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## STATUTORY INSTRUMENTS

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# 2003 No. 3226

## FINANCIAL SERVICES AND MARKETS

### The Financial Collateral Arrangements (No.2) Regulations 2003

<i>Made</i>	- - - -	<i>10th December 2003</i>
<i>Laid before Parliament</i>		<i>10th December 2003</i>
<i>Coming into force</i>		
<i>Regulation 2</i>		<i>11th December 2003</i>
<i>Remainder</i>		<i>26th December 2003</i>

The Treasury, being a government department designated <sup>M1</sup> for the purposes of section 2(2) of the European Communities Act 1972 <sup>M2</sup> in relation to collateral security, in exercise of the powers conferred on them by that section, hereby make the following Regulations:

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#### Marginal Citations

**M1** [S.I. 2003/1888](#)

**M2** [1972 c. 68](#)

## PART 1

### General

VALID FROM 26/12/2003

#### Citation and commencement

1.—(1) These Regulations may be cited as the Financial Collateral Arrangements (No. 2) Regulations 2003.

(2) Regulation 2 shall come into force on 11th December 2003 and all other Regulations thereof shall come into force on 26th December 2003.

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## Revocation

2. The Financial Collateral Arrangements Regulations 2003 <sup>M3</sup> are hereby revoked.

### Marginal Citations

M3 S.I. 2003/3112

VALID FROM 26/12/2003

## Interpretation

3. In these Regulations —

“book entry securities collateral” means financial collateral subject to a financial collateral arrangement which consists of financial instruments, title to which is evidenced by entries in a register or account maintained by or on behalf of an intermediary;

“cash” means money in any currency, credited to an account, or a similar claim for repayment of money and includes money market deposits and sums due or payable to, or received between the parties in connection with the operation of a financial collateral arrangement or a close-out netting provision;

“close-out netting provision” means a term of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or any legislative provision under which on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise—

- (a) the obligations of the parties are accelerated to become immediately due and expressed as an obligation to pay an amount representing the original obligation’s estimated current value or replacement cost, or are terminated and replaced by an obligation to pay such an amount; or
- (b) an account is taken of what is due from each party to the other in respect of such obligations and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party;

“enforcement event” means an event of default, or any similar event as agreed between the parties, on the occurrence of which, under the terms of a financial collateral arrangement or by operation of law, the collateral-taker is entitled to realise or appropriate financial collateral or a close-out netting provision comes into effect;

“equivalent financial collateral” means—

- (a) in relation to cash, a payment of the same amount and in the same currency;
- (b) in relation to financial instruments, 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 the 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;

and includes the original financial collateral provided under the arrangement;

“financial collateral arrangement” means a title transfer financial collateral arrangement or a security financial collateral arrangement, whether or not these are covered by a master agreement or general terms and conditions;

“financial collateral” means either cash or financial instruments;

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“financial instruments” means—

- (a) shares in companies and other securities equivalent to shares in companies;
- (b) bonds and other forms of instruments giving rise to or acknowledging indebtedness if these are tradeable on the capital market; and
- (c) any other securities which are normally dealt in and which give the right to acquire any such shares, bonds, instruments or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment);

and includes units of a collective investment scheme within the meaning of the Financial Services and Markets Act 2000 <sup>M4</sup>, eligible debt securities within the meaning of the Uncertificated Securities Regulations 2001 <sup>M5</sup>, money market instruments, claims relating to or rights in or in respect of any of the financial instruments included in this definition and any rights, privileges or benefits attached to or arising from any such financial instruments;

“intermediary” means a person that maintains registers or accounts to which financial instruments may be credited or debited, for others or both for others and for its own account but does not include—

- (a) a person who acts as a registrar or transfer agent for the issuer of financial instruments; or
- (b) a person who maintains registers or accounts in the capacity of operator of a system for the holding and transfer of financial instruments on records of the issuer or other records which constitute the primary record of entitlement to financial instruments as against the issuer;

“non-natural person” means any corporate body, unincorporated firm, partnership or body with legal personality except an individual, including any such entity constituted under the law of a country or territory outside the United Kingdom or any such entity constituted under international law;

“relevant account” means, in relation to book entry securities collateral which is subject to a financial collateral arrangement, the register or account, which may be maintained by the collateral-taker, in which entries are made, by which that book entry securities collateral is transferred or designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf;

“relevant financial obligations” means the obligations which are secured or otherwise covered by a financial collateral arrangement, and such obligations may consist of or include—

- (a) present or future, actual or contingent or prospective obligations (including such obligations arising under a master agreement or similar arrangement);
- (b) obligations owed to the collateral-taker by a person other than the collateral-provider;
- (c) obligations of a specified class or kind arising from time to time;

