

Fiducia cum creditore contracta in EU law

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Abstract

The scientific interest has arisen from many questions related to the collateral with title transfer of the ownership. Why EU law adopted an old and prohibited for many centuries and many legal systems title transfer collateral in Financial Collateral Directive (FCD)? Through the centuries it was accepted that this collateral was too risky for debtor, because he transferred full ownership, the value of which sometimes was more than the secured debt. Is this the right direction for secured transaction in settlement systems? May this legal framework work better?

'The laws and the models are there. All we need is the will and the determination to implement them.'

David E. Allan

1. Introduction

Dear Colleagues¹,

At first I would like to thank you Professor Jesper Lau Hansen and FOCOFIMA² for inviting me here and for chance to present to you a lecture called "*Fiducia cum creditore contracta* in EU law". The scientific interest has arisen from many questions related to the collateral with title transfer of the ownership. Why EU law adopted an old and prohibited for many centuries and many legal systems title transfer collateral in Financial Collateral Directive³ (FCD)? Through the centuries it was accepted that this collateral was too risky for debtor, because he transferred full ownership, the value of which sometimes was more than the secured

¹ This is a lecture, which was held on 10 September 2009 at Law Faculty (Metro 1, Fiolstræde 4-6), University of Copenhagen

² Forum for Company Law and Financial Market Law

³ Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=32002L0047&mod=guichett

debt. Is this the right direction for secured transaction in settlement systems? May this legal framework work better?

I want to dedicate this lecture to David Allan, who was Emeritus Professor at Bond University, Australia and thank him for his moral support and encouragement of my special interests in the field of collateral legislation in my early stage of research. He was also a Member of the EBRD Advisory Board who worked on Model Law on Secured Transactions (MLST). Unfortunately, he left us in 2006. I will use his words, said in the Introduction to the Workshop on Personal Property Security Law Reform, Australia to start this lecture. Collateral should be “Cheaper, Faster, Simpler, Easier, Safer” than anything we have at present, and “Compatible” with the laws of those countries with which we have financial relations and transactions⁴. I think that these words, which are said about the Australian legislation are valid for EU efforts in the field of collateral unification and they should be the cornerstone of these efforts.

This lecture is based on the study of six title transfer collateral (TTC) characteristics (definition; equivalent collateral; formation; capacity; effect and effect in insolvency). These characteristics shall be examined on four levels.

The study will start with some historical notes about the so called *fiducia* contract, which would be the starting point and cornerstone of the research. *Fiducia* or *fiducia cum creditore contracta* is a Roman law collateral form, which I shall investigate and later compare with its ancestor – TTC, which has been adopted by Financial Collateral Directive (FCD). Special attention should be given to trans-nationalisation and global integration of the legal norms in this specific area. This is a very important step forward to limiting credit risk in financial transactions in the European economy. The compatibility and common understanding in legal nature and the effect of these secured transactions would be a guarantee for sustainability of securities markets. Afterwards I shall compare how FCD title transfer collateral is adopted by five EU member states. Then I would make brief remarks on the UNIDROIT Draft Convention on Substantive Rules regarding Intermediated Securities. This would help for making conclusions.

I would like to thank to Prof. Malina Novkirishka from Plovdiv University for her assistance and advices relating to Roman law. For Denmark legislation I have received valuable assistance from Professor Ulrik Rammeskov Bang-Pedersen and Professor Rasmus Kristian Feldthusen from University of Copenhagen, Faculty of Law for which I am very grateful. For Estonian law section I received helpful inputs from Professor Irene Kull from University of Tartu, for which I would like to thank her. Last but not least I very thankful to Dr Silvia Tsoneva from New Bulgarian University and Ralitzia Antcheva for their language remarks.

2. TTC in Roman law

It is normal to have no confidence between the parties of commercial contracts. If they do not know each other well that could be an obstacle for their contract relationship. It was the same

⁴ David E. Allan *Uniform personal property security legislation for Australia; Introduction to the Workshop on personal property security law reform* 14 Bond LR (2002) 4

in Roman times. This obstacle can be avoided by way of secured transactions. Their aim is to give eventual debtor's performance substitute in case of default. The general term for secured transactions in Roman law was *cautiones* (collaterals). The *cautiones* were different, depending on:

- i) their grounds –
 - *cautio necessaria* (arises from legal norm) and
 - *cautio voluntaria* (arises from private agreement);
- ii) their recourses –
 - *cautio verbalis* (by way of *stipulatio*);
 - *cautio realis* – by way of surety (*fideiussoria*), pledge (*pignus*) or title transfer (*fiducia cum creditore*)⁵.

As I have mentioned TTC is a new legal notion, but it has its historical roots in Roman law. We should bear in mind that like most collateral *fiducia* presupposed a debt (or main obligation), which had to be secured. This may be the oldest form of secured transaction *in rem* and later was replaced by other collateral contracts like *pignus* and *hypothec*.

The word "*fiducia*" comes from the Latin word *fides*, which means 'faith' or 'trust'. *Fides* believed in honesty of the other. It was a loyalty to the given word. At the very beginning it was used in informal agreements (*fiducia, fidepromissio, fideiussio*).

2.1. Definition

We may find information about the *fiducia* transaction in The Institutes of Gaius. He described both - *fiducia cum creditore* and *fiducia cum amico*. The first was a form of proprietary security, and the second was a form of safe custody. *Fiducia cum amico* was used generally to ensure proper management of the property of the Roman citizen traveling abroad. In this second form we may see the trust law roots. *Fiducia cum amico* stays outside of the intended research scope, because it had no collateral aim.

