uniform approach to financial collateral arrangements in the draft law. In this context the ECB notes that the fact that the draft law's scope covers natural persons is without prejudice to consumer protection provisions (Article 2). However, the ECB wonders whether, by harmonising the enforcement methods for pledges which specify the prior absence of any court involvement, the last subparagraph of Article 119nonies(2) of the Law of 4 December 1990 concerning financial operations and financial markets has not been affected. In particular, this provision mentions involving the president of the commercial court to enforce a pledge on debt instruments granted by a collective investment institution. The ECB therefore recommends abolishing such involvement if the pledged debt instruments are financial instruments or cash.
5. The ECB notes that Article 3(1), of the draft law defines 'financial instruments' by reference to Article 2(1), of the Law of 2 August 2002 concerning the supervision of the financial sector and of financial services. The ECB welcomes the fact that this definition is broader than the one provided in the Directive. However, in line with the ECB's suggestion to the Council when the Directive was proposed, which remains relevant and which the ECB maintains, the ECB suggests that it be considered whether the scope of the draft law could be extended to cover all types of assets that are

⁴ See paragraph 4 of CON/2003/11.

⁵ See paragraph 5 of CON/2003/11.

eligible for Eurosystem credit operations, including, *inter alia*, credit claims in the form of bank loans⁶.

6. The ECB notes that the last subparagraph of Article 4(1) of the draft law provides legal certainty with regard to the fact that the general requirement under Belgian law that a pledgor does not remain in possession of the pledged asset is satisfied if financial instruments are credited on a special account, including an account opened in the name of the pledgor ('hold-in-custody pledge'). The ECB considers that, particularly where such a hold-in-custody-pledge is used and in order to satisfy the dispossession requirement, the pledgor should not be able to dispose of the pledged financial instruments. The ECB understands that similar reasons of legal certainty underlie Article 5 of the draft law, which clarifies the validity and enforceability of financial collateral arrangements concluded by a representative of the beneficiaries of collateral acting in his own name but on behalf of these beneficiaries ('security agent'). In the same vein, the ECB notes that Article 20(2) and Article 25(2) of the draft law clarify the protection of the pledgee if the pledgor is not the owner of dematerialised (book-entry) securities. Considering the overriding importance and benefits of legal certainty, especially in an area where the volume of transactions and the possible systemic implications of a lack of legal certainty are considerable, the ECB welcomes such clarifications.
7. The ECB also welcomes the fact that the draft law's provisions on (i) the proof of conclusion of financial collateral arrangements and of the provision of financial collateral (Article 6), (ii) the ways of realising financial collateral provided under a security financial collateral arrangement (a pledge under Belgian law) and the absence of requirements for such realisation (Articles 8 and 9), and (iii) the right to use financial collateral under such arrangements (Article 11), comply with the relevant provisions in the Directive. With regard to the reference in Article 6 of the draft law to demonstrating the proof of conclusion of arrangements by any legal means accepted in commercial matters, the ECB notes that this kind of proof will apply to all financial collateral arrangements, including arrangements that consist of a pledge on financial collateral that is governed by civil law. As regards Articles 8 and 9 of the draft law, the ECB notes that the uniform enforcement rules will also apply to commercial pledges on financial collateral, which is the reason that the draft law also abrogates existing Belgian legislation on the enforcement of such collateral, i.e. the third and fourth paragraphs of Article 4 of the Law of 5 May 1872. In view of the fact that this legislation also applies to the commissioners' statutory lien and their financial backers, the ECB wonders whether this abrogation might not also affect the procedure for the enforcement of this lien where it relates to financial instruments or cash.
8. The ECB welcomes the abolition in Article 7(1) of the draft law of the existing formal requirements under Belgian law for a civil pledge on financial collateral. The ECB notes that Belgian law does not currently contain formal requirements for the creation, validity and third-party enforceability of the following:

⁶ See paragraph 10 of ECB Opinion CON/2001/13 (OJ C 196, 12.7.2001, p. 12). See also paragraph 6 of CON/2003/11.

- (i) commercial pledges on financial collateral generally, and
- (ii) pledges on special kinds of financial collateral specifically (i.e. dematerialised securities and financial instruments subject to Royal Decree No. 62 of 10 November 1967),

apart from the general requirement of dispossession of the pledge, which is confirmed in the second subparagraph of Article 4(1) of the draft law and which is permitted under Article 3(2) of the Directive.

Therefore, the ECB welcomes the fact that adopting of the draft law will ensure compliance with Article 3 of the Directive.