“reorganisation measures” means—

- (a) administration within the meaning of the Insolvency Act 1986 <sup>M6</sup> or the Insolvency (Northern Ireland) Order 1989 <sup>M7</sup>;
- (b) a company voluntary arrangement within the meaning of that Act or that Order ;
- (c) administration of a partnership within the meaning of that Act <sup>M8</sup> or that Order or, in the case of a Scottish partnership, the Bankruptcy (Scotland) Act 1985 <sup>M9</sup>;
- (d) a partnership voluntary arrangement within the meaning of the Insolvency Act 1986 <sup>M10</sup> or the Insolvency (Northern Ireland) Order 1989 or, in the case of a Scottish partnership, the Bankruptcy (Scotland) Act 1985; and

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- (e) the making of an interim order on an administration application;
- “security financial collateral arrangement” means an agreement or arrangement, evidenced in writing, where—
- (a) the purpose of the agreement or arrangement is to secure the relevant financial obligations owed to the collateral-taker;
- (b) the collateral-provider creates or there arises a security interest in financial collateral to secure those obligations;
- (c) the financial collateral is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf; any right of the collateral-provider to substitute equivalent financial collateral or withdraw excess financial collateral shall not prevent the financial collateral being in the possession or under the control of the collateral-taker; and
- (d) the collateral-provider and the collateral-taker are both non-natural persons;
- “security interest” means any legal or equitable interest or any right in security, other than a title transfer financial collateral arrangement, created or otherwise arising by way of security including—
- (a) a pledge;
- (b) a mortgage;
- (c) a fixed charge;
- (d) a charge created as a floating charge where the financial collateral charged is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf; any right of the collateral-provider to substitute equivalent financial collateral or withdraw excess financial collateral shall not prevent the financial collateral being in the possession or under the control of the collateral-taker; or
- (e) a lien;
- “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 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;
- “winding-up proceedings” means—
- (a) winding up by the court; or
- (b) voluntary winding up;
- within the meaning of the Insolvency Act 1986 or the Insolvency (Northern Ireland) Order 1989 or, in the case of Scottish partnerships, the Bankruptcy (Scotland) Act 1985.

#### Marginal Citations

M4 2000 c. 8.

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- M5** S.I.2001/3755 as amended by S.I. 2003/1633.  
**M6** 1986 c. 45 (As amended by Schedule 16 to the Enterprise Act 2002 c. 40).  
**M7** S.I. 1989/2405 (N.I. 19).  
**M8** As modified by S.I. 1994/2421 (that order was amended by S.I. 2002/2708 and S.I. 2002/1308).  
**M9** 1985 c. 66.  
**M10** As modified by S.I. 1994 /2421.

VALID FROM 26/12/2003

## PART 2

### Modification of law requiring formalities

#### **Certain legislation requiring formalities not to apply to financial collateral arrangements**

4.—(1) Section 4 of the Statute of Frauds 1677 <sup>M11</sup> (no action on a third party's promise unless in writing and signed) shall not apply (if it would otherwise do so) in relation to a financial collateral arrangement.

(2) Section 53(1)(c) of the Law of Property Act 1925 <sup>M12</sup> (disposition of equitable interest to be in writing and signed) shall not apply (if it would otherwise do so) in relation to a financial collateral arrangement.

(3) Section 136 of the Law of Property Act 1925 (legal assignments of things in action) shall not apply (if it would otherwise do so) in relation to a financial collateral arrangement, to the extent that the section requires an assignment to be signed by the assignor or a person authorised on its behalf, in order to be effectual in law.

(4) Section 395 of the Companies Act 1985 <sup>M13</sup> (certain charges void if not registered) shall not apply (if it would otherwise do so) in relation to a security financial collateral arrangement or any charge created or otherwise arising under a security financial collateral arrangement

(5) Section 4 of the Industrial and Provident Societies Act 1967 <sup>M14</sup> (filing of information relating to charges) shall not apply (if it would otherwise do so) in relation to a security financial collateral arrangement or any charge created or otherwise arising under a security financial collateral arrangement.

#### **Marginal Citations**

- M11** 1677 c. 3  
**M12** 1925 c. 20  
**M13** 1985 c. 6  
**M14** 1967 c. 48

#### **Certain legislation affecting Scottish companies not to apply to financial collateral arrangements**

5. Section 410 of the Companies Act 1985 (certain charges void if not registered (Scotland)) shall not apply (if it would otherwise do so) in relation to a security financial collateral arrangement or any charge created or otherwise arising under a security financial collateral arrangement.