When we are talking about *fiducia cum creditore* and other Roman law collaterals I should underline two legal expressions, for which I shall use their Latin terms and meaning:

- *dominium* - which signifies full ownership. Full means the widest right over property. Owner is free to decide or dispose of his property as he wishes. *Dominium* is exclusive – the owner may do anything, which is not prohibited by the law. He had the absolute power over this property and may require from any third parties to respect his right.
- *detentio* - which means possession over some property, but it is narrower than *dominium*. The possessor does not have the ownership over the property as in *dominium*. I am using this term only to describe creditor's right to possess property for debt security. It is

⁵ Cf. Барон Система римского гражданского права, Выпуск первый. Общая часть. Книга I (1898) 174-175

closest to charge, because it is probably the most general and neutral expression in English to cover consensual security rights⁶.

As I mentioned, this form of security, was forgotten or forbidden through the ages. In *fiducia cum creditore contracta*, *fiduciant* (secured debtor) transferred *dominium* (full ownership) to *fiduciary* (secured creditor) on condition that *fiduciary* would transfer it back when the debt was paid.

2.2. Other transactions

Pignus was collateral in which debtor transferred only *detentio*, not *dominium* for securing debt. In case of default the creditor had right to sell the thing. If we compare *pignus* with *fiducia* it should be noted that they may have common historical roots, but they were absolutely different from legal point of view. Debtor in *pignus* never transferred his *dominium* and creditor never became real owner. Creditor had only right of possession and seizure (*jus possidendi*) and right of foreclosure and sale (*jus distrahendi*).

Hypotheca was collateral in which neither *dominium*, nor *detentio* was given to the creditor. Creditor had right to sell the property in case of debtor's default. This was close to the *pignus* right of foreclosure and sale (*jus distrahendi*). The absence of right of possession and seizure (*jus possidendi*) in *hypotheca* made this collateral form very risky for the creditor.

We may find information about the next collateral form called *lex commissoria* in The Opinions of Julius Paulus addressed to his son (Book II)⁷. *Lex commissoria* was in some extent a mixture between *fiducia* and *pignus*. Debtor transferred *detentio* for debt security with special clause – if he was not able to perform his duty the creditor might acquire *dominium* over collateral. Creditor had another right – express clause (the *pactum vendendi*), which gave him a right to sell the pledge developed along with the *lex commissoria*. These two clauses in security agreements apparently satisfied the strong commercial demands from the second century B.C. through the second century A.D., for no change seems to have occurred during that period. A combination of the *lex commissoria* and *pactum vendendi* indicates that the creditor had a right rather than an obligation to sell the pledge⁸. This collateral form was abolished by Emperor Constantine the Great in 326 A.D.

We may conclude that *fiducia cum creditore contracta* was different from *pignus*, *hypotheca* and *lex commissoria*. There is no denying that all collaterals influenced each other, but *fiducia* was the only one, which initially transferred the *dominium*.

⁶ Art. 1.1. *Model Law on Secured Transactions*, Note on terminology (2004), <http://www.ebrd.com/pubs/legal/secured.pdf>

⁷ http://webu2.upmf-grenoble.fr/Haiti/Cours/Ak/Anglica/Paul2_Scott.htm#13

⁸ Donald E. Philipson *Development of the Roman Law of Debt Security*, *Stanford Law Review*, Vol. 20, No 6 (Jun., 1968), p. 1242

2.3. Formation of *fiducia cum creditore contracta*

Formation of *fiducia cum creditore* was possible by two different ways – *mancipatio* and *in jure cessio*.

Mancipatio was the oldest form of property acquisition. It was Quiritian law transfer of ownership manner and derivative ownership delivery. *Mancipatio* was possible only for *res Mancipi*. It demanded except the contract parties (five witnesses (*cives romani puberes*) and one man called *libripens* with *libra* in his hands. At the beginning of the procedure buyer appeared, at the end seller. Buyer took the thing and pronounced solemn words (*nuncupatio*): *Aio Hanc rem ex J.Q. meam esse aio, eaque mihi empta esto hoc aere aenaque libra* and after the struck scales (*libra*) with piece of copper (*raudusculum*), which was hold by *libripens* and transferred *raudusculum pretii loco* to the seller⁹.

In jure cessio was a possibility for the title transfer thorough technical judicial proceeding for ownership. It was fictitious suit and it was called *imaginaria vindicatio*¹⁰. The main difference with the abovementioned *mancipatio* was that the object of *in jure cessio* proceeding were not limited only to *res Mancipi*, but it includes *res nec Mancipi* too. The parties (seller and buyer) appeared beside the magistrate. The thing (or part of it) was necessary to appear at the time of the proceeding too. The buyer took the thing in his hands and said the following solemn words: *hanc ego rem ex J.Q. meam esse aio*¹¹. This was *rei vindicatio* claim about the thing against the seller¹². Then the magistrate asked the seller: *an contra vindicet?*¹³ The seller missed *contravindicatio*. After then the magistrate adjudged the thing to the buyer.

It should be noted that the above mentioned title transfer possibilities are not designed only for the purposes of *fiducia cum creditore*. In that case a special *pactum fiduciae* should be added. *Pactum fiduciae* was a solemn act, which indicated creditor's back transfer obligation (*causa fiduciae*). When transfer was through *mancipatio*, *causa fiduciae* was included in *nuncupatio*, when it was by way of *in jure cession*; *causa fiduciae* was included in *vindicatio*¹⁴.

