

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

IRELAND

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 Ireland 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 Ireland in relation to collateral arrangements. It is not intended to be a definitive summary of the legal position relating to collateral in Ireland 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 Ireland and is simply intended to encourage debate and discussion of the relevant issues.

The information set out in this summary is subject to modification to the extent that the Irish entity involved is other than a company incorporated under the Companies Acts, 1963 to 1999 or, if it is such a company, is regulated by additional legislation other than the Central Bank Acts, 1942 to 1998 or the Investment Intermediaries Act, 1995 (as amended).

There is little Irish authority which offers any direct guidance on the matters referred to in this summary. This uncertainty should be recognised when considering the conclusions reached below.

KEY POINTS FOR CONSIDERATION FOR IRELAND

- (1) The owner of a share in a pool of Fungible Securities may have absolute title to and/or an indirect interest in 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 requirements of the *lex loci* to a holding or the transfer of Fungible Securities and the creation and perfection of a security interest in Fungible Securities and would also apply the governing law of any agreement to determine the validity of the transfer of and creation of a security interest in Fungible Securities.
- (4) A security interest may need to be officially registered with certain state agencies.

- (5) A pledgee may not use pledged assets as its own property without the other party's consent. It is not clear what the position is with consent.
- (6) No formal procedures apply to enforcement of a security interest.
- (7) Enforcement of a security interest may be stayed on insolvency (involving examination procedure).
- (8) Title transfer arrangements will not, as a general rule, be recharacterised.
- (9) Close-out netting under an ISDA Master Agreement is enforceable in certain circumstances.
- (10) Contractual set-off may be enforceable on insolvency.
- (11) Third party claims will not disrupt set-off and netting between solvent counterparties in certain circumstances.
- (12) Top-up collateral will not be avoided as a preference in certain circumstances.

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

There is little relevant authority in Irish law to establish with certainty the characterisation of the nature of a participant's interest in a holding of Fungible Securities and there is a lack of authority on certain analogous positions which form the basis of some English academic analysis. Although the English position is itself based on slender authority, there is a growing consensus amongst leading English commentators on the correct analysis. This would be of persuasive authority in Ireland.

2. How would such an interest be characterised under the laws of Ireland?

Assuming Irish law governs the relevant relationships, this will depend on the terms of the relevant documentation. As indicated above, there is little Irish case law which offers any direct guidance but it is likely that the interest will be characterised either as contractual rights against the custodian or indirect, or co-proprietary rights in an unallocated pool of fungible assets, depending on its contractual characterisation.

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

Fungible Securities would most likely be deemed by an Irish court to be located:

- (i) in the case of a certificated security in bearer form, in the place where the certificate is located;
- (ii) in the case of a certificated security in registered form, in the place where the register is located;
- (iii) in the case of a dematerialised security, in the place where the book-entry representing such security is located;

- (iv) in the case of cash, in the place where the account to which the cash is credited is located.
- (v) in the case of securities referred to at (i), (ii) (including an immobilised security) or (iii) above and held on a fungible basis with, or credited to the books of, a custodian, this will depend on the characterisation of the rights of the holder of the security against the custodian (see the response to 2. above). The location of a:
 - (a) contractual right only will be the governing law of that contractual right; and
 - (b) indirect co-proprietary right in the underlying assets is likely to be the location of the custodian.

Note that the European Communities (Finality of Settlement in Payment and Securities Settlement Systems) Regulations, 1998 (the "FoS Regulations") came into force on 4th January, 1999 - implementing European Directive 98/26/EC of 19th May, 1998 (the "Settlement Finality Directive") in Ireland.

This is intended to clarify that where a participant is a "member" of a "payment system" and collateral is provided to such participant and the participant's right is recorded on a register in a Member State, the laws of that Member State determine perfection requirements.

However, the ambit of the FoS regulations is unclear. Indirect participants in payment systems are not addressed. It is also unclear whether the relevant collateral must be provided to the "member" in connection with its participation in the payment system, or whether it is sufficient that it merely be a member, in order to take the benefit of the FoS Regulations. It would appear, however, that it is more likely that membership, only, is required. The definition of "payment system" is currently limited to certain payment/securities settlement systems established in Ireland. This, however, appears unintentional, given that the FoS Regulations would implement the Settlement Finality Directive, but requires clarification.

