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BY E-MAIL AND BY POST

European Commission
Internal Market and Services DG
Financial Services Policy and Financial Markets
Financial Markets Infrastructure
Rue de la Loi
B-1049 Brussels
BELGIUM

For the attention of:
Mr Tomas Thorsén

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Dear Sirs

Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements

We are grateful for your kind invitation to respond to your questionnaire to the private sector on the implementation in the Member States of the European Community of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (the **FCAD**). We understand that you have also sent a detailed questionnaire to each Member State regarding its implementation of the FCAD, a copy of which we have had the opportunity to review. We understand that this review is undertaken by the Commission in compliance with its obligation under Article 10 of the FCAD to present a report to the European Parliament and Council on the application of the FCAD, with particular reference to the opt-outs in Article 1(3) and Article 1(4) and Article 5 dealing with the right of use of financial collateral by a collateral taker under a security arrangement.

ISDA is the global trade association representing leading participants in the privately negotiated derivatives industry (more than 700 institutions from 50 countries), a business which includes interest rate, currency, commodity, credit and equity swaps, options and forwards, as well as

related products such as caps, collars, floors and swaptions. Promoting legal certainty for cross-border financial transactions through law reform has been one of ISDA's core missions since it was chartered in 1985.

As you know, we have had a longstanding interest in the FCAD. The ISDA Collateral Law Reform Group was originally founded in early 1999 to compile information on the many obstacles then existing to efficient creation, perfection and enforcement of financial collateral arrangements in Europe, including cumbersome and archaic formalities, restrictive insolvency law rules and other difficulties in the national legal regimes of the then 15 Member States. [1] ISDA was already aware of a number of the difficulties market participants were facing as a result of its growing database of legal opinions on its own published collateral documents.[2]

In November 1999 we published our report entitled "Collateral Arrangements in the European Financial Markets – The Need for National Law Reform", a revised and updated edition of which was published in March 2000, together with Country Reports from each of the 15 Member States, in each case responding to a common questionnaire covering a variety of issues, including the rules relating to creation, perfection and enforcement of security and title transfer collateral arrangements, the nature of a person's interest in securities held in book-entry form by an intermediary, the conflict of laws rule for intermediated securities, preference and other insolvency law rules potentially affecting enforcement of collateral, recharacterisation risk in relation to title transfer collateral and other issues.[3]

When the Commission adopted collateral law reform as one of the core objectives of its Financial Services Action Plan, we submitted our Summary Report and the Country Reports to the Commission's Forum Group on Collateral. Subsequently, we actively participated in the consultative process on the draft Directive as it was involving, including attending meetings with members of the Commission, the Council and the Parliament to provide financial market input and offer information, for example, on market practice and market concerns. We have also followed closely the implementation of the FCAD across the EU and also by neighboring European countries, including members of the EEA and EFTA and potential future accession countries.

In response to your private sector questionnaire, we have not been in a position to survey the 25 Member States in depth – which, in any event, would seem unnecessary given the very detailed questionnaire the Commission has sent to the Member States on the FCAD. We also expect that you will be receiving responses from individual financial market participants based in various Member States, who should be able to provide direct information on questions such as costs of implementation, which are covered in your questionnaire.

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1 The CLRG has since become involved in financial collateral law reform issues in other parts of the world as well as in international initiatives by the Hague Conference on Private International Law, UNIDROIT and UNCITRAL.

2 Principally, the 1994 ISDA Credit Support Annex (Bilateral Form) under New York law and the 1995 ISDA Credit Support Annex (Bilateral Form – Transfer) and 1995 ISDA Credit Support Deed (Bilateral Form – Security) under English law.

3 The March 2000 versions of the CLRG Report and the Country Reports are available from ISDA's website at http://www.isda.org (following the link from the home page to Committees/Collateral Committee/Collateral Law Law Reform Group).

We have had the opportunity to consult members and other financial market participants in the Member States, and we are able to offer some observations on the implementation of the FCAD. We set out below a summary of the principal themes that have been of concern to the financial markets in relation to implementation. We also include the following Appendices to this letter:

1. *Appendix 1*: a summary in tabular form of the implementing legislation in the Member States, including the date the legislation came into force and the title of the legislation (where available in the original language and/or an unofficial translation of the title of the legislation in English);

2. *Appendix 2*: a summary organised by Member State of comments raised by local members in each of those Member States. This summary is not meant to be definitive or exhaustive, but merely illustrative, and we hope helpful. Not all Member States are included because we did not receive detailed comments in time for this submission from each Member State, but that does not mean that there are no local concerns regarding the implementation. Some additional comments may be found under "Comments" in Appendix 1.

3. *Appendix 3*: a list of local counsel in each of the 25 Member States who have contributed to Appendix 1 and/or Appendix 2.

We would like to take the opportunity, first of all, to say that we believe that the FCAD has largely been a success. We believe that it has dramatically improved the legal environment for financial collateral arrangements in Europe, promoting convergence among the national legal regimes, at the level of general principles, and considerably strengthening legal certainty for such arrangements. We believe that the FCAD has therefore improved the efficiency, stability and liquidity of Europe's wholesale financial markets.

Our experience to date shows that, nonetheless, there are some areas where improvements could be made. Our principal concerns regarding the implementation of the FCAD are as follows:

- The definition of what constitutes being "under the control" of the collateral taker for purposes of Article 2(2) of the FCAD has proven difficult or uncertain in many (if not most) Member States, with the consequent risk of divergent interpretations across the EU.

- As we indicated would be the case during the consultative process, the inclusion of three opt-outs from the provisions of the Directive has run directly counter to the market interest in a uniform regime for financial collateral across the EU. We believe that it would be beneficial to the European financial markets for this to be addressed by amending legislation eliminating the opt-outs, but we are aware that political concerns may make this difficult to achieve in practice.