2.4. Capacity

Transfer was available only for Roman citizens (*cives*) or to other freemen who had been granted commercial power (*commercium*)¹⁵. *Commercium* together with *conubium* were two sides of capacity in Roman law.

⁹ Ф. Чиларжъ, *Учебникъ институцій римского права*, Издание второе (1906) 123

¹⁰ Cf. А. Покровский *История римского права* (1998) 331

¹¹ К.Ф. Чиларжъ, *Учебникъ институцій римского права*, Издание второе (1906) 125

¹² А. Покровский, *История римского права* (1998) 331

¹³ К.Ф. Чиларжъ, *Учебникъ институцій римского права*, Издание второе (1906) 125

¹⁴ Cf. К.Ф. Чиларжъ, *Учебникъ институцій римского права*, Издание второе (1906) 162

¹⁵ Donald E. Philipson *Development of the Roman Law of Debt Security*, Stanford Law Review, Vol. 20, No 6 (Jun., 1968), p. 1230-1231

2.5. *Effect of fiducia cum creditore*

Fiducia cum creditore includes two relations:

- i) the initial transfer of *dominium* (full ownership), which *causa* is to secure debt by way of title transfer
- ii) the subsequent transfer (*pactum fiduciae*) back transfer of the *dominium*, which transfer is under condition and depends on debtor's performance of obligation

Two different situations were possible. In case of debtor's performance creditor was obliged under *pactum fiduciae* to transfer back *dominium* to debtor. It depended of the way of the initial transfer – *mancipatio* or *in jure cessio*. In case of *mancipatio*, *remancipatio* was needed. If no *remancipatio* took place, but only a simple re-stitutio, *usucapio* was necessary to restore the Quiri-tarian ownership, and this was called *usureceptio*¹⁶. In case of creditor's reluctance of *dominium* back transfer, debtor had a special defense by special *actio*, which was called *actio fiduciae directa* or *fiduciaria*. It was also possible for creditor to had *actio fiducia contraria* in case of caused damages by the thing. Creditor might dispose the collateral in the favour of third party, before the eventual default. Debtor had no *rei vindictaio* from third party. The *actio fiduciae* was personal action for damages. If the creditor was condemned in the action, the consequence was *infamia*. The consequences of *infamia* were the loss of certain political rights, but not all¹⁷.

Another risk was possible for debtor. The thing was included in creditor's *patrimonium* (property), because of *dominium* transfer. In case of creditor's insolvency collateral was remained to be part of his property.

3. TTC in contemporary EU legislation

In 2002 FCD has been adopted. The aim of FCD is to create a uniform EU legal framework to limit credit risk in financial transactions through the provision of securities and cash as collateral¹⁸. Reaching this aim should create clear, uniform EU legal framework for the use of collateral and contribute to the greater integration and cost-efficiency of European financial markets. Harmonized collateral rules will lower credit losses, encourage cross-border business and competitiveness¹⁹.

3.1. Definition

According to FCD, TTC is an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of financial collateral to a collateral taker for

¹⁶ Smith, *Dictionary of Greek and Roman Antiquities* (1870) 536

¹⁷ Smith, *Dictionary of Greek and Roman Antiquities* (1870) 635

¹⁸ http://ec.europa.eu/internal_market/financial-markets/collateral/index_en.htm

¹⁹ http://ec.europa.eu/internal_market/financial-markets/collateral/index_en.htm

the purpose of securing or otherwise covering the performance of relevant financial obligations²⁰.

When we are talking about TTC I should underline two legal expressions and their meaning:

- *full ownership of collateral* – FCD does not include definition of this. Full ownership is used in Recital 13, Art. 2 (1) (b) and Art. 2 (1) (c). The idea is that the collateral taker (who is creditor by the words of FCD) is the owner and has *dominium* over the collateral.
- *security* – which in my opinion is closer to Roman law *detention* for security purposes. According to Art. 2 (1) (c) FCD collateral taker has security over collateral, but the full ownership of the financial collateral remains with the collateral provider when the security right is established. It is obvious that security is a narrower right compared to full ownership.

3.2. *Other transactions*

Security collateral arrangement is the other FCD collateral²¹. It is defined as an arrangement under which a collateral provider provides financial collateral by way of security in favour of, or to, a collateral taker, and where the full ownership of the financial collateral remains with the collateral provider when the security right is established. Collateral taker may appropriate collateral in case of default²². Security collateral arrangement has a specific ‘right of use’, which is described as right of the collateral taker to use and dispose of financial collateral provided under a security financial collateral arrangement as the owner of it in accordance with the terms of the security financial collateral arrangement²³. This right is in close connection with an obligation, which arises when this right is exercised. Where a collateral taker exercises a right of use, he thereby incurs an obligation to transfer equivalent collateral to replace the original financial collateral at the latest on the due date for the performance of the relevant financial obligations covered by the security financial collateral arrangement²⁴.

