

International Swaps and Derivatives Association, Inc.
COLLATERAL LAW REFORM GROUP

BELGIUM

COUNTRY REPORT

Supplement to
*Collateral Arrangements in the European Financial Markets:
The Need for National Law Reform*

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Summary report on the legal framework for collateral arrangements for financial activity

Summary of the legal analysis under the laws of Belgium applicable to collateral arrangements intended to secure financial trading activity in relation to privately negotiated derivative transactions, securities trading, securities repurchase transactions, stock lending and similar financial transactions in the wholesale financial markets. It is assumed that at least one of the parties involved is a financial institution (credit institution or investment firm) and that the collateral involved is cash, in euros or some other freely available currency, and/or fungible securities listed on a stock exchange or recognised market and held in immobilised or dematerialised form in a clearing system (“Fungible Securities”). References to “collateral” below indicate cash and Fungible Securities, unless otherwise specified.

This summary was prepared for the purpose of identifying possible areas of uncertainty or commercial impracticality arising under the laws of Belgium in relation to collateral arrangements. It is not intended to be a definitive summary of the legal position relating to collateral in Belgium and should not be relied on as such.

The position is stated as of December 1999.

This summary, prepared by the Collateral Law Reform Group, does not necessarily represent the views of ISDA or any of its members. It is a subjective assessment of the position in Belgium and is simply intended to encourage debate and discussion of the relevant issues.

KEY POINTS FOR CONSIDERATION FOR BELGIUM

- (1) The owner of a share in a pool of Fungible Securities would have an intangible property right giving absolute title to the assets.
- (2) The *lex loci* of Fungible Securities held through an account in a clearing system is the place where the account is held.
- (3) Conflicts of law rules would apply the *lex loci* to a holding or the transfer of Fungible Securities and the perfection of a security interest in Fungible Securities and the governing law of the agreement to the creation of a security interest.
- (4) If security assets other than cash are held by a third party custodian the security interest must be notified to the third party. If cash in a bank account is subject to a security interest, the account must be blocked or alternatively the bank, as debtor, must be notified.
- (5) No official registration of a security interest with any state agency is necessary.
- (6) A pledgee may not use pledged assets as its own property unless it has obtained approval from the pledgor.

- (7) Formal procedures apply to enforcement of a security interest. This does not apply to collateral transferred under a title transfer arrangement.
- (8) From a "lex situs" perspective, enforcement of a security interest may not be delayed in relation to Fungible Securities but may be delayed if the security asset is cash. From a "lex concursus" perspective, any security interest may be stayed on insolvency regardless of the law under which the security interest was created. This does not apply to collateral transferred under a title transfer arrangement.
- (9) Title transfer arrangements will not be recharacterised.
- (10) Close-out netting under an ISDA Master Agreement is enforceable.
- (11) Contractual set-off is only enforceable on insolvency for connected obligations.
- (12) Third party claims should not disrupt set-off and netting between solvent counterparties.
- (13) Top-up collateral will not be avoided as a preference subject to certain conditions.

1. Do the laws of Belgium deal clearly with the nature of a participant's interest in a holding of Fungible Securities?

Yes. See Royal Decree No. 62 of November 10, 1967 (enhancing the circulation of securities) and the Law of January 2, 1991 (on the Market of the Securities of the State Debt and the Monetary Policy Instruments).

2. How would such an interest be characterised under this law?

The interest of a holder of Fungible Securities, as a client of a member of the local Central Securities Depository ("CSD") with whom the holder has deposited the Fungible Securities, is described as an intangible property right in the Fungible Securities as credited to the accounts of the CSD member.

3. How would the location of Fungible Securities be determined under the laws of Belgium?

Under Belgian conflicts of laws rules, registered and dematerialised securities are located where the register or booking system is located. Bearer securities are located where they are physically held. All forms of securities however, can be held through one or multiple intermediaries/custodians on a fungible basis. The location of such securities should be determined by looking at the laws of the jurisdiction of the intermediary through which the securities are held.