- There are numerous differences of detail in the implementation of the Directive across the EU, which we expect will be highlighted by the responses to the Commission's questionnaire to Member States. It would be good if these differences could be eliminated as far as possible, either by an amending Directive or other appropriate instrument or appropriate

guidance by the Commission to Member States. We would be happy to discuss this in more detail with the Commission at the appropriate time once the Commission has had a chance to assess the returns received from the Member States.

- Also, it appears that a small number of Member States have not fully implemented the Directive in certain respects. If this is borne out by the Commission's own research, we would urge the Commission to ensure that this is remedied.

- Article 7 of the Directive requires Member States to ensure that close-out netting can take effect in accordance with its terms, but does not provide any guidance to Member States as to the principles that should underlie a modern regime for close-out netting – in contrast to the rest of the FCAD, which sets out such principles for financial collateral arrangements. We have previously written to the Commission pointing out the desirability of some form of European instrument on close-out netting to provide support to newer Member States on the introduction of close-out netting and to promote convergence between the current netting regimes of older Member States.

- Article 9 of the Directive sets out a conflict of laws rule for intermediated securities which is not consistent with the conflict of laws rule set out in the Hague Securities Convention.[4] In particular, Article 9 of the Directive relies on assigning a location to a securities account, which is problematic in practice for a variety of reasons and therefore does not provide the long term legal certainty in relation to this issue which the market requires.

We remain at your disposal to discuss any of the foregoing issues, any of the issues raised in Appendix 1 or 2 to this letter or, indeed, any other issue arising out of the Commission's review of Member State and other industry responses to the Commission's questionnaires. The FCAD has greatly improved the legal certainty of financial collateral arrangements in Europe, but there remain a number of respects in which that certainty could be strengthened. Please feel free to contact the undersigned if you have any questions or desire further information.

Yours faithfully,

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[4] The Convention on the law applicable to certain rights in respect of securities held with an intermediary, the text of which was adopted by the Hague Conference on Private International Law in December 2002, but which is not yet in force.

APPENDIX 1

Summary of Implementing Legislation and Exercise of Opt-outs from the FCAD

This table provides summary information and is for guidance only; it is not legal advice and should not be relied upon as a basis for providing definitive advice. English translations of the titles of implementing legislation are unofficial and are for guidance only. They should not be relied upon as being the official title.

Key: A = applicable, NA = not applicable

Country	Date legislation comes/came into force	Art. 1(3) opt-out? (Non-natural person)	Art. 1(4)(b) opt-out? (Affiliated equities)	Art. 4(3) Opt-out? (Appropriation)	Name of implementing legislation	Comments
Austria	1 December 2003	A	NA	NA	Finanzsicherheiten-Gesetz-FinSG (NR: GP XXII RV 251 AB 272 S.38)	
Belgium	1 February 2005	NA	NA	NA	Wet betreffende de financiële zekerheden/ Loi relative aux sûretés financières (Law on Financial Collateral)	The law is much more encompassing than the Directive. Financial collateral and netting arrangements between any kind of parties, including in most cases individuals, are covered. Flanking fiscal measures are adopted.
Cyprus	19 March 2004	NA	NA	NA	Financial Collateral Arrangements Law of 2004	Save the opt-out provisions, the text of the Law is identical to the text of the Directive
Czech Republic	29 September 2005	A (depending on certain economic criteria)	NA	NA	Act No. 377/2005 Coll., on the Supplementary Supervision of Banks, Savings and Credit Co-operatives, Electronic Money Institutions, Insurance Companies and Securities Dealers in Financial Conglomerates and on Amendments to Several Other Acts (Act on Financial Conglomerates).	Certain points from the Directive were implemented in an unnecessarily restrictive manner, e.g. the definition of an enforcement event and that the substitution can only be effected with equivalent collateral. Amendments to ISDA CSAs required. A new definition of close-out netting.

Country	Date legislation comes/came into force	Art. 1(3) opt-out? (Non-natural person)	Art. 1(4)(b) opt-out? (Affiliated equities)	Art. 4(3) Opt-out? (Appropriation)	Name of implementing legislation	Comments
Denmark	1 January 2004	NA	A	NA	New chapter 18A ("Aftaler om Finansiell Sikkerhedsstillelse og Slutafregning") to the Securities Trading Act	Legislation expressly recognises close-out netting even if notice is required from the non-defaulting party. In other words, AET is no longer necessary in Denmark. Non-defaulting party may demand that close-out netting be carried through in such a way as to ensure that the parties are placed in the same position as if close-out netting had taken place without undue delay after the time where the non-defaulting party became, or ought to have become, aware of the insolvency proceedings in question
Estonia	1 May 2004	NA	NA	NA	Act to Amend Law of Property Act, Estonian Central Register of Securities Act, Credit Institutions Act, Insurance Activities Act, Bankruptcy Act, Law of Obligations Act, Private International Law Act and Securities Market Act (in Estonian: Asjaõigusseaduse, Eesti väärtpaberite keskregistri seaduse, krediidiasutuste seaduse, kindlustustegevuse seaduse, pankrotiseaduse, võlaõigusseaduse, rahvusvahelise eraõiguse seaduse ja väärtpaberituru seaduse muutmise seadus)	
Finland	1 February 2004	NA*	NA**	NA	Fi Rahoitusvakuuslaki / Swe:Lag om finansiella säkerheter 20.1.2004/11 (Collateral Arrangements Act)	* Security granted by non-natural persons other than "institutions" (as defined in the Act) covered only where the collateral taker is an "institution" and where the collateral consists of assets covered by the Act other than non-listed shares. ** Art. 1(4)(b) opt-out extends to shares in housing and real estate companies.