Repurchase agreement (repo transaction) can be described as conditional sale of assets subject to a repurchase right and duty of the seller²⁵. It could say that repo transaction is not collateral itself. It would mean that in the seller’s bankruptcy, the conditional buyer in possession will in principle be able to retain the assets or if possession was left with the seller he may be able to repossess them²⁶. It is difficult to define TTC as conditional sale. There is a condition, but this transfer is not a sale. The condition is debtor’s performance of the relevant financial obligation. Title transfer is not a sale, because of the collateral aim of the transaction. Another

²⁰ Article 2 (1) (b)

²¹ Art. 2 (1) (c) FCD

²² Art. 2 (1) (l) FCD

²³ Art. 2 (1) (m) FCD

²⁴ Art. 5 (2) FCD

²⁵ J H Dalhuisen, *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law* 3rd ed. (2007) 1067

²⁶ J H Dalhuisen, *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law* 3rd ed. (2007) 1068

difference is that TTC is outside of insolvency proceedings. Member States should ensure that certain provisions of insolvency law do not apply to such arrangements.

We can compare TTC with cession only in cases where cash is given as collateral. Theory defines cession as an act of transfer by which personal rights (claims) are transferred from one estate to another and without co-operation or knowledge of the debtor or even against his will²⁷. Some legal systems require a special notice with information for transfer to debtor, which is prerequisite for the operation of cession to him and to third parties.

3.3. Equivalent collateral

Equivalent collateral²⁸ is a collateral taker's (creditor's) property, which has to replace the original financial collateral. The collateral taker's obligation to provide equivalent collateral arises in two different cases:

i) for security collateral arrangement – when a collateral taker exercises his right of use, he is obliged to transfer equivalent collateral to replace the original financial collateral²⁹;

ii) for TTC³⁰

Equivalent collateral should be:

(i) in relation to cash, means a payment of the same amount and in the same currency;

(ii) in relation to financial instruments, means financial instruments of the same issuer or debtor, forming part of the same issue or class and of the same nominal amount, currency and description or, where a financial collateral arrangement provides for the transfer of other assets following the occurrence of any event relating to or affecting any financial instruments provided as financial collateral, those other assets;

Special attention should be paid to the definition “other assets”. If other assets are acceptable for collateral, it would break the limitation of the FCD objects. The abolishment of “other assets” in FCD should be recommended.

3.4. TTC formation

TTC should not depend on any formal requirements³¹. Its creation, validity, perfection, enforceability or admissibility in evidence should be discharged from any formal requirements. It can be evidenced in writing or in a legally equivalent manner³².

²⁷ Susan Scott, *The Law of Cession*, 2nd ed. (1991) 7

²⁸ Art. 2 (1) (i) FCD

²⁹ Art. 5 (2) FCD

³⁰ Art. 6 (2) FCD

³¹ Recital 10 and Art. 3 FCD

³² Art. 3 (2) FCD

3.5. Capacity

FCD restricts categories of persons who may be collateral taker and collateral provider³³. They should belong to the following:

- i) a public body;
- ii) a financial institution under supervision;
- iii) a regulated central counterparty;

FCD is not applicable for physical persons. It is accepted that this collateral is too risky in non commercial transactions.

3.6. TTC effect

The scope of TTC effect is limited only to settlement systems. TTC presupposes the existence of financial obligation. TTC effect (as *fiducia cum creditore*) includes two relationships:

- i) initial - to provide security³⁴;
- ii) subsequent - to transfers back the ownership (it is not arranged in FCD). The last one depends on the existence of an enforcement event

The initial transfer is needed. The collateral provider should transfer full ownership of financial collateral to a collateral taker for the purpose of securing the performance of relevant financial obligations³⁵.

The collateral provider has no *rei vindicatio* right in case of collateral taker's disposal. In case of default, the collateral taker has close-out netting option. What does close out-netting mean? FCD describes³⁶ close-out netting as:

...provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or, in the absence of any such provision, any statutory rule by which, on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise

The netting is a special form of set-off, which is available in settlement systems. The close-out netting is netting which takes place only in case of default. The provision of close-out netting is usually a provision in a financial collateral arrangement. It takes place only in case of default and is effective even in bankruptcy proceedings.

FCD presents another very interesting possibility:

³³ Article 1 (2) FCD

³⁴ Art. 2 (1) (b) FCD

³⁵ Art. 2 (1) (b) FCD

³⁶ Art. 2 (1) (n) FCD

If an enforcement event occurs while any obligation of the collateral taker to transfer equivalent collateral under a title transfer financial collateral arrangement remains outstanding, the obligation may be the subject of a close-out netting provision³⁷.

Collateral taker may dispose of the collateral. In this case he has an obligation (in case of performance) to transfer back the collateral to the initial owner. Does it sound familiar? As I have noticed equivalent collateral is typical for security collateral arrangement, when collateral taker uses his right of use.

3.7. *TTC effect in insolvency*

The FCD contains a number of provisions of insolvency law which have a potentially negative impact on the size of the estate of an insolvent entity³⁸. Three points may be underline:

- i) no retroactive force of the declaration of insolvency (“zero hour rule”)³⁹ – money and securities paid by the insolvent party on the day of declaration of insolvency, but before the exact moment of that declaration, fall outside the insolvent estate⁴⁰;
- ii) Enforceability of legal acts after the declaration of insolvency⁴¹. FCD allows an insolvent entity’s counterpart under financial collateral arrangement to invoke provisions protecting his interest in respect of legal acts performed in the day of, but after the moment of the declaration of insolvency⁴². This shall be legally enforceable and binding on third parties if the collateral taker can prove that he was not aware, nor should have been aware, of the commencement of such proceedings.
- iii) “Freeze periods” not applicable⁴³. FCD render inoperable temporary “freeze periods” under national insolvency law during which (secured) creditors cannot execute their rights⁴⁴.