4. Under Belgium's conflict of laws rules, what law would govern:

(a) the characterisation of a person's holding of Fungible Securities?

The law of the jurisdiction of the intermediary through which such participant holds its Fungible Securities.

(b) the creation of a security interest in cash or Fungible Securities?

Belgian law recognises the parties' right to choose the governing law of the agreement creating the security interest, provided that the agreement has an international dimension (for example, the parties are of different nationalities or the collateral is located outside of Belgium or even the mere fact that the agreement is internationally accepted) and provided it is not the intention of the parties to avoid the application of mandatory provisions of Belgian law.

(c) the formal validity or perfection of a security interest in cash or Fungible Securities?

This will be governed by the law of the location of the collateral (*lex situs* or *lex rei sitae*). In the case of cash held in a bank account, the location of the collateral is deemed to be the place where the bank holding the account is situated.

(d) the effectiveness and formal validity of a transfer of title to Fungible Securities?

The law of the location of the collateral.

It should be noted that for certain purposes, the governing law of the contract (*lex contractus*) and the law of the location of the collateral (*lex situs*) could be overridden by mandatory rules of Belgian insolvency law (*lex concursus*).

5. What types of security interests may be created under the laws of Belgium in:**(a) cash?****(b) Fungible Securities?**

Where more than one type of security interest is possible, please indicate which type(s) would typically be used for collateral arrangements involving cash and/or Fungible Securities, and why.

(a) Pledge of cash or pledge over the current account.

(b) Pledge (see Art. 5 R.D. no. 62).

Please see Question 9(a) in relation to transfer of title (Art.25 bis Law of January 2, 1991).

6. In relation to each of these types of security interest, describe briefly any filing, registration, notification, notarisation or other formal requirements necessary to ensure validity of (or “perfect”) the security interest? In relation to each type of security interest, please indicate the consequence of failing to comply with the relevant requirement.**(a) Pledge of cash or current account**

Under Belgian law a commercial pledge is created and perfected by way of the entering into of a pledge agreement and dispossession of the pledged asset. The dispossession is subject to different rules according to the nature of the pledged asset. Cash should be delivered to the pledgee (or a third party).

In the case of cash on current account, the pledged asset is the claim for reimbursement vis-à-vis the account holding bank. The pledge will be valid and enforceable vis-à-vis all third parties (except the debtor and third parties having a concurrent right with respect to the same claim) by entering into a pledge agreement. For perfection towards the debtor and third parties having a concurrent right, the debtor must be notified of the fact that the account has been pledged or acknowledge it (the account does not need to be blocked).

(b) Pledge of Fungible Securities

The only formality with which the parties must comply is the booking of the pledged Fungible Securities to a “special account” with a financial institution or CSD in conformity with Article 5 of the R.D. no. 62. In the case of immobilised or dematerialised securities the pledged securities should be booked to a special account in the books of the relevant account keeping institution or with the appointed operator of the applicable clearing system in conformity with Article 7 of the Law of January 2, 1991.

7. In relation to each type of security interest, indicate whether the collateral receiver is entitled to use the collateral as though it were the absolute owner of the collateral, including the right to sell, lend or re-pledge (rehypothecate) the collateral to a third party.

The pledged assets will remain the property of the pledgor. Thus, as a general rule, the secured party cannot use, sell or otherwise dispose of the pledged assets, because this would be incompatible with the limited nature of the interest which the pledgee has in the collateral.

In the case of cash that was delivered to the pledgee, the pledgee can use it, subject to an obligation to return an equal amount of cash when release of the pledge is required under the pledge agreement (for example, upon satisfaction of the secured obligations). In the case of Fungible Securities, the pledgor can authorise the pledgee to sell them and to replace the sold securities either by the cash proceeds or by newly acquired securities.