Country	Date legislation comes/came into force	Art. 1(3) opt-out? (Non-natural person)	Art. 1(4)(b) opt-out? (Affiliated equities)	Art. 4(3) Opt-out? (Appropriation)	Name of implementing legislation	Comments
France	25 February 2005	A*	NA	NA	*Ordonnance no. 2005-*171 dated 24 February 2005 published in the *Journal Officiel* dated 25 February 2005	* Art. 1(3) opt-out not intended to affect current netting and collateral regime for repos, stock loans and derivatives.
Germany	9 April 2004	NA*	A**	NA	Law on Implementation of the Financial Collateral Directive (BGB I, 2004, 502)	* With respect to persons according to Art.1(2)(e), Directive, financial collateral means only collateral which is granted for obligations arising from contracts or from brokering of contracts regarding (i) the acquisition and disposition of financial instruments, (ii) repurchase, lending or comparable businesses with respect to financial instruments, or (iii) loans for the financing of the acquisition of financial instruments. ** If the collateral giver is a person according to Art.1(2)(e), then the collateral giver's own shares and the shares of affiliated entities do not qualify as Directive financial collateral The legislation also covers FCAs where the collateral giver is a non-EU-person comparable to the entities enumerated in Art.1(2)(a) to (e) of the Directive (wider than Directive).
Greece	December 2004	NA	NA	NA	Law 3301/2004	

Country	Date legislation comes/came into force	Art. 1(3) opt-out? (Non-natural person)	Art. 1(4)(b) opt-out? (Affiliated equities)	Art. 4(3) Opt-out? (Appropriation)	Name of implementing legislation	Comments
Hungary	1 May 2004	NA*	NA	NA	Act XXVII of 2004 on the amendment of certain financial laws with a view to law harmonisation	* Legislation applies even where both parties are natural persons (wider than Directive). The legislation is silent on title transfer collateral arrangements. Act XLVIII of 2004 on the amendment of certain acts relating to financial services amended the Capital Markets Act with effect from 10 June 2004. This included a reference in the definition of close-out netting to "a security deposit contract or other contract made for security purposes." We argued before the ministries that title transfer collateral arrangements should be expressly recognised. However, in the Justice Ministry's view, due to the fact that as from 1 May 2004 security deposits are bankruptcy remote under Hungarian law, there is no need for an express recognition of title transfer collateral arrangements. The adopted wording above is a compromise. It is acceptable because title transfer arrangements can be interpreted in the broader term "other contract made for security purposes."
Ireland	9 January 2004	NA	NA*	NA	European Communities (Financial Collateral Arrangements) Regulations 2004, SI No. 1 of 2004	* Para. 3(1) of the Regulations defines "financial collateral" so as to exclude shares in companies whose "exclusive purpose is (a) to own means of production that are essential for the collateral provider's business or (b) to own real property".
Italy	30 July 2004	NA	NA	NA	Implemented by Legislative Decree No.170 of 21 May 2004, published in the Italian Official Gazette No. 164 of 15 July 2004	

Country	Date legislation comes/came into force	Art. 1(3) opt-out? (Non-natural person)	Art. 1(4)(b) opt-out? (Affiliated equities)	Art. 4(3) Opt-out? (Appropriation)	Name of implementing legislation	Comments
Latvia	25 May 2005	NA*	NA	NA	Financial Collateral Law (Finanšu nodrošinājuma likums)**	* The Financial Collateral Law is applicable even if one of the parties to a financial collateral arrangement is a public or financial institution (as defined in Section 3, Part 1 of the Law), and the other party is a legal person, natural person or other non-legal person or an association of such persons. But it seems that a financial collateral arrangement will not be deemed to exist where neither of the parties is a public or financial institution (e.g. in the case where both parties are private companies). ** Additional minor amendments are inserted into the Commercial Pledge Law (Komercķīlas likums), Financial Instruments' Market Law (Finanšu instrumentu tirgus likums) and the Law "On the Insolvency of Undertakings and Companies" (Likums "Par uzņēmumu un uzņēmējsabiedrību maksātnespēju"), in order to ensure that the regulation contained in the Financial Collateral Law prevails over any conflicting norms in these other laws.
Lithuania	1 May 2004	NA	NA	NA	Law on Financial collateral Arrangements of the Republic of Lithuania No IX-2127 (in Lithuanian: Finansinio užtikrinimo susitarimų įstatymas)	
Luxembourg	20 August 2005	NA*	NA	NA	The Luxembourg act dated 5 August 2005 concerning financial collateral arrangements (the Collateral Act 2005)	* Close out netting works irrespective of the status of the parties concerned (wider than Directive).

Country	Date legislation comes/came into force	Art. 1(3) opt-out? (Non-natural person)	Art. 1(4)(b) opt-out? (Affiliated equities)	Art. 4(3) Opt-out? (Appropriation)	Name of implementing legislation	Comments
Malta	1 May 2004	NA	NA	NA	Financial Collateral Arrangements Regulations 2004	The local implementing legislation was amended in March 2005 to bring A1(2)(e) of the Directive within its scope (ie *"a person other than a natural person, including unincorporated firms and partnerships, provided that the other party is an entity as defined in point (a) to (d) of the Directive"*).
Netherlands	20 January 2006	NA	NA	NA		The Dutch legislation introduces a new form of 'qualified contract', i.e. the financial collateral agreement, to which general provisions of pledge and of transfer are applicable by way of reference, but from which specific provisions have been expressed not to apply.
Norway	1 July 2004	NA	NA	NA	The Financial Collateral Arrangements Act of 26 March 2004 (lov om finansiell sikkerhetsstillelse)	
Poland	1 May 2004	NA	A	NA	*Ustawa o niektórych zabezpieczeniach finansowych* (Act on certain Financial Collateral Arrangements)	The law is not consistent with certain provisions of the Bankruptcy Law, namely: - netting of collateral is not recognised upon and after declaration of bankruptcy (contrary to art. 7.1 of the Directive); and - establishment of collateral requires "date certain" for its effectiveness upon declaration of bankruptcy (contrary to art. 3.1 of the Directive)
Portugal	7 June 2004	NA	NA	NA	Decree-Law n. 108/2004	
Slovak Republic	1 January 2006	A	NA	A	Act on bankruptcy and restructuring 7/2005 Coll., as amended; Securities Act 566/2001 Coll., as amended	- applicable only to the financial institutions - enforcement in insolvency events not totally risk-free due to certain timing issues;