3.8. *Amendment proposal*

It should be noted that Proposal for a directive amending the Settlement Finality Directive and the Financial Collateral Arrangements Directive⁴⁵ has been presented. It suggests amendment of Article 2 (1) (b), as follows:

''title transfer financial collateral arrangement' means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of, or full entitlement to,

³⁷ Art. 6 (2) FCD

³⁸ Thomas Keijser, A need for a change; The undesirable consequences of Settlement Finality Directive and the Collateral Directive in the field of property and insolvency law, in particular for small and medium-sized enterprises, *Zeitschrift fuer Europaeisches Privatrecht* (2006) 318

³⁹ Art. 8 (1) (a) FCD

⁴⁰ Cf. Thomas Keijser, op. cit. 318

⁴¹ Art. 8 (2) FCD

⁴² Cf. Thomas Keijser, op. cit. 319

⁴³ Art. 8 (1) (b) FCD

⁴⁴ Cf. Thomas Keijser, op. cit. 320

⁴⁵ http://ec.europa.eu/internal_market/financial-markets/docs/proposal/sfd_fcd_proposal_en.pdf

financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations;"

A new text has been added. Full entitlement has been arranged. It relates to credit claims as possible collateral. In TTC definition, the words "or full entitlement to" are added to distinguish between ownership of cash or financial instruments on the one hand and "entitlement" to credit claims on the other hand⁴⁶. This idea implements using of so called 'security cession' for FCD purposes together with cash⁴⁷ (as FCD defined it). It is correct to say that the ownership is transferred, but this is ownership over 'claim' (or *res incorporales*).

A list of claims submitted in writing to the collateral taker is sufficient to prove the mobilisation and the identification of the claim provided as collateral⁴⁸. Another writing statement is proposed ensuring that the debtors may validly waive from:

- (i) their rights of set-off vis-à-vis the creditors of the credit claim and vis-à-vis persons to which the creditor assigned, pledged or otherwise mobilised the credit claim as collateral; and
- (ii) their rights arising from banking secrecy rules that would otherwise prevent or restrict the ability of the creditor of the credit claim to provide information on the credit claim or the debtor for the purposes of using the credit claim as collateral.

The proposal for including credit claims as possible collateral should be evaluated in the light of possible debtor's substitution.

4. TTC in Member states legislation

Now I would like to compare five different national FCD implementations. It is interesting to compare both – English official language member states on one hand, with non-English language official member states. In some non-English speaking countries English translation of FCD was used and then the home legal act was translated again into English.

4.1. Denmark

According to the information given in Evaluation Report, Denmark answers that the use of collateral between market participants has not increased significantly since the implementation of the Directive⁴⁹. The most important result of the Directive is the cross-border legal certainty about top-up collateral, title transfer financial collateral and netting⁵⁰.

⁴⁶ http://ec.europa.eu/internal_market/financial-markets/docs/proposal/sfd_fcd_proposal_en.pdf

⁴⁷ Art. 2 (1) (d) FCD

⁴⁸ Proposed amendment in Article 1 (5) FCD

⁴⁹ Directive 2002/47/EC on Financial Collateral Arrangements Draft Questionnaire to Member States For the drafting of the Evaluation Report, http://ec.europa.eu/internal_market/financial-markets/docs/collateral/2006-consultation/denmark_en.pdf 2

⁵⁰ Directive 2002/47/EC on Financial Collateral Arrangements Draft Questionnaire to Member States For the drafting of the Evaluation Report, http://ec.europa.eu/internal_market/financial-markets/docs/collateral/2006-consultation/denmark_en.pdf 2

In Denmark FCD has been adopted in Chapter 18A of Securities Trading Act (STA). The act transposing the directive was passed 2003.12.19 and entered into force 2004.01.01. Only three articles describe collateral with title transfer⁵¹. This does not include common financial collateral articles, which are valid for both – TTC and security collateral arrangements.

There is no TTC specific definition as in FCD⁵². Art. 58a (1) STA states that “collateralization” is possible through title transfer. This article adopts narrower TTC definition than the given in FCD Art. 2 (1) (b) FCD. The initial transfer may be deduced. Repurchase agreements are not included.

The equivalent collateral is defined as⁵³:

an amount of the same size and the same currency as the original collateral, if this was provided in the form of cash or securities identical to the original collateral, if this was provided in the form of securities.

If we compare this definition with its FCD equivalent⁵⁴ in art. 2 (1) (i) it should be noted that in the Danish version so called ‘other assets’ are omitted. In my opinion this is the correct approach, which is not followed by other legal systems. If we accept the possibility for other assets it would mean that the scope of collateral would not be limited to cash and securities as FCD provides.

STA⁵⁵ requires formal act for TTC formation. It shall be in writing or it shall be possible to document it in another manner legally equal to this. In my opinion if writing form is imperative this is different by the FCD requirements⁵⁶ –. I am not sure about this form requirement. It is difficult to define whether this form is for validity (*ad solemnitatem*) or for proof (*ad probationem*)?

According to capacity, STA scope has been widened to a certain extent as two persons mentioned in FCD⁵⁷ or natural persons may also enter into a financial collateral arrangement⁵⁸. However, the scope of financial obligations have been narrowed in these cases⁵⁹.

Realization of collateralisation in the form of title-transfer is effected through setting off the value of the collateral against the collateralised liabilities⁶⁰.