9. The ECB notes that Article 10 of the draft law concerns the ranking between a pledge and two kinds of statutory liens on the same financial assets. These liens are (i) the lien of qualified intermediaries and of clearing and settlement institutions on financial collateral provided by their clients and participants, respectively; and (ii) the NBB/BNB's lien on securities booked in their owners' name with the NBB/BNB or with the NBB/BNB's securities clearing system. The ECB considers that the ranking issue is most likely to arise when the statutory lien's beneficiary acts as the agreed third-party depositor of financial assets in execution of a pledge on these assets. The draft law states that, unless parties have agreed otherwise and provided that the beneficiary of the statutory lien either has agreed to credit the pledged financial instruments or securities to a special account or, if cash is pledged, has recognised this pledge, priority should be given to the pledge. For the same reasons provided in paragraph 6, the ECB welcomes this clarification.
10. The ECB notes that Article 12 of the draft law, which deals with title transfer of collateral arrangements, other than repurchase transactions, is intended to implement Article 6 of the Directive. The ECB also notes that, contrary to the situation for pledges, repurchase transactions, and netting arrangements, Article 12 does not apply to arrangements between or with natural persons. While the ECB acknowledges that the Directive does not apply to natural persons, the ECB underlines the similar economic and financial nature of pledges and title transfer collateral arrangements (whether or not they are repurchase transactions), as well as the benefit of having the same simple and reliable legal regime for all types of financial collateral arrangements, irrespective of the nature of the parties involved (see paragraph 4). The ECB therefore recommends considering whether any concerns that underlie this outright exclusion might also be covered by the general reference to consumer protection in Article 2 of the draft law. Relying on this general reference would have the added benefit of enhancing the draft law's uniformity, clarity and legal certainty.
11. As regards netting arrangements, the ECB notes that Article 14 of the draft law, which recognises any netting arrangement and close-out provision to allow such netting, goes beyond the Directive as it is not restricted to (i) close-out netting provisions of which a financial collateral arrangement forms part; or (ii) specific categories of parties to the arrangement. The ECB welcomes this broad approach, since it considers it critical to have a high degree of legal certainty regarding the enforceability of close-out netting provisions in the event of counterparty default. By uniformly

applying close-out netting provisions to all financial transactions legal certainty is ensured and the necessary level of legal protection for key financial instruments which play a vital role in financial markets is guaranteed. This will promote the certainty of transactions and the legitimate expectations of parties in an area where any doubt risks creating severe systemic damage and impairing market efficiency. Furthermore, the ECB understands Article 7(b) of the Directive as considering an assignment of rights to result in the same legal consequences for the enforceability of a close-out netting provision as, for instance, an attachment or an insolvency situation. In order to adequately reflect this meaning Article 14 of the draft law could be rephrased as follows:

‘Netting arrangements, as well as any resolution or early termination provisions and conditions that are established to allow novation or set-off, may, in the event of an assignment of the rights to which they apply, the opening of insolvency proceedings, an attachment, or any other concursus situation be enforced vis-à-vis the creditors (...).’

In order to cater for situations where such assignments occur Article 14 of the draft law could usefully include a reference to the time at which the debt and claim to be set off existed. Finally, the ECB notes that Article 14 of the draft law only deals with issues of the enforceability of netting arrangements in insolvency and similar situations. The ECB understands that Belgian law generally does not establish formal requirements that render netting arrangements effective and enforceable. The ECB nonetheless questions whether, in view of Article 7(2) of the Directive, the draft law should expressly state that, even if the netting arrangement does not contain an express provision to this effect, the arrangement will, when the netting event occurs, not require any formality, such as, for instance, a notice or default letter from the party who intends to rely on the event, unless the parties agree otherwise.

12. The ECB further notes that Articles 15 and 16 of the draft law specifically deal with the validity, enforceability and legal consequences of financial collateral and netting arrangements, as well as with the protection of substitution and top-up collateral (‘margin call’) arrangements, in the event of insolvency or attachment proceedings. The ECB wonders whether the express reference in Article 15(1) of the draft law to Article 17(3) of the Bankruptcy Law is necessary in view of Article 8(3)(b)(ii) of the Directive. Such a reference might give the impression that other relevant provisions of the Bankruptcy Act, which do not concern the zero-hour rule, do not apply to Article 15 of the draft law. Article 17(3) of the Bankruptcy Law deals with the separate issue of prohibiting the granting of pledges for previously incurred debts during the suspect period prior to a bankruptcy. Moreover, Article 15(1) of the draft law – including the reference therein to Article 17(3) of the Bankruptcy Law – is applicable to substitution and top-up collateral (Article 15(2)), which, however, seems to conflict with Article 16(1) and (2) of the draft law, which expressly exclude the application of Article 17(3) of the Bankruptcy Law to substitution and top-up collateral. The ECB therefore raises the question as to the appropriateness of a reference in Article 15(1) to Article 17(3) of the Bankruptcy Law.