Country	Date legislation comes/came into force	Art. 1(3) opt-out? (Non-natural person)	Art. 1(4)(b) opt-out? (Affiliated equities)	Art. 4(3) Opt-out? (Appropriation)	Name of implementing legislation	Comments
Slovenia	30 April 2004	A*	NA	NA	Zakon o financnih zavarovanjih (Act on Financial Collateral Arrangements), Official Gazette of the Republic of Slovenia No.47/2004	After initial assessment, it appears that pre-existing Slovenian law does not provide for the enforceability of the close out netting upon insolvency, and the new law on financial collateral appears to allow enforceability of the close out netting provision upon insolvency only if the close out netting provision relates to the financial collateral agreement entered between the parties (thus, it would not apply if there was no collateral provided or agreed upon). * The Act on Financial Collateral Arrangements applies to legal entities which are not financial institutions if: 1. they exceed at least two of the thresholds (below) stipulated by the Slovakian Companies Act for defining large companies ("velike družbe"); and 2. the other contracting party falls within one of the other categories. The thresholds are: - more than 250 employees; - more than SIT 6,800,000,000.00 (EUR 28,368,000.00) net sale income; and - more than SIT 3,400,000,000.00 (EUR 14,1484,000.40) net asset value.
Spain	15 March 2005	NA	NA	NA	Royal Decree Law 5/2005 of 11 March, 2005	Royal Decree Law 5/2005 of 11 March, 2005 currently provides for, among others, the recognition of the enforceability of close out netting in contractual netting agreements upon insolvency and under certain circumstances. This also applies to margin or collateral arrangements entered into in connection with such contractual netting agreements.

Country	Date legislation comes/came into force	Art. 1(3) opt-out? (Non-natural person)	Art. 1(4)(b) opt-out? (Affiliated equities)	Art. 4(3) Opt-out? (Appropriation)	Name of implementing legislation	Comments
Sweden	1 May 2005	A	A*	NA	Chapter 5, Section 16 and Chapter 8, Section 10 of the Bankruptcy Act (1987:672), Chapter 3, Sections 1 and 3 of the Financial Instruments Trading Act (1991:980), Chapter 2, Sections 20 and 21 of the Company Reorganisation Act (1996:764) and Chapter 15, Section 10 of the Banking and Financing Business Act (2004:297)	* 1(4)(b) opt-out extends only to **non-listed** shares in affiliated undertakings.
United Kingdom	26 December 2003	NA*	NA	NA	The Financial Collateral Arrangements (No.2) Regulations 2003, SI No. 3226 of 2003.	* Legislation applies even where both parties are non-natural persons (wider than Directive). Also some variation from Directive in definitions relating to "financial collateral".

APPENDIX 2

Selected Issues Relating to the Implementation of the FCAD in certain Member States

Country	Comments on the implementation of the Directive
Belgium	**General comments** • Implementing law goes beyond Directive, much broader than Directive, seen as providing a modern and consistent regulatory framework • No requirement that one of the parties is a public authority or financial institution • Applies to all financial collateral arrangements, regardless of nature of collateral provider / taker • Includes transactions with individuals (subject to certain exceptions) • Definition of financial instrument broader than definition in Directive (eg expressly includes dematerialised and book-entry securities) • Applies to netting arrangements in general, not limited to close-out netting **Points for clarification** • Uncertainty over certain aspects of the implementing law, for example, concern that implementing law may have reintroduced the requirement of "effective dispossession" / "effective control" for financial instruments and cash to qualify as valid collateral arrangement and some doubt as to whether Article 7 (recognition of close-out netting) of Directive has been fully transposed. • Implementing law only allows right of use to pledge in relation financial instruments but not to cash. This deviates from Directive which envisages right of use for both.
Czech Republic	**General comments** • Implementation of Directive has given rise to a number of concerns. • Security financial collateral arrangements (especially Articles 4 and 5) have in principle been implemented well. • Both security and title transfer financial collateral arrangements are in principle well protected from the effects of insolvency proceedings.

	• Article 6 of the Directive has not been specifically implemented and title transfer collateral arrangements are not protected strictly in accordance with their terms. The Czech legislators instead chose to specifically provide for a security transfer of financial instruments and a security transfer of cash. The law regulates how these two title transfer collateral arrangements can be created and enforced in a similar way to security financial collateral arrangements. As a result, it seems that to use title transfer collateral arrangements under market standard documents such as the ISDA English Credit Support Annex, one must often either rely on a quite far-stretched interpretation of the law (which may well turn out not to be upheld by Czech courts) or modify the very basic concepts of these documents. • Article 2(1)(i): The definition of "equivalent financial collateral" was correctly translated but mistakenly used also in connection with the substitution of collateral and provision of top-up collateral. As a consequence, Czech law seems to limit substitution of collateral and provision of top-up collateral to "equivalent financial collateral" instead of "collateral of substantially the same value" as set out in Article 8(3) of the Directive. • Article 2(1)(l): In the definition of "enforcement event", the words "an event of default or any similar event […]" were implemented as "non-performance of a collateralised claim of a financial nature or any analogous event […]". This seems to be much more restrictive and may in practice exclude any event of default other than non-payment. • Article 2(1)(n): The Czech definition of "close-out netting" contains no reference to financial collateral arrangements. The possibility to include collateral in close-out netting is questionable in some cases. **Specific comments on opt / appropriation / right of use** • Article 1(3) – Czech law allows "ordinary" corporate entities to enter into financial collateral arrangements depending on certain economic criteria (net assets, annual turnover, own capital). • Article 4(3) – Czech law allows appropriation in financial collateral arrangements. • Article 5 – Czech law generally recognises the right of use in financial collateral arrangements.
Cyprus	**General comments** • The impact of the implementing law, and by implication the EU Financial Collateral Directive, in Cyprus has been positive both in all respects; it is now easier to create and enforce collateral arrangements. The legal procedure and administrative requirements that governed the regime prior to the entry into force of the Law have either been reduced or eliminated.