⁵¹ Art. 58a (1); 58j (2) and Art. 58k (1) STA

⁵² Art. 2 (1) (b) FCD

⁵³ Art. 58f. (4) STA

⁵⁴ Art. 2 (1) (i) FCD

⁵⁵ Art. 58a (2) STA

⁵⁶ Art. 3 FCD

⁵⁷ Art. 1 (2) (e) FCD

⁵⁸ Directive 2002/47/EC on Financial Collateral Arrangements Draft Questionnaire to Member States For the drafting of the Evaluation Report, http://ec.europa.eu/internal_market/financial-markets/docs/collateral/2006-consultation/denmark_en.pdf, 2

⁵⁹ Cf. sect. 58 e, par. 3-4, of the Act

⁶⁰ Art. 58j (2) STA

In the event of breach before the collateral taker has met any obligation to transfer equivalent collateral, the obligation may be made the subject of netting through close-out netting if this is provided for in the arrangement⁶¹.

STA do not implement “zero hour rule”⁶² and “freeze periods”.

Close-out netting, which is carried out after the party in breach has been declared bankrupt, may include claims that incurred before the time when the party not in breach knew, or should have known, the circumstances occasioning the reference date. Claims incurred after the end of the day when the bankruptcy was published in the Danish Official Gazette may not, however be included in.

About enforceability of legal acts after the declaration of insolvency STA states that:

In situations where the party in breach is made subject to insolvency proceedings, said party may, however, demand that the close-out netting be carried out in such a manner that the conditions applicable to the parties are the same as they would have been if close-out netting had been effected without undue delay after the time when the party not in breach knew, or should have known, that the party in breach was made subject to insolvency proceedings⁶³.

A new moment has been introduced⁶⁴, which states that with legal consequences for the estate and the creditors, agreement may be made to the effect that if a breach arises, close-out netting shall not be effected until the party not in breach gives notification in this respect to the party in breach.

4.2. Bulgaria

Bulgarian Law on Financial Collateral Arrangements (LFCA) has been adopted in 2006. LFCA definition⁶⁵ states that under a TTC, including repurchase agreements (repo agreements), the collateral provider shall transfer the full ownership of the financial collateral to the collateral taker in order to secure the performance of the relevant financial obligations. Definition follows FCD one⁶⁶.

Equivalent collateral description⁶⁷ is strict repetition of FCD⁶⁸:

Equivalent financial collateral shall be:

1. in relation to money claims – crediting an account with the same amount in the same currency;
2. in relation to financial instruments:
 - a) financial instruments of the same issuer or debtor, forming part of the same issue or class and of the same face value, currency and description;

⁶¹ Art. 58k (2) STA transposes Art. 6 (2) FCD

⁶² Art.58h, (4) STA

⁶³ Art. 58h (2) STA

⁶⁴ Art. 58h (2) STA

⁶⁵ Art. 2 (3) LFCA

⁶⁶ Art. 2 (1) (b) FCD

⁶⁷ Art. 9 (3) LFCA

⁶⁸ Art. 2 (1) (i) FCD

b) other assets if a financial collateral arrangement provides for the transfer of other assets following the occurrence of any event relating to or affecting any financial instruments provided as financial collateral.

It may be criticized for the repletion concerning to the so called “other assets”. As I have mentioned this would change the subject of collateral, which would not be appropriate and would fall outside of FCD scope.

Under LFCA title transfer collateral is not a formal transaction. TTC shall be evidenced in writing, and the written document shall identify the financial collateral⁶⁹. When title transfer transaction subject are dematerialized securities⁷⁰ by the Rules and Regulations of Central Depository AD⁷¹ states:

In order to register the transfer of the securities which are subject of the financial collateral agreement with ownership transfer, the Secured Entity and the Securer shall provide to the Central Depository a notary-certified copy of the Financial Collateral Agreements with Ownership Transfer.

This inconsistency from FCD point of view has its explanation. Central Security Depository does not want to allow fraud.

Capacity requirements are described⁷² and it is almost the same as FCD⁷³.

Only initial stage of collateral transfer has been described⁷⁴:

Financial collateral shall be provided by being ...transferred

Difference may be occurred in TTC effect. The collateral taker's possibility for equivalent collateral transfer is describes darkly⁷⁵, which is settled in FCD⁷⁶. This situation is described as follows:

Under the title transfer arrangement, the parties may agree on the collateral taker's obligation to provide equivalent financial collateral.

Unfortunately legislator omitted to implement FCD article, which deals with collaterals taker's close-out netting right over the equivalent collateral under TTC⁷⁷.

LFCA arranges collateral taker's privilege over the collateral⁷⁸. It is strange that both provisions describe different privilege. TTC⁷⁹ precedes security collateral arrangement privilege⁸⁰.

⁶⁹ Art. 6 (1) LFCA

⁷⁰ Art. 16 (1) by Enclosure 12

⁷¹ http://www.csd-bg.bg/EN_site/index.php?menu=zakon_bg&id=3

⁷² Art. 3 LFCA

⁷³ Art. 1 (2) FCD

⁷⁴ Art. 5 (1) LFCA

⁷⁵ Art. 2 (3) LFCA

⁷⁶ Art. 6 (2) FCD

⁷⁷ Art. 6 (2) FCD

Insolvency law framework is almost the same as FCD provides. Article 14 (3) LFCA arranges the “zero hour rule”⁸¹ and “freeze periods”⁸². A special article is dedicated to the enforceability of legal acts after the declaration of insolvency⁸³.

