

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

# **SWEDEN**

## **COUNTRY REPORT**

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

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## COLLATERAL LAW REFORM GROUP

# SWEDEN

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

Summary of the legal analysis under the laws of Sweden 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 held listed on a stock exchange or recognised market and 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 Sweden in relation to collateral arrangements. It is not intended to be a definitive summary of the legal position relating to collateral in Sweden 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 Sweden and is simply intended to encourage debate and discussion of the relevant issues.*

### **KEY POINTS FOR CONSIDERATION FOR SWEDEN**

- (1) The owner of a share in a pool of Fungible Securities in a Swedish clearing system would have absolute title to the assets.
- (2) The *lex loci* of Fungible Securities held through an account in a clearing system is probably the place where the account is held.
- (3) Conflicts of law rules would probably apply the *lex loci* to a holding or the transfer of Fungible Securities and the creation and perfection of a security interest in Fungible Securities.
- (4) If security assets are held by a third party bank or custodian the security interest must be notified to the third party.
- (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.
- (7) Formal procedures apply to enforcement of a security interest but may be varied by agreement.
- (8) Enforcement of a security interest may not be delayed except that it may be stayed on insolvency by at least one and up to ten weeks.

- (9) Title transfer arrangements will not be recharacterised.
- (10) Close-out netting under an ISDA Master Agreement is enforceable.
- (11) Contractual set-off is enforceable on insolvency.
- (12) Third party claims will not disrupt set-off and netting between solvent counterparties.
- (13) Top-up collateral will not be avoided as a preference.

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

Swedish law deals clearly with the nature of a participant's interest in a holding of Fungible Securities only as regards holdings in a Swedish clearing system. Until the beginning of this year only the Swedish Securities Register Center ("VPC") could legally be, a clearing system in Sweden and VPC is still the only clearing system in practice.

**2. How would such an interest be characterised under those laws?**

Swedish law would see the holder of a VPC-registered security as the owner of the security registered in his name (rather than as having an interest in a global note or similar).

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

Swedish securities held in VPC are not represented by any physical instrument and the law does not expressly deal with the question of location. However recent changes in the law also permit an instrument issued outside Sweden and represented by a global note or similar to be held in a Swedish clearing system. The statute regarding the registration of financial instruments includes provisions on how an owner may dispose of securities registered to his account, including the notation of pledges and seems to assume that Swedish law will apply. As regards Fungible Securities held in a clearing system outside Sweden, Swedish law is not clear. These could be seen as being located where the global note is or, perhaps more likely, where the clearing system is located. See also Question 4. below.

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

- (a) **the characterisation of a person's holding of Fungible Securities?**
- (b) **the creation of a security interest in cash or Fungible Securities?**
- (c) **the formal validity or perfection of a security interest in cash or Fungible Securities?**
- (d) **the effectiveness and formal validity of a transfer of title to Fungible Securities?**

It appears likely that the laws applicable to the clearing system would govern the perfection of a security interest in Fungible Securities, at least when the security interest is capable of being registered or otherwise noted by the clearing system. It is expected that European Directive 98/26/EC of May 19, 1998 on settlement finality in payment and securities settlement systems (the "Settlement Finality Directive") will be implemented in Sweden in December 1999. When the Settlement Finality Directive has been implemented this legislation will require that

the law of the clearing system governs the perfection of a security interest in Fungible Securities, at least when it comes to clearing systems which have been notified to the Commission by the applicable Member State. However this will not apply when Fungible Securities are held in a clearing system by a nominee (for example, a bank) and the security interest is shown only in the records of the nominee and not notified to the relevant clearing system. It is likely that this will be dealt with separately in the implementing legislation.

As regards characterisation of a person's holding of Fungible Securities and the effectiveness of a transfer of title, again it would appear likely that the law governing the relevant clearing system would govern. It cannot, however, be ruled out that another jurisdiction would be held to be applicable under Swedish conflicts of laws rules: including the jurisdiction of the transferor/ pledgor; the jurisdiction of the issuer of the security; the jurisdiction where the underlying global note, if any, is physically held; or the jurisdiction, the laws of which are expressed to govern the transfer/pledge.

As regards cash, the location of the cash or the bank account most likely would govern but again it is possible that the law of the jurisdiction of the pledgor or the governing law of the pledge agreement may apply.

**5. What types of security interest may be created under the laws of Sweden 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.**

Swedish law would typically use a pledge to create a security interest in cash or fungible securities.

**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.**

In order to perfect a pledge the pledgor must be deprived of the power to dispose of the collateral. This is achieved either by physically handing the collateral to the pledgee or by notifying the pledge to any third party in possession of the collateral. For example when a bank account is pledged the pledgor must not be allowed to make any withdrawals therefrom without the consent in each specific case of the pledgee. The consequence of not duly perfecting is loss of protection against the pledgor's other creditors.

**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.**

Under Swedish law a pledgee shall keep the collateral separate and must not use it. It may re-pledge it to a third party but then always subject to the rights of the pledgor.