	• The formalities laid down by the Cyprus Contract Law regarding execution of pledges are no longer applicable • Similarly, further formalities required by the Cyprus Companies Law, e.g. registration of a charge with the Registrar of Companies, are no longer applicable • A court order regarding the appropriation of a secured asset is no longer needed • The insolvency regime has changed vis-à-vis the enforcement of securities in insolvency situations. All the restrictions have been removed.
Denmark	• Prior to the implementation of the Directive in Denmark, there was a real risk that title transfer financial collateral arrangements would be re-characterised as security arrangements. With the implementation act, this risk no longer exists and the act expressly recognises title transfer financial collateral arrangements. • The implementation of Article 7 of the Collateral Directive expressly recognises close-out netting agreements and thus precludes, within the scope of the Securities Trading Act, where such an agreement is in place, the otherwise existing right under Danish insolvency law for an insolvency official to "cherry-pick" among the insolvent entity's agreements. • Financial collateral arrangements are recognised in so far as they relate to "financial obligations" • Article 1(2) of the Collateral Directive is implemented with the implementation act, but is wider in scope in that where both parties to an arrangement are legal persons within the meaning of Article 1(2)(e) of the Collateral Directive (Section 58b no. 6 of the Securities Trading Act), a financial collateral arrangement may still be recognised, but only to the extent that the obligations in question arise from FX or securities trading. • The Danish implementation act does not operate with the term "relevant financial obligation", but rather with the term "financial obligation", which is defined as an obligation, which gives a collateral taker the right for a cash settlement or delivery of securities. Where both parties to a financial collateral arrangement are legal persons within the meaning of Article 1.2(e) (in the Danish Securities Trading Act, Section 58b, no 6), the definition of "financial obligations" is narrowed to include only claims arising out of FX or securities trading. While the definition of "financial obligation" is worded to apply directly only in respect of financial collateral arrangements (cf. the word "collateral taker" (in Danish *sikkerhedshaver*), the term "financial obligation" is used in the act also in the context of close-out netting agreements, even where these are not part of a financial collateral arrangement. It must be assumed that the intention is for the term to apply to both categories of agreements.

	• The term "insolvency proceedings" is defined in the implementation act to include any procedure covered by Article 2(1)(j) and (k) of the Collateral Directive. • "Close-out netting provision" is not defined in the implementation act. • For an agreement on a financial collateral arrangement to be effective, there is a requirement that the agreement be made in writing or documented in some other legally equivalent way. • Cash collateral may be realised by way of set off or discharge of the financial obligation in question. • Financial collateral in the form of securities may by realised by way of sale or, if the principles for valuation of the collateral have been agreed in the financial collateral agreement, by way of appropriation. • If agreed in the financial collateral arrangement, the implementation act ensures the collateral taker a right of use, and, if the collateral taker exercises such right, the equivalent collateral is treated as having been provided at the same time as the original collateral also for insolvency law purposes. • Be it a title financial collateral taker or a security financial collateral taker, where a right of use has been agreed, the exercise of the right of use will not prejudice the collateral taker's rights under the collateral arrangement. • The obligation to return equivalent collateral may be made subject to close-out netting. • As regards the questions of perfection and realisation, the implementation act recognises title transfer collateral arrangements and it is stipulated that such arrangement shall take effect in accordance with its terms. • A close-out netting provision will (subject to the below mentioned insolvency law exceptions) be effective notwithstanding commencement/continuation of winding-up or reorganisation procedures and it is not conditional upon any of the acts mentioned in Article 4(4) of the Collateral Directive. • Subject to the rules on reversal contained in the Danish Bankruptcy Act (consolidated act no. 118 of 4th February 1997 as amended), there is no Danish rule of law which would operate to invalidate a financial collateral agreement entered into before the passing of a decree commencing insolvency proceedings. The Bankruptcy Act contains certain provisions relating to, among other things, payments with unusual means, preferences, security for existing obligations etc. which may lead to a reversal. • Even if entered into after the passing of the insolvency decree, the collateral arrangement will be valid if the collateral taker is able to prove that it did not know of, nor ought to have known of, the decree. Only after the expiry of the day in which the insolvency decree is published in the Danish Official Gazette

	does the insolvency decree take effect vis-à-vis counterparties who were in good faith concerning the passing of the decree. • Section 58n of the Securities Trading Act transcribes Article 9 of the Collateral Directive. Accordingly, the relevant criteria is where the account is held to be located. The decision of where a relevant account is deemed to be maintained is governed neither by statute nor case-law. The deciding factor will presumably be where the account may in actual fact be said to be maintained. Apart from that, it must be expected that Section 58n will be interpreted in accordance with the rules in the Hague Convention, which will be incorporated in Danish law at later stage.
Estonia	**General comments** • On a general level, wider choice of financial collateral (previously in practice limited to pledge and mortgage) and decreased administrative burden (no filing requirements, no formal execution requirements for creation of collateral). **Problems** • Implementation limited to financial institutions but excludes other businesses • Financial Collateral Arrangement are accessory to specific underlying claim under Estonian law **Suggestion for amendments of Directive** • Suggested that Directive should apply to all legal persons
Finland	• The Collateral Directive (the "Directive") was implemented in Finland by the enactment of a new Financial Collateral Act (the "Act") in addition to certain amendments to the existing legislation, e.g. to the Securities Markets Act and to the Act on Book-Entry Accounts. • The Directive was not consistent with Finnish law, which did not previously acknowledge security assignments or pledge arrangements including pledgee's disposal right during the security period. • The Finnish legislation has widened the scope of the Directive so as to include also normal commercial entities to the extent that they grant collateral to a financial institution. Additionally, private persons may also act as collateral takers for the purpose of the Act provided that the collateral provider is an institution. • While the Directive attempts to harmonize the formal requirements applying to the creation of perfected security over financial collateral, it does not specify how the transfer of possession of such assets is to be effected. Therefore, this continues to be a matter to be determined individually by each member state preventing full transparency in applicable rules. Additionally, the limited