4. Under Irish conflict of laws rules, what law would govern:

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

Contractual rights in relation to the holding would be governed by the law of the relevant contract governing the holding. Proprietary rights would be governed by the law of the place where the Fungible Securities are located.

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

The governing law of the relevant security agreement.

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

Irish courts will recognise a security interest as valid if it is valid under the law governing the security interest and provided the relevant perfection requirements are fulfilled both in Ireland (see the response to Question 6. below) and under the laws of the place where the collateral is located, and the governing law of the security interest.

It is also unclear as a matter of Irish law as to whether a charge over deposit held with the secured party would be effective. The only Irish authority (from 1985 - well before the 1997 House of Lords decision in *Morris*) indicated that such effectiveness was difficult to accept. The *Morris* decision would be of persuasive authority.

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

The governing law of the relevant transfer agreement, provided all applicable perfection requirements are fulfilled.

5. What types of security interest may be created under the laws of Ireland 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 charge on cash may be created under Irish law. A mortgage or charge on Fungible Securities may be created under Irish law. In the case of Fungible Securities, the relevant security agreement would normally create a mortgage and a charge to give the highest possible degree of protection against the rights of third parties.

6. In relation to each of these types of security interest, describe briefly any filing, registration, notification, notarisation or other formal requirement 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.

Most security interests (including floating charges and charges on “book debts”, which term includes certain cash deposits and accretions on securities) created by Irish companies and by companies incorporated outside Ireland but with an established place of business in Ireland, must be filed in the Irish Companies Registration Office within 21 days of their creation. If not, the charge is deemed void against a liquidator and any creditor of the company (without affecting the validity of the secured debt itself) and the secured debt becomes immediately due and payable. The position is comparable to the English position.

In addition, the general rule regarding priorities of charges over book debts and choses in action (that is, intangibles) under Irish law is that they are governed by the order in which notice is received by a third party debtor (unless a subsequent chargee has notice of the prior charge). Notwithstanding therefore that a chargor will undertake not to create further security over its book and other debts, the priority of the chargee in relation to such book debts can be displaced by a subsequent chargee without notice. Furthermore, prior to the giving of such notice, a third party debtor is discharged by payment to the chargor and set-off rights between the debtor and the chargor continue to accrue. There is no requirement that the debtor acknowledges receipt of the notice. Plainly, however, this is useful from an evidentiary perspective.

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.

Irish law does not expressly permit use of collateral whether or not such use is permitted by the security agreement and it is unlikely that such a right would be permitted under Irish law. If the security agreement is governed by a law other than Irish law and such law, and that of the location of the collateral, permits the use of the collateral an Irish Court would probably not interfere with the ability to rehypothecate, but the Irish court's characterisation of the interest thereby resulting might be affected. For example, if the collateral receiver has sold the collateral to a third party, the collateral receiver may be left only with a contractual right of set-off and not a proprietary interest by way of security in particular assets.

- 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.**

There are no particular formalities to be followed. Enforcement may occur in accordance with the terms of the security agreement without court approval or intervention and without any form of auction or other procedure required.

If the collateral provider is subject to examination under Irish insolvency law, which is a form of reorganisation or rehabilitation proceeding, then enforcement of the security interest would be subject to a stay for a period of time determined by the Irish court (the "protection period"). This stay would also probably affect the exercise of rights of set-off, relating to bank accounts and the rights of the secured party may be impaired or reduced under any scheme of arrangement proposed by the examiner if such scheme is approved by the court. The secured party would, however, as a creditor of the collateral provider have the right to vote against any such impairment or reduction and appear at the court confirmation hearing.

The examination procedure is likely to be substantially modified if current proposed legislation is enacted. This is unlikely to occur prior to 2000.

Entities regulated by the Central Bank of Ireland may be the subject of a direction of the Central Bank which may, depending on the terms of the security agreement, the proposed manner of enforcement and the terms of the direction, prevent enforcement.

It may be that certain types of security interest and/or title transfer collateral agreement would fall within the terms of the Irish netting legislation, in which case the stay imposed during the protection period would not apply.