13. The ECB welcomes the fact that Article 17 of the draft law, which deals with various private international law issues, mirrors Article 9 of the Directive, apart from the justifiable addition of a reference in Article 17 to the possible application of Article 8(2) of the Law of 28 April 1999. In line with what is stated in the draft law's explanatory memorandum, the ECB notes that the draft law might be affected by the Hague Convention on the law applicable to certain rights in relation to securities held with an intermediary (hereinafter the 'Convention'), the ratification of which is currently being considered by the Community and the Member States. Article 9 of the Directive, and consequently Article 17 of the draft law are not compatible with the Convention in so far as the Convention adopts a choice of law approach. The ECB wishes to stress that all parties involved in the legislative process should investigate closely the Convention's potential impact on systemic stability and on the treatment of collateral transactions to avoid undermining the current level of protection⁷. This might include, *inter alia*, limiting the choice of law applying to proprietary rights in respect of securities held on accounts with a systemically important system (in particular securities settlement systems evaluated and used by the Eurosystem) to the law governing that system, as well as other measures designed to safeguard systemic finality, certainty and transparency.
14. The ECB notes that Article 18 of the draft law limits the regulation of Belgian dematerialised public debt securities to institutions that are located in Belgium and that are holding such securities on their accounts on behalf of third parties, instead of the current situation whereby this regulation also extends to Belgian dematerialised securities that are held outside Belgium. Furthermore, the licensing of certain of these institutions will pass from the Minister of Finance to the Belgian Banking, Finance and Insurance Commission (CBFA). The ECB notes that Article 22 of the draft law consequently puts the CBFA in charge of supervising compliance by these institutions with the rules governing the holding of dematerialised public debt securities and provides for the possibility of the CBFA imposing sanctions on, and taking other measures vis-à-vis these institutions in the event of failure to comply.
15. The ECB also welcomes the fact that Article 19 of the draft law reinforces the NBB/BNB's task as settlement entity in charge of holding public debt securities and of settling transactions in such securities. It notes that the institutions having such securities on their accounts will no longer be obliged to only and/or directly book these securities on their accounts with the NBB/BNB. Indeed, Article 19 of the draft law provides for a multi-tiered system of indirectly held dematerialised public debt securities. In this context, the ECB underlines the importance of the periodic reconciliation of the securities settlement systems' own records with those of the entity in charge of the issuer's accounts, in this case the NBB/BNB. In order to facilitate transfer between international securities settlement systems, the Article also empowers the King to regulate the custody of dematerialised securities denominated in foreign currency or in units of account; and the custody of securities.

⁷ See also paragraph 13 of CON/2003/11.

16. For financial stability reasons, the ECB welcomes the fact that Articles 22bis and 23bis of the draft law extend the scope of the CBFA's consolidated prudential supervision to settlement institutions referred to in the Law of 2 August 2002 and to institutions carrying out the operational management of services provided by such settlement institutions. The ECB also welcomes the fact that Article 26bis of the draft law extends the supervisory regime of the CBFA for settlement institutions and the oversight of the NBB/BNB for settlement systems to institutions established in Belgium carrying out such operational management services. The ECB notes that these institutions will be designated by Royal Decree and that the intention is to designate institutions that provide substantial and critical operational and intellectual services to settlement institutions. The designated institutions will need a licence from the CBFA and conditions regarding their licensing and operation will also be laid down in a Royal Decree. The ECB also notes that this supervisory regime and oversight could extend to institutions established outside Belgium. The ECB welcomes in this respect the express requirement that such extension must comply with Belgium's international obligations. The ECB trusts that it will be consulted on the abovementioned Royal Decrees since their subject matter falls within the ECB's fields of competence.
17. The ECB confirms that it has no objection to the competent national authorities making this opinion publicly available at their discretion. This opinion will be published on the ECB's website six months after the date of its adoption.

Done at Frankfurt am Main, 4 August 2004.

[signed]

The President of the ECB

Jean-Claude TRICHET