	scope of the Finnish tax law hinders the use of financial collateral for the purpose of the Act in practice. • The Act applies to legal persons (or non-natural persons), other than institutions, when they act as collateral providers and when institutions act as collateral takers and where the collateral consists of assets covered by the Act, other than non-listed shares. Also private persons may act as collateral takers when the collateral provider is an institution defined in the Act. • Perfection of security created under the Finnish law requires either (i) transfer of possession, e.g. bonds, unlisted shares, fund units or account money (should physical security documents exist), (ii) registration in the book-entry system, e.g. listed shares or (iii) a notice, e.g. if the pledged assets are in a third party possession or no physical security documents exist. • Appropriation is possible only if the parties have separately agreed so. However, the parties do not need to agree on the valuation of the appropriation. The Act includes a general provision to this effect which is based on requirement to apply market values. • Under Finnish mandatory law, there is a general prohibition of forfeiture of collateral. Therefore, the pledgee realizing collateral is liable for remitting to the pledgor any amount of proceeds exceeding the amount of outstanding secured obligations. • The commencement of insolvency proceedings against the pledgor does not prevent the pledgee from using its rights relating to the security financial collateral arrangement. • The collateral taker has a general duty to care. This duty implies that he or she may not realize the collateral by selling it significantly under its value. The collateral taker is also liable for remitting to the pledgor the amount of proceeds exceeding the amount of outstanding secured obligations. • The Act stipulates that the parties may agree on a provision whereby the collateral taker is allowed to sell or otherwise dispose of the pledged securities or account money prior to the secured debt falling due provided that the collateral taker returns equivalent collateral at the due date unless set-off against the outstanding debt. • The pledge continues uninterrupted when equivalent collateral is returned in place of the original collateral. The legal effects and priority rules are determined based on the time when the original collateral was granted. As far as recovery rules are concerned, the equivalent collateral is not considered as being granted for existing or old debt. • A title transfer financial arrangement is effective when the securities have been assigned into the possession of the collateral taker or when the transfer of securities and account money has otherwise been carried out in accordance with the relevant provisions regarding title transfer.

	• The Act stipulates that the parties may agree that upon a debt falling due all opposite claims of the parties are subject to closed-out netting. Such claims may include the obligation to return equivalent collateral. • Under Finnish law the bankruptcy or reorganization proceedings commence when a court order to this effect has been passed. Consequently, a financial collateral arrangement that has come into existence prior to the commencement of such proceedings is generally held valid and binding. However, such arrangement as any other transaction is subject to the mandatory provisions of the Finnish Recovery Act and therefore, may be revoked e.g. if it has been concluded for the purpose of unduly favoring a particular creditor to the detriment of another creditor or transferring property out of the reach of the creditors or increasing the debts of the debtor to the detriment of the creditors, always provided that (i) the debtor was insolvent at the time the transaction was concluded or the transaction contributed to the debtor's insolvency, and that (ii) the other party knew or should have known of the insolvency or of the impact of such transaction on the debtor's financial state as well as of the circumstances due to which the transaction was unsuitable. If such a transaction was concluded earlier than five years before the application for bankruptcy or reorganization was filed with the competent court, the transaction may be revoked only if the secured party was someone closely related to the debtor. • The Act stipulates that the security interest shall be valid even though the grantor did not have the powers to dispose of the collateral due to the commencement of insolvency proceedings if the collateral taker was not aware of the same. Further, the Act stipulates that if the financial obligation for which the financial collateral has been granted prior to the commencement of insolvency proceedings comes into existence after the commencement of such proceedings, the security interest is valid if the collateral taker was not aware of the same. • Collateral can generally be recovered by the grantor's bankruptcy estate or by the administrator of the grantor in reorganization if the security interest was perfected within three months prior to the commencement of the insolvency, if (i) such security interest was not agreed on at the time the debt came into existence, or (ii) the transfer of possession, notice of assignment or other means of perfecting the security interest was not carried out without undue delay after the origination of the debt. However, the Act stipulates that a financial collateral or additional collateral granted may not be recovered if it has been agreed between the parties in advance and the purpose of granting collateral or additional collateral is based on decrease in value of the collateral. Additionally, it is required that granting such collateral is considered to be ordinary when taking into account all circumstances. Replacement security requires also that the parties have agreed on the matter in advance. • Finnish courts will normally apply the "*lex rei sitae*" principle to the effectiveness in relation to *inter alia* third party creditors of the creation and perfection of collateral and other security, and the effectiveness in such respect of security.