8. Briefly describe the enforcement procedures for each type of security interest commonly used for collateral in relation to financial activity. For example, is court approval required before the security interest may be enforced and/or is some form of auction procedure required. Indicate any practical difficulties typically encountered and also the relative efficiency and speed (or lack of same) of such procedures. Comment in particular on the possibility of a stay or freeze in the event that the collateral provider is subject to formal insolvency proceedings of any type.

(a) Pledge of cash and Fungible Securities which consists of securities the value of which is not readily ascertainable in a Belgian or foreign regulated market

In relation to cash, pursuant to Article 3 of the Act of May 5, 1872, the pledgee is allowed to collect the cash on the pledged account in capital and interest to settle its claim.

In relation to Fungible Securities, the pledgee may only enforce his pledge upon prior court authorisation pursuant to the Act of May 5, 1872 which governs commercial pledges. This procedure is rather formalistic with strict delays and notification

procedures to be obeyed. However, once the enforcement order of the court is obtained, it cannot be stayed by the filing of an opposition or of an appeal.

(b) Pledge of Fungible Securities which consists of securities the value of which is readily ascertainable in a Belgian or foreign regulated market

Following prior notification by written summons to the pledgor, the Fungible Securities may be sold by the pledgee through a private or public sale in a Belgian or foreign regulated market, at the earliest possible date taking into account the volume of transactions. The proceeds of sale have to be applied to the debt outstanding to the pledgee by way of principal, interest and costs. The balance, if any, must be returned to the pledgor. In enforcing the pledgee's interest in the collateral, the pledgee has no duty other than to obtain the best available price according to market conditions.

With regard to (a) and (b) above, if the collateral provider is a Belgian entity, subject to Belgian insolvency proceedings, it should be noted that Belgian insolvency laws may delay the secured party from promptly liquidating securities collateral. There are two types of insolvency proceedings under Belgian law, namely bankruptcy proceedings (*faillite/faillissement*) and judicial composition proceedings (*concordat judiciaire/gerechtelijk akkoord*). In the event of bankruptcy proceedings, all enforcement measures are suspended until after the cut-off date for the checking of claims by the courts. If a judicial composition procedure has been instigated, then no action may be taken by the secured party during the observation period. This may not exceed six months, but can be extended for three months after the original period.

9. (a) In relation to collateral arrangements based on transfer of title, please indicate whether there is a risk that the courts of Belgium would recharacterise the transfer of title as the creation of a form of security interest? If so, please give some indication of the degree of that risk (for example, very low, low, medium, high, very high). Please indicate the consequences of such a recharacterisation.

Belgian law recognises transfer of title arrangements specifically in relation to repos (see Art. 23 law of January 2, 1991) and generally under Article 25bis of the law of January 2, 1991.

Article 25bis of the Law of January 2, 1991 explicitly recognises the technique of transfer of title as a form of collateral provided that the conditions set out in the law have been followed. Title transfer collateral arrangements may be agreed only between professional market players (Article 25bis enumerates a limited number of types of counterparty); the transferred assets must be cash, securities or other financial instruments booked to an account; the purpose of the transfer must be the collateralisation of certain obligations owed by the transferor to the transferee; and the transfer of title arrangement must contain a contractual obligation on the part of the transferee of the collateral to transfer the cash or securities, or similar securities or valuables, back to the transferor upon complete fulfilment by the transferor of its obligations. The only other formality with which the parties need to comply is the transfer from the account of the collateral provider to the account of the collateral taker.

If these conditions are met, protection against recharacterisation applies not only to the initial transfer of securities, financial instruments or cash, but also extends to subsequent transfers of cash, securities or other financial instruments as margin, and any substitutions of new instruments or cash for the originally transferred assets. The collateral receiver is considered to be the absolute owner of the collateral, as a result of which he has the right to sell, lend or use the collateral in any other manner and the assets are available for the satisfaction of the creditors of the transferee. Since the collateral receiver becomes the absolute owner of the

collateral, no enforcement procedures apply. Although there is no case-law on point, any restrictions on the use of the transferred assets should not affect the legal treatment of the arrangements, provided that the parties comply with the conditions of Article 25bis of the law of January, 1991.