4.3. Estonia

Estonia has implemented FCD in its Law Property Act⁸⁴ (LPA). The reason is Estonian tradition of implementation EU law into already existing legal acts trying to keep legal systematization, logic and terminology. LPA definition states that encumbrance of a security or a financial claim with transfer of the security or financial claim in order to provide collateral is deemed to be financial collateral⁸⁵.

Equivalent collateral should be of the same type and with the same value⁸⁶. It is in close connection with the collateral taker’s right of disposition. LPA does not allow using of FCD “other assets” as Danish Art. 58f. (4) STA. This legal approach should be preferred than inclusion of “other assets”.

According to LPA financial collateral arrangement shall be entered into in a format which can be reproduced in writing⁸⁷. It is difficult to delimit does the form is *ad solemnitatem* or *ad probationem*.

Capacity of the persons entered into financial collateral arrangement⁸⁸ is described in and it reproduces FCD requirements.

TTC effect may be deduced by LPA. It describes the initial transfer of ownership, which aim is collateralization:

Encumbrance ... with ... transfer of the security or financial claim in order to provide collateral...⁸⁹

TTC effect in insolvency is not available by this act.

⁷⁸ Art. 11 (5) and (7) LFCA

⁷⁹ Art. 11 (7) LFCA

⁸⁰ Art. 11 (5) LFCA

⁸¹ Art. 14 (4) LFCA

⁸² Art. 14 (3) LFCA

⁸³ Art. 14 (4) LFCA

⁸⁴ <http://www.legaltext.ee>

⁸⁵ § 314¹ (1) LPA

⁸⁶ § 314¹ (3) LPA

⁸⁷ § 315 (2¹) LPA

⁸⁸ § 314¹ (1) LPA

⁸⁹ § 314¹ (1) LPA

4.4. Ireland

TTC is regulated by S.I. No. 1/2004 — European Communities (Financial Collateral Arrangements) Regulations 2004⁹⁰ (ECR) and S.I. No. 89 of 2004 European Communities (Financial Collateral Arrangements) (Amendment) Regulations 2004⁹¹.

Its definition⁹² is the same as FCD one⁹³. The only difference may be occurred in the terms describing TTC aim. In FCD it is described as ‘*for the purpose*’ of securing or otherwise covering the performance of relevant financial obligations. ECR uses following words: *in order* to secure or otherwise cover the performance of relevant financial obligations. FCD accents on the reason for which collateral is done. ECR stresses on the fact so that is possible.

According to the equivalent collateral FCD definition⁹⁴ it is reproduced⁹⁵, including so called “other assets”, which I have mentioned above many times. TTC may use equivalent collateral⁹⁶.

According to formal requirements it is clear that writing form is only for evidence⁹⁷. Article 4 ECR applies for collateral provider and taker’s capacity. TTC arrangement has effect in accordance with its terms⁹⁸. Collateral may be subject of close-out netting⁹⁹. Legal framework of TTC effect in insolvency is the same as FCD regulation¹⁰⁰.

4.5. United Kingdom

The Financial Collateral Arrangements (No.2) Regulations¹⁰¹ (FCAR) has been the statutory instrument, which implemented FCD in UK legislation. Definition is set up in Part I. p. 3 FCAR 2003 and it is broader then FCD one:

"title transfer financial collateral arrangement" means an agreement or arrangement, including a repurchase agreement, evidenced in writing, where -

(a) the purpose of the agreement or arrangement is to secure or otherwise cover the relevant financial obligations owed to the collateral-taker;

(b) the collateral-provider transfers legal and beneficial ownership in financial collateral to a collateral-taker on terms that when the relevant financial obligations are discharged the

⁹⁰ <http://www.irishstatutebook.ie/2004/en/si/0001.html>

⁹¹ <http://www.irishstatutebook.ie/2004/en/si/0089.html>

⁹² Art. 3 ECR

⁹³ Art. 2 (1) (b) FCD

⁹⁴ Art. 2 (1) (i) FCD

⁹⁵ Art. 3 (1) ECR

⁹⁶ Art. 12 ECR (which implements Article 6 FCD) states

⁹⁷ Art. 5 ECR

⁹⁸ Art. 12 (1) ECR

⁹⁹ Art. 12 (2) ECR

¹⁰⁰ Art. 14 (a) ECR relates to the “zero hour rule” effect in insolvency, Article 15 ECR 2004 arranges enforceability of legal acts after the declaration of insolvency and Article 14 (b) ECR - “freeze periods”

¹⁰¹ <http://www.opsi.gov.uk/si/si2003/20033226.htm>

collateral-taker must transfer legal and beneficial ownership of equivalent financial collateral to the collateral-provider; and

(c) the collateral-provider and the collateral-taker are both non-natural persons;

According to this definition when the relevant financial obligations are discharged it may conclude that collateral taker should transfer back only equivalent financial collateral.

Equivalent financial collateral¹⁰² follows the FCD definition including so called “other assets”.

Certain legislation requiring formalities does not apply to financial collateral arrangements¹⁰³. TTC shall be evidence in writing¹⁰⁴.

FCAR has broader interpretation¹⁰⁵ about capacity than FCD provides¹⁰⁶. The collateral-provider and the collateral-taker may be every non-natural person.

The TTC effect has been mentioned above. In this definition both – the initial and back transfer relationships are included:

- i) the collateral-provider transfers legal and beneficial ownership in financial collateral to a collateral-taker, but on terms that when the relevant financial obligations are discharged
- ii) the collateral-taker must transfer legal and beneficial ownership of equivalent financial collateral to the collateral-provider;

Many insolvency legal acts have been modified for FCD right transposition.