France	**General comments** • Greater flexibility (ie allowing parties to freely structure financial collateral arrangements either by way of title transfer or security interest, abolishing formal requirements, recognising close-out netting notwithstanding insolvency) • Confirming ability of French collective investment schemes to provide financial collateral (indication that French funds are increasingly making use of opportunity to give/take collateral). • French law goes further than Directive in that it allows natural persons to benefit from the provisions of the new netting regime (cf. Article 1(e) of Directive). • Full effect of Directive restricted to transactions between regulated entities, i.e. opt-out under Article 1(3) exercised. **Suggestions for clarification** • Right of re-use (Article 5). This is a major change under French law. Market still uncertain as to precise regime of the right to re-use. Tax and accounting regimes of the collateral being re-used need to be clarified. • Concept of "financial obligation". Code refers to financial obligations of parties, tracking the term "relevant financial obligation" used in Directive. Reference to "financial" confusing because the obligations can relate either to financial instruments or any other type of agreement between regulated entities. Suggested that Code may be amended to refer to "obligations" rather than "financial obligations".
Greece	• The Financial Collateral Directive has been transposed into Greek law by Law 3301/2004 (entered into force in December 2004). • Law 3301/2004 does not deviate from the provisions of the Directive, subject to necessary references in Article 1 to the Greek law provisions corresponding to the respective provisions of Article 1 of the Directive (on the entities falling within its scope of application) and to the Greek law provisions on pledge, assignment and enforcement (from which the provisions of Law 3301/2004 deviate). • It is still early to assess any positive impact of the Directive as far as Greek court and market practice are concerned (Law 3301/2004 was recently enacted). • Experience to date suggests that there is an interest in the Greek market in the benefits from the enforcement and insolvency provisions of the Directive. Where appropriate, standard forms used by Greek banks have started to refer

	to this type of security. • To the extent that the security is created over securities listed on the Athens Exchange, for the time being it is still unclear whether the secured creditor would actually be able to benefit from articles 4 and 5 (or, where relevant, Article 6) of the Directive and corresponding articles of Law 3301/2004. The reason for this is that the Athens Securities Depositary Regulation currently only refers to "traditional" enforcement procedures (under the general provisions of the Greek Civil Code, the Greek Code of Civil Procedure and Law 3632/1928 on transaction on the Athens Exchange) which are not helpful in the context of the Directive. • In connection with Article 9 of the Directive, it would appear helpful to provide for a process whereby underlying securities located in another member state and represented by book entries into an account maintained in the member state governing the collateral could be "marked" under a standardised procedure (common for all member states). This might ensure more certainty and ensure full access to the underlying securities independently of whether the security provider, the secured creditor or a third party custodian appears as owner in any local securities register.
Ireland	**General comments** • The Irish Regulations do not seek to integrate the regime created by the Collateral Directive in the pre-existing Irish regime; they create a separate regime. Pre-existing statutory provisions that would be amended or disapplied as regards the arrangements the subject of the Irish Regulations are not expressly referred to as amended/disapplied. No effort has been made to seek to integrate the regimes and separate protective regimes now apply. • The Irish Regulations have provided comfort in the case of certain structures but we have no available information on the basis of which the extent of the achievement of the Collateral Directive's objectives may be measured. • Aware of reliance having been placed on it in certain contexts where transactions could not have been effected without reliance upon it (e.g. certain rated structures). • The right of appropriation and recognition of third party security interests are useful. The limited nature of the collateralised obligations and financial collateral has reduced the effectiveness in the case of arrangements where the pool of assets/obligations might fluctuate. • It appears to be the case that where a filing would previously have been made, a precautionary filing continues to be made regardless of whether it is required.

Latvia	**General comments** • On a general level, wider choice of financial collateral (previously in practice limited to pledge and mortgage) and decreased administrative burden (no filing requirements, no formal execution requirements for creation of collateral). • Some banks have made extensive use of financial collateral arrangements. However, many banks still insist on traditional form of collateral such as pledges and mortgages. Insurance sector appears not to have made use of new arrangements so far. • Certain banks now apply financial collateral arrangements to all their client relationships. • Applicability of financial collateral arrangements go beyond Directive because they can apply to natural persons **Issues for consideration** • Ambiguities in Directive have remained in implementing law. In particular, notion of collateral being "provided" in Article 1(2) and the scope of exemptions of financial collateral arrangements from insolvency laws (Article 8(4)).
Lithuania	**General comments** • On a general level, wider choice of financial collateral (previously in practice limited to pledge and mortgage) and decreased administrative burden (no filing requirements, no formal execution requirements for creation of collateral). • Use of collateral considered as a novel concept, so too early to evaluate practical impact on Lithuanian financial markets. • There is not enough practical precedent to reveal any deficiencies in the Directive. • Major implementation cost for private sector is study of new laws, training staff and drafting standard documentation for practical application of financial collateral arrangements.
Luxembourg	**Positive features of the Luxembourg implementation** • liberalised rules creating and enforcing financial collateral arrangements and protection of financial collateral arrangements from insolvency rules; • confirmation of the validity of transfer of title by way of security and recognition of the right of the pledgee to re-hypothecate pledged assets;

- enforceability of substitution of collateral and margin calls provisions in insolvency situations;
- strengthened enforceability of netting arrangements in insolvency situations; and
- clarification of conflict of law rules issues for financial instruments in book-entry form.

Right of use

- Article 5 of the Directive deals with right of use of financial collateral security under security financial collateral arrangements. Article 10 of the Luxembourg law implementing the Directive (the **Law**) provides the legal basis for the pledgee to use and dispose of the assets that are secured by the arrangement, subject to certain conditions. There is a right of use, provided that the parties have agreed to it and provided that by the time the secured debt becomes due, the pledgee returns the asset or an equivalent asset, or if agreed among the parties, applies the value of the asset to the secured debt.

Issues arising

- The main problem with the Directive relates to interpretation of definitions. There were some issues of interpretation raised by the Council of state (*Conseil d'Etat*) in their opinion (a*vis*) of 13 April 2005. One question was whether the phrase financial collateral (*garantie financière*) or surety (*sûretés)* should be used in the Law. It was decided that the term *garantie financière* should be used as the Directive intended to deal with more recent types of security, as opposed to more classical types of security associated with the term *sûreté*. The *Conseil d'Etat* also considered specifically the issue of the domestic law going beyond the minimum required by the Directive, stating that the incorporation of the Directive cannot drive back or narrow judicial instruments that have already been approved on a national level. Their *Avis* goes so far as to say that there should be a positive effort by the authors of the Directive to take the opportunity to benefit from the provisions of domestic law, where it is not in conflict with the Directive, so that throughout the EU there is a minimum level of harmonisation. This harmonisation is what the people who use collateral arrangements really want.