If the conditions of the abovementioned legislation are not fulfilled or if the legislation is not applicable, a well-known judgement of the Belgian Cour de Cassation dated 17th October, 1996, although not very clear, appears to hold that a transfer of title in these circumstances will not be enforceable against third parties. Recharacterisation will therefore not be necessary.

9. (b) If the agreement is governed by a foreign system of law that does not recharacterise, would the risk of recharacterisation under domestic law still be present?

As noted above, recharacterisation will probably not occur due to the fact that the transfer of title, where it falls outside the relevant legislation, will probably not be enforceable against third parties.

10. Is close-out netting, for example under a 1992 ISDA Master Agreement, enforceable under the laws of Belgium? If so, but subject to certain limitations (for example, as to the nature of the counterparty or types of transaction included within the netting), please indicate briefly what those limitations are.

Yes. Belgian law will only interfere if chosen as the law applicable to the agreement or if insolvency proceedings have been commenced in Belgium against a company that is governed by Belgian law or an individual engaged in business with a principal establishment in Belgium. Provided no insolvency or similar proceedings have already commenced against a Belgian counterparty, close-out netting will be enforceable under Belgian law.

Specific legislation providing for the enforcement of automatic termination clauses and all types of netting agreements between financial institutions (banks, broker-dealers and any other kind of financial establishment) notwithstanding any insolvency proceedings was adopted in Article 157 of the Credit Institution Act of March 22, 1993. This Article ensures the enforceability of netting and set-off between two financial institutions when the insolvent party to an agreement is a Belgian financial institution.

See also the netting opinion provided to ISDA by Coppens Van Ommeslaghe Horsmans & Faurès of July 1998.

11. Is contractual set-off and/or insolvency set-off enforceable in the event of formal insolvency proceeding in the courts of Belgium in relation to a counterparty organised in that country? Please indicate the answer in relation to each type of formal insolvency proceedings (including rehabilitation or reorganisation proceedings such as administration or *redressement judiciaire*) possible in that country in relation to a corporate entity (including a financial institution). Comment in particular on the possibility of a stay or freeze in the event that the collateral provider is subject to formal insolvency proceedings of any type.

There are two types of insolvency proceedings under Belgian law, namely bankruptcy proceedings (*faillite/faillissement*) and judicial composition proceedings (*concordat judiciaire/gerechtigd akkoord*). If a party to an agreement containing netting provisions is subject to insolvency proceedings in Belgium (bankruptcy or judicial composition), Belgian insolvency law may affect the rights of the parties to that agreement to the extent that these

conflict with principles of public policy including the *pari passu* ranking of creditors. The *pari passu* principle will affect the rights of the solvent party to terminate the contract, to require a payment of damages on early termination of the contract, or to net positive and negative amounts for the value of the terminated transactions under the agreement.

Automatic Termination

Composition proceedings do not themselves cause contracts entered into by the debtor to be terminated and Article 28 of the Composition Act expressly prohibits termination clauses linked to the commencement of composition proceedings or associated events unless specific legislation exists to exempt such an agreement such as Article 157 of the Credit Institution Act of March 22, 1993.

Set-off

If the two institutions do not qualify as financial institutions under the Act of March 22, 1993, set-off or netting is only possible after the commencement of insolvency proceedings to the extent that the mutual debts to be set off are closely interrelated. It can be argued that swap transactions entered into under the same Master Agreement between the same parties will be considered to be sufficiently connected to allow insolvency set-off.