5. TTC in UNIDROIT Draft Convention on Substantive Rules regarding Intermediated Securities

Draft Convention on Substantive Rules regarding Intermediated Securities (UNIDROIT Convention) mentioning TTC.

TTC definition is close to FCD one:

an agreement, including an agreement providing for the sale and repurchase of securities, between a collateral provider and a collateral taker providing (in whatever terms) for the transfer of full ownership of intermediated securities by the collateral provider to the collateral taker for the purpose of securing or otherwise covering the performance of relevant obligations¹⁰⁷

¹⁰² Part I, p. 3 FCAR

¹⁰³ Part II FCAR

¹⁰⁴ Part I, p. 3 FCAR

¹⁰⁵ Part I, p. 3 FCAR

¹⁰⁶ Art. 1 (2) FCD

¹⁰⁷ Art. 31 (3) (c) UNIDROIT Convention

The difference can be found only in its narrower subject than FCD (it not relates to ‘cash’). The initial transfer is described together with the main relevant obligations.

Equivalent collateral is of the same description as collateral securities¹⁰⁸.

UNIDROIT Convention does not require TTC form.

UNIDROIT Convention does not limit parties’ capacity. Collateral taker is a person to whom an interest in intermediated securities is granted under a collateral agreement and collateral provider is an account holder by whom an interest in intermediated securities is granted under a collateral agreement¹⁰⁹.

TTC should take effect in accordance with its terms¹¹⁰. Close-out netting is also possible¹¹¹.

UNIDROIT Convention arranges both “zero hour rule” and “freeze periods”. Collateral agreement shall not be treated as invalid, reversed or declared void solely on the basis that the agreement is entered into or the collateral securities are delivered during a prescribed period before, or on the day of but before, the commencement of an insolvency proceeding in respect of the collateral provider¹¹².

6. Conclusions

TTC has been studied in Roman, EU, national and international level. Is it possible to use some *fiducia cum creditore* ideas in contemporary TTC? In my opinion it is possible. Let’s go back to those six TTC characteristics, which I have mentioned above: definition; equivalent collateral; formation; capacity; TTC effect and TTC effect in insolvency. Let’s compare them with Roman law framework (where it is comparable).

6.1. Definition and effect

As I have mentioned above from The Institutes of Gaius we can deduce *fiducia cum creditore* description as a debtor’s property transfer to another. It was clear that this transfer was on condition that it should be restored to him (in case of debtor’s performance) and this was called *pactum fiduciae*. According to FCD definition¹¹³ this obligation is not visible and I think it should be added. It could be recommended that a broader TTC definition is adopted as United Kingdom implementation¹¹⁴, which includes both the initial and back transfer relation.

¹⁰⁸ Art. 31 (3) (i) UNIDROIT Convention

¹⁰⁹ Art. 31 (3) (f), (g) UNIDROIT Convention

¹¹⁰ Art. 32 UNIDROIT Convention

¹¹¹ Art. 33 (1) UNIDROIT Convention

¹¹² Art. 37 UNIDROIT Convention

¹¹³ Art. 2 (1) (b) FCD

¹¹⁴ Part I. p. 3 FCAR

Another question can arise about determination of collateral value. We could also recommend that the contract parties have a right to determine (initially or on a specific date, depending on the market price) the date on which the collateral shall be evaluated. This is needed, because of the right of the debtor to recover surplus. The same solution was accepted in Roman law. Title 13, Concerning the *Lex Commissoria*, Book II, The Opinions of Julius Paulus addressed to his son.

6.2. Equivalent Collateral

According to the TTC definition it should be clear whether equivalent collateral is allowed? If collateral taker has the right to dispose of the initial collateral and provide an “equivalent” one this shall make TTC almost the same as security collateral arrangement. The only difference would be the moment of appropriation. I may see only tax reasons behind this solution.

It is recommended that provided by FCD ‘other assets’ should not be allowed as Danish and Estonian legislation provides.

6.3. TTC effect in insolvency

According to Institutes of Gaius “the owner can always thus re-acquire after payment of the debt”. It relates only in case that collateral taker did not dispose collateral. If he disposed it, than debtor had *actio fidei iudiciae directa* or *fiduciaria*. We can use the idea of it in the light of Art. 5 (3) FCD, which provides the following:

The equivalent collateral transferred in discharge of an obligation as described in paragraph 2, first subparagraph, shall be subject to the same security financial collateral agreement to which the original financial collateral was subject and shall be treated as having been provided under the security financial collateral arrangement at the same time as the original financial collateral was first provided.

It should be stressed that Art. 5 (3) FCD arranges only security financial collateral arrangement. This defense should be provided also in Art. 6 FCD. Collateral provider should have the same insolvency defense (application of “zero hour rule”; enforceability of legal acts after the declaration of collateral taker’s insolvency and “freeze periods” not applicability) concerning to equivalent collateral (or in case that collateral taker may transfer back) the initial one.

I would like to end this lecture with another David Allan words, which I shall paraphrase a little – let us take steps to ensure that we have laws which are suitable for the credit economies of the 21st century. The laws and the models are there. All we need is the will and determination to adopt them¹¹⁵.

Thank you for your attention.

¹¹⁵ David E. Allan *Uniform personal property security legislation for Australia; Introduction to the Workshop on personal property security law reform* 14 Bond LR 4 (2002) 7