- 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.**

Enforcement of a security interest must usually take place through a public auction or, if the collateral is securities traded on a recognised exchange by sale on the exchange. It is possible for the parties to agree differently in the pledge agreement. While enforcement is still possible on the bankruptcy of the pledgor, rules of an administrative nature would cause delays. Typically some eight to ten weeks must pass from the beginning of any bankruptcy proceedings before the pledge may be enforced, unless the receiver in bankruptcy agrees to enforcement earlier than this. Regardless of when in the bankruptcy proceedings enforcement takes place, the receiver must be notified one week in advance. There are no additional stays or freezes when it comes to enforcing a security interest, apart from the above administrative delays in relation to the enforcement of pledges.

- 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 Sweden 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.**

Transfer of title collateral arrangements are possible but not very common under Swedish law. A transferee will be able to use transferred assets as its own property. Possession of the assets must therefore be transferred so that the transferee is deprived of any power to dispose of the assets.

- 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 regards collateral arrangements based on an absolute transfer of title and expressed to be governed by a law other than Swedish law (such as ISDA) we believe that such an arrangement would be upheld by a Swedish court and would not be subject to any stay in bankruptcy described above (provided the parties have not actually kept the collateral separate as though subject to a traditional pledge). When it comes to voidable preferences and the like, we believe that a Swedish court would view a collateral arrangement based on transfer of title in the same way as a pledge. As set out in more detail under 13 below, this should not cause too much concern if the arrangements are documented under the English law ISDA Credit Support Annex.

For the avoidance of doubt, we do not express any view on the tax or accounting treatment of collateral arrangements based on a transfer of title.

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

Close-out netting under a 1992 ISDA Master Agreement in relation to transactions customarily documented under such an agreement is enforceable under Swedish law. There

is, some uncertainty amongst market participants as to whether or not the parties must have elected for automatic early termination to apply in order for close out netting to be enforceable and usual market practice is to elect for this to apply.

See also the netting opinions provided to ISDA by Landahl & Wistrand of March 1998 and December 1998.

- 11. Is contractual set-off and/or insolvency set-off enforceable in the event of formal insolvency proceedings in the courts of Sweden in relation to a counterparty organised in Sweden? 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 Sweden 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.**

Contractual set-off and insolvency set-off are generally enforceable as regards mutual claims between the two parties in all types of Swedish insolvency proceedings subject to certain general equitable considerations. There are no additional stays or freezes when it comes to benefiting from rights of set-off (except for the administrative delays mentioned above in relation to the enforcement of rights under a pledge).

- 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?**

A party can only assign rights to which he is entitled, so that if the rights of an insolvent party to redelivery of equivalent collateral are subject to any netting or set-off (as would be the case under the ISDA Credit Support Annex (English law)) an assignment would only take place subject to this limitation. The same principles apply *mutatis mutandis* to attachments. Only the actual rights of the insolvent party could be attached. A right to set off may be qualified however if the obligations to be set off are not connected.

Following an assignment by the insolvent of a claim, its counterparty would still have a right of set-off if:

- (a) the counterparty's rights against the assignor were acquired before the counterparty was made aware of, or ought to have known about, the assignment; and
- (b) the claims of the counterparty were due and payable either (i) at the time of the assignment or (ii) no later than the assigned claim.

In respect of creditors seeking an order for attachment, the prevailing view is that the counterparty's right of set-off would prevail against any creditors and the counterparty would be able to set off mutual obligations existing at the time the counterparty received notice of the attachment proceedings.

- 13. In relation to mark-to-market collateral arrangements, is there any risk under the preference (or similar) rules of Sweden 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 not be vulnerable to avoidance in any insolvency proceedings if made in accordance with binding obligations agreed in connection with the trading of financial instruments, other similar rights or obligations or currencies. Any such agreement should be in accordance with terms generally used in such markets (for example, an ISDA credit support document). There are exceptions to this rule if the top-up collateral was not transferred at the times set out in the agreement or if transferred in circumstances which make the provision of security unusual.

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

Law reform to remove the risk of delay in enforcing security interests would be welcome. There is also some concern about the uncertainty involved under Swedish conflicts of laws rules when non-Swedish securities are used as collateral. It is possible that the legislation implementing the Settlement Finality Directive will include provisions dealing with the conflicts of laws rules when non-Swedish security assets are used. It is also proposed that the Parliament may at the same time amend the Swedish Bankruptcy Code to allow a secured party to enforce its security interest immediately in any bankruptcy proceedings, provided the collateral consists of either foreign exchange or financial instruments quoted on a Swedish or foreign stock exchange or in an authorised or otherwise recognised market and that the assets are sold at the price quoted on the exchange or in the market as the case may be. Finally it has been suggested that any legislation could clarify the enforceability of termination by notice under the ISDA Master Agreement.

*The Collateral Law Reform Group acknowledges the assistance of Advokatfirman Vinge KB, Stockholm in the preparation of this report. That firm, however, accepts no liability in relation to this report.*