- 12. Would the exercise of netting or set off rights under a title transfer collateral arrangement be vulnerable to the rights of third parties in the event of the insolvency of the collateral giver? For example, would it be possible to the collateral giver to disrupt (deliberately or inadvertently) the netting or set-off by assigning to a third party creditor its right to redelivery of equivalent collateral under the collateral arrangement? Could that right to redelivery be attached by a third party creditor of the collateral giver free of the collateral taker's netting or set off rights under the collateral arrangement?**

Under Belgian law the assignment of an existing or conditional claim to redelivery of equivalent collateral, as well as the attachment of such an existing or conditional claim, is possible. However it is very unlikely that any assignee or attaching creditor will take such claim free of any rights of netting or set-off that are related to that claim under the terms of the collateral agreement creating the claim.

Moreover, depending on the manner in which the collateral arrangement is drafted, it might be that the obligation to redeliver equivalent collateral is conditional upon certain conditions (for example, the collateral provider fulfilling its obligations, or the collateral provider not becoming insolvent). As a result of such provisions, in the event the collateral giver fails to pay its obligations or becomes insolvent, the right to redelivery of equivalent collateral would never come into existence or would cease to exist, as the case may be. It is therefore important to determine under the (law applicable to the) collateral agreement what rights are related to the claim and whether the claim is conditional upon the performance of other obligations or upon certain events. The collateral arrangement may contain specific provisions dealing with this issue.

13. In relation to mark-to market collateral arrangements, is there any risk under the preference (or similar) rules of Belgium that “top-up” deliveries of collateral would be vulnerable to avoidance if made during a relevant period prior to the insolvency of the collateral giver?

Deliveries of top-up collateral will be considered valid and enforceable even if delivered during the preference period, provided that the collateral was delivered under the framework of a repo or transfer of title arrangement. It is expressly stated in Article 23 bis (for repo transactions) and in Article 25 bis (for transfer of title transactions) (both introduced by the Law of July 15, 1998 concerning some amendments of legal provisions concerning financial instruments and clearing systems) of the law of 2nd January, 1991 that top-up collateral and substitutions of collateral are enforceable even if these take place during a preference period.

Article 26 of the Law of 2nd January, 1991, again introduced in this law by the Law of July 15, 1998, stipulates that Article 17 of the Bankruptcy Law of August 8, 1997 is not applicable to transactions described in Article 23 bis and 25 bis.¹

Deliveries of top-up collateral during the preference period under the framework of a pledge agreement will be valid if delivered for sufficient consideration (for example, a corresponding increase of exposure) and if not for pre-existing debts. A court may set a preference period of up to the six months preceding the date of a declaration of bankruptcy. During the preference period any new pledged collateral for matured obligations of the debtor or any new transaction may be challenged if the person receiving collateral is aware of the debtor's insolvency. In addition any transaction agreed with the intention to defraud other creditors may be challenged regardless of whether it occurred during the preference period or before then.

14. Please add any additional comments on the general legal framework for collateral arrangements under the laws of that country, whether based on creation of a security interest or on title transfer, highlighting any difficulties that should be addressed in any project for collateral law reform in that country.

Belgium has a very modern and developed legal framework for pledges, repurchase transactions and transfer of title arrangements with regard to cash and Fungible Securities. As a result collateral located in Belgium enjoys an advanced degree of protection using any of these three collateralisation techniques. However, with regard to Belgian collateral providers, (that is, regardless of where the collateral is located) the rules of set-off should be clarified. If a set-off agreement is with a non-financial company, the enforceability of rights of set-off relies solely on previous jurisprudence. Legislation would remove any remaining uncertainty (no matter how small) in this respect.

The Collateral Law Reform Group acknowledges the assistance of Euroclear in the preparation of this report. Euroclear, however, accepts no liability in relation to this report.

¹ Article 17 of the Bankruptcy Law stipulates that the payment of an unmatured debt (for example, by way of netting) or the creation of a pledge for a pre-existing debt will not be enforceable against a third party if the payment or pledge is made during the suspect period.