

European financial markets: financial collateral arrangements and legal certainty, consequences on the SMEs

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The Commission presented a report on the appropriateness of Article 3(1) of Directive 2002/47/EC on financial collateral arrangements.

To recall, Directive 2002/47/EC of the European Parliament and of the Council on financial collateral arrangements as amended by Directive 2009/44/EC (FCD) creates a **harmonised EU legal framework for the creation and enforcement of collateral**, i.e. ‘title transfer financial collateral arrangements where the full title to the collateral is transferred to the collateral taker or security financial collateral arrangements where the collateral taker receives a security right, e.g. a pledge or a charge. Since the financial crisis, collateral has become increasingly important, driven by a market need for more secured funding and regulatory requirements. In 2009, the FCD was amended to introduce ‘**credit claims**’ as collateral. A ‘credit claim’ is defined in the FCD as a pecuniary claim arising from an agreement where a credit institution grants credit in the form of a loan.

The 2009 revision of the FCD (Article 3(1)) prevents Member States from requiring that the creation or validity of financial collateral arrangements relating to credit claims be dependent on the performance of a formal act, e.g. registration or the notification of the debtor. **This revision aims to ensure that Member States have an option to require formal acts**, e.g. registration or notification, relating to credit claims used as collateral for purposes of perfection, priority, enforceability or admissibility in evidence against the debtor or third parties.

Under the 2009 revision, the Commission was asked to report on the **continuing appropriateness of the Member State option**.

The report focuses on the implementation of **Article 3(1) of the revised FCD**. Its scope is whether the Directive works effectively and efficiently as regards formal acts required to provide credit claims as collateral.

Implementation of the Directive: Directive 2009/44/EC revising the FCD was adopted on 6 May 2009. It was implemented in most Member States in 2011 and all had transposed it by 2012.

Any quantitative assessment of the impact of Directive 2009/44/EC on the mobilisation of credit claims **is challenging** (the use of credit claims as collateral rose from 23% to 26% of total collateral used. However, it declined between 2012–2013 from 26% to 19%).

Overall, **the objective of the FCD to facilitate the use of credit claims has been achieved**. There is evidence that the inclusion of credit claims within the harmonised framework for collateral has facilitated their use in certain jurisdictions.

The FCD also removed formal requirements for the creation or validity of collateral arrangements. In effect, the risk of invalidation of such arrangements has been eliminated, aiding the mobilisation of credit claims.

Differences in the formalities and techniques available to collateralise credit claims still persist between Member States. Nevertheless, even when credit claim collateral remains subjected to national formal requirements, once they are complied with, the collateral benefits from the ease of enforcement introduced by the FCD.

The cross-border use of credit claims collateral is still subject to legal uncertainty due to the effect of different national requirements and the incomplete harmonisation of conflict of laws rules at EU level.

Appropriateness of Article 3(1) of the FCD: the report noted that several policy choices could be considered as regards Article 3(1) of the FCD.

1) The status quo could be kept: this is explicitly favoured by twelve Member States that argue the opt-out provision allows for a reasonable balance of the interests.

2) Article 3(1) option could be removed: this would oblige Member States to remove all national provisions for credit claims used as collateral that require the performance of formal acts, e.g. registration or notification of the debtor. This is advocated by four Member States arguing that a deletion of the option would create an EU level playing field and enhance legal certainty, fostering the cross-border use of credit claims.

3) A review of the FCD could be considered: this could reflect on the harmonisation of substantive law issues, e.g. formal acts required for the perfection, priority, enforceability or admissibility in evidence against the debtor or third parties, when credit claims are used as collateral as well as on the appropriateness of ensuring that set-off is fully excluded with respect to credit claims mobilised as collateral with central banks.

Commission's position: stressing that action at the EU level must respect the principle of **proportionality**, the Commission considered that formal requirements can fulfil a useful purpose and requiring their complete removal would therefore not be appropriate. Leaving the choice of such requirements to Member States creates difficulties in cross-border situations, but harmonising them may interfere with other interrelated provisions of national law.

Moreover, the costs and benefits of any harmonisation would need to be balanced very carefully and should only be considered as part of a broader reform after a thorough evaluation of the FCD. In this context, **the Commission stated that Article 3(1) of the FCD seems to continue to be appropriate.**

As announced in the '[Action Plan on Building a Capital Markets Union](#)', the Commission has launched a **broad review** on the progress in removing barriers to cross border clearing and settlement with a view, amongst other things, to improving legal certainty in the cross-border exchange of collateral. To this end, the Commission has established an expert group, the European **Post-Trade Forum**, to identify the remaining barriers.

By 2017, the Commission will take forward early targeted work with view to reducing the uncertainty surrounding securities ownership as well as propose uniform rules to determine with legal certainty which national law shall apply to third party effects of the assignment of claims. This will contribute to achieving greater legal certainty also in cases of cross-border mobilisation of credit claims as collateral and correct the drawbacks of the existing situation.