- 9.a. In relation to local law collateral arrangements based on transfer of title, please indicate whether there is a risk that the courts of Ireland 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.**

The Irish courts would not recharacterise a transfer of title as a security interest unless there is evidence that the parties intended that the purported transfer would take effect other than as an outright transfer of title. Use of wording in a document inconsistent with outright transfer could be prejudicial unless it is clear that outright transfer is intended. For example, there is a material risk of recharacterisation under the PSA Master Repurchase Agreement (September 1996 version).

Consequences: if the transfer were recharacterised as a form of security interest and if it is registrable under the Irish companies legislation, then it would be void against a liquidator and any creditor of the collateral provider, although it would still be valid *inter se* as between the collateral provider and the collateral receiver.

- 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?**

The position would be the same as that outlined in the answer to Question 9.a. above.

- 10. Is close-out netting, for example, under a 1992 ISDA Master Agreement, enforceable under the laws of Ireland? 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.**

There is netting legislation in Ireland. The legislation lays down certain conditions before netting would apply, but these are generally satisfied in the case of a 1992 ISDA Master Agreement relating to privately negotiated derivative transactions, depending on the type of derivatives transacted. A wide variety of derivatives transactions are addressed by the legislation but, for example, not all types of credit derivative are addressed.

See also the netting opinion provided to ISDA by McCann FitzGerald of January 1999.

- 11. Is contractual set-off and/or insolvency set-off enforceable in the event of formal insolvency proceedings in the courts of Ireland in relation to a counterparty organised in Ireland? Please indicate the answer in relation to each type of formal insolvency proceeding (including rehabilitation or reorganisation proceedings such as administration or *redressement judiciaire*) possible in Ireland 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.**

Irish case-law has upheld bilateral contractual rights of set-off in insolvency. The position regarding multilateral contractual set-off is unclear. As mentioned above, in the case of examination, set-off is probably suspended for the relevant protection period (there is an argument that the suspension of set-off rights should be interpreted narrowly, but it is doubtful).

In relation to the possibility of a stay or freeze, see the answer to Question 8 above.

- 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 for 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?**

Provided that (a) the title transfer collateral arrangement and (b) the contract(s) giving rise to the claims supported by the title transfer collateral arrangement have been entered into before the collateral taker has notice of the claim of the third party creditor, then the collateral taker has priority in the exercise of its netting and/or set-off right against the value of the collateral under the collateral arrangement. In other words, in such circumstances the third party creditor's interest is subject to the collateral taker's right to net and/or set off.

Issues of fraudulent preference or improper or fraudulent transfers of assets may also be relevant.

- 13. In relation to mark-to-market collateral arrangements, is there any risk under the preference (or similar) rules of Ireland 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?**

Top-up collateral transfers should not be preferential provided that they are made in accordance with the terms of a collateral agreement entered into prior to the commencement of the relevant suspect period, and the collateral giver's dominant intention is not to prefer the collateral taker and the effect of the substitution or transfer of margin is not to effect a fraud on the creditors of the collateral giver or a transfer of assets at an undervalue.

- 14. Please add any additional comments on the general legal framework for collateral arrangements under the laws of Ireland, 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 Ireland.**

Although the Irish position is similar to the English position, there are some important differences, most notably in relation to the scope of examination, which is more draconian (from a creditor's point of view) than administration in the UK. Proposed amendment legislation, when enacted, will, assuming that it will be enacted in its current form, improve the position of creditors.

Since title transfer collateral arrangements should work successfully under Irish law, the primary objective should be to ensure that there are no tax disadvantages to such a route (tax issues are not addressed by this summary) and that it is clearly protected from the effect of examination, perhaps by bringing such arrangements expressly within the scope of the Irish netting legislation, where possible

Some clarification of the characterisation of a holding of Fungible Securities, of the relevant Irish conflict of law rules and of the Irish rules relating to registration of charges as they apply to mortgages/charges on Fungible Securities and Cash would be desirable.

The Collateral Law Reform Group acknowledges the assistance of McCann Fitzgerald, Dublin in the preparation of this report. That firm, however, accepts no liability in relation to this report.