- A problem that is continuing and could potentially cause difficulties in the future relates to the particular definition given to financial instruments (*instruments financiers*)(that is, the scope "*ratione materiae*" of the Law). The Law attempts to cover <u>all</u> types of financial instruments, but this is problematic. In an attempt to be all encompassing the Law is rather vague. Given the innovative nature of the financial sector in devising new investment products it is not clear whether commodity transactions (documented in the form of forward contracts) or commodity options on the one hand and contractual rights relating to financial instruments on the other hand would fall within the definition provided by the Law.

	• There is little statistical information available that would enable one to quantify the positive impacts of the implementation of the Directive in Luxembourg. The Law has increased the ability to create, use and enforce financial collateral arrangements. On a country-wide basis one cannot say precisely how much this increase is. Other than the issues highlighted above, there are to our knowledge no major negative impact following the implementation of the Directive.
Poland	**Problems with implementation of Directive in area of netting of title transfer collateral** • There is no problem with netting of the collateral as long as there is no bankruptcy. • If netting of financial collateral is provided for in a "framework agreement" as defined in Article. 85 of the Bankruptcy Law (an ISDA Master, after small modifications, will be recognised as such), the netting of the financial collateral will be recognised if the Directive applies horizontally and will not be recognised if Polish law is interpreted without taking into account the Directive. • The netting of the financial collateral will not be recognised when there is no "framework agreement".
Spain	**Positive impacts of the Directive** • Appropriation is now possible • Realisation/enforcement has been simplified. • Effectiveness of financial collateral arrangements and close out netting in winding up and reorganisation measures situations has been assured. • Right of use of collateral under a security financial collateral arrangement now permitted. • Use of title transfer collateral arrangements strengthened eliminating recharacterisation risk. • Elimination of claw back risks, for example, in relation to top-up deliveries of of collateral. • Clarification of some conflict of laws rules • Notarisation was commonly used for credit support annexes. This burden has disappeared.

	Issues arising • Debate has arisen in Spain as a result of the implementation of the Directive as it is not clear if the financial collateral arrangements apply only to master agreements (ISDA, EMA, etc) or to any other credit agreements guaranteed with financial instruments and/or cash • Market participants would welcome a clarification as to the scope of application of the Directive and particularly in relation to the definition of relevant financial obligations. Under the current definition any banking obligation could fall under the scope of application of the Directive. In countries like Spain where notarisation was broadly used, the banking system is not fully confident executing these financial collateral arrangements without the intervention of the relevant public officer (the Notary public)
United Kingdom	• The UK implemented the Directive without exercising any of the three opt-outs. In fact, the UK implementation of the Directive is broader than the Directive in certain respects, most importantly in not requiring that at least one of the parties fall within one of categories (a) to (d) in Article 1(2) of the Directive. In other words, the UK implementation extends the benefit of the Directive to a corporate-to-corporate financial collateral arrangement. Private individuals, however, are not included within the scope of implementation. • The UK implementation covers all obligations "secured or otherwise covered" by a financial collateral arrangement, whereas the Directive is limited to financial obligations "which give a right to cash settlement and/or delivery of financial instruments". • The definition of "cash" in the UK implementation is broader than in the Directive, primarily because it includes sums payable upon the close-out of a financial arrangement. This has generally been considered a helpful expansion by the market. • There has been some uncertainty in the United Kingdom as to the extent to which the UK implementation covers floating charges. Some floating charges appear to be within the scope of implementation, while others are clearly not. To some extent, this is linked to the following point. • A major concern of market participants has been establishing with clarity the meaning of the term "control" for purposes of determining whether financial collateral has been "provided" to a collateral taker so as to fall within the benefit of the FCAD regime. • There has been some market concern about the definition of "financial instruments" and interpretation, for example, of the words "tradeable on a capital market" which appear in the UK version of this definition. What sort of restrictions on trading might raise a question as to whether the restricted instrument is "tradeable on a capital market"?

	• The impact of the UK implementation has been almost entirely on security financial collateral arrangements. The benefit for title transfer financial collateral arrangements has been marginal and theoretical, but this is largely because this approach was already robust under pre-Directive law. • Benefits of the Directive implementation for security financial collateral arrangements include: o elimination of the requirement to register a security financial collateral arrangement under section 395 of the Companies Act 1985 (but some market participants continue to register out of an excess of caution – partly because of some of the uncertainties referred to above) o disapplication of various insolvency and other statutory rules with potential effect on enforcement, most importantly the administration freeze on enforcement of security o clarification that a right of use is possible in a security financial collateral arrangement and therefore elimination of the theoretical risk that such a right of use would be a "clog on the equity of redemption" o clarification that a security financial collateral taker may appropriate financial collateral without having to apply to a court for an order of foreclosure o clarification that the PRIMA principle is the correct conflict of laws rule for intermediated securities • Anecdotal evidence suggests that there has been some increase in the use of security, as opposed to title transfer, financial collateral arrangements, but title transfer remains the predominant approach in the wholesale financial markets, largely because of the uncertainties referred to above and also the impact of a UK case known as *Oakley v Animal*, although the Court of Appeal decision in that case late last year has laid to rest most of the concerns raised by the first instance judgement. • Some drafting issues relating to the UK implementation have been discussed by market practitioners with the UK authorities, and therefore there may at some point be amending Regulations addressing some of these issues.

APPENDIX 3

ISDA would like to thank the following local counsel who kindly contributed information used in compiling this response to the Commission's questionnaire. None of the information in this letter is intended to be definitive or to be relied upon as legal advice. In particular, the references in this response, in view of the timetable for completion, have not been independently verified by local counsel and therefore should be double-checked with local counsel, who accept no liability for the contents of this response letter.

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