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### **No additional formalities required for creation of a right in security over book entry securities collateral in Scotland**

6.—(1) Where under the law of Scotland an act is required as a condition for transferring, creating or enforcing a right in security over any book entry securities collateral, that requirement shall not apply (if it would otherwise do so).

(2) For the purposes of paragraph (1) an “act”—

- (a) is any act other than an entry on a register or account maintained by or on behalf of an intermediary which evidences title to the book entry securities collateral;
- (b) includes the entering of the collateral-taker’s name in a company’s register of members.

### **Certain legislation affecting Northern Ireland companies and requiring formalities not to apply to financial collateral arrangements**

7. Article 402 of the Companies (Northern Ireland) Order 1986 <sup>M15</sup> (certain charges void if not registered) shall not apply (if it would otherwise do so) in relation to a security financial collateral arrangement or any charge created or otherwise arising under a security financial collateral arrangement.

#### **Marginal Citations**

**M15** [S.I. 1032/1986 \(N.I. 6\)](#)

VALID FROM 26/12/2003

## **PART 3**

### **Modification of insolvency law**

#### **Certain legislation restricting enforcement of security not to apply to financial collateral arrangements**

8.—(1) The following provisions of Schedule B1 to the Insolvency Act 1986 <sup>M16</sup> (administration) shall not apply to any security interest created or otherwise arising under a financial collateral arrangement—

- (a) paragraph 43(2) (restriction on enforcement of security or repossession of goods) including that provision as applied by paragraph 44 (interim moratorium); and
- (b) paragraphs 70 and 71 (power of administrator to deal with charged property).

(2) Paragraph 41(2) of Schedule B1 to the Insolvency Act 1986 (receiver to vacate office when so required by administrator) shall not apply to a receiver appointed under a charge created or otherwise arising under a financial collateral arrangement.

(3) The following provisions of the Insolvency Act 1986<sup>M17</sup> (administration) shall not apply in relation to any security interest created or otherwise arising under a financial collateral arrangement—

- (a) sections 10(1)(b) and 11(3)(c) (restriction on enforcement of security while petition for administration order pending or order in force); and
- (b) section 15(1) and 15(2) (power of administrator to deal with charged property).

(4) Section 11(2) of the Insolvency Act 1986 (receiver to vacate office when so required by administrator) shall not apply to a receiver appointed under a charge created or otherwise arising under a financial collateral arrangement.

(5) Paragraph 20 and sub-paragraph 12(1)(g) of Schedule A1 to the Insolvency Act 1986 <sup>M18</sup> (Effect of moratorium on creditors) shall not apply (if it would otherwise do so) to any security interest created or otherwise arising under a financial collateral arrangement.

#### **Marginal Citations**

**M16** Schedule B1 of the Insolvency Act 1986 was inserted by section 248 of, and Schedule 16 to the Enterprise Act 2002 c. 40.

**M17** These provisions of the Insolvency Act 1986 are preserved in relation to special administration regimes by section 249 of the Enterprise Act 2002.

**M18** Schedule A1 to the Insolvency Act 1986 was inserted by section 1 of, and Schedule 1 to the Insolvency Act 2000 c. 39.

#### **Certain Northern Ireland legislation restricting enforcement of security not to apply to financial collateral arrangements**

9.—(1) The following provisions of the Insolvency (Northern Ireland) Order 1989 (administration) shall not apply to any security interest created or otherwise arising under a financial collateral arrangement—

- (a) Article 23(1)(b) and Article 24(3)(c) (restriction on enforcement of security while petition for administration order pending or order in force); and
- (b) Article 28(1) and (2) (power of administrator to deal with charged property).

(2) Article 24(2) of that Order (receiver to vacate office at request of administrator) shall not apply to a receiver appointed under a charge created or otherwise arising under a financial collateral arrangement.

#### **Certain insolvency legislation on avoidance of contracts and floating charges not to apply to financial collateral arrangements**

10.—(1) In relation to winding-up proceedings of a collateral-taker or collateral-provider, section 127 of the Insolvency Act 1986 (avoidance of property dispositions, etc) shall not apply (if it would otherwise do so)—

- (a) to any property or security interest subject to a disposition or created or otherwise arising under a financial collateral arrangement; or
- (b) to prevent a close-out netting provision taking effect in accordance with its terms.

(2) Section 88 of the Insolvency Act 1986 (avoidance of share transfers, etc after winding-up resolution) shall not apply (if it would otherwise do so) to any transfer of shares under a financial collateral arrangement.

(3) Section 176A of the Insolvency Act 1986 <sup>M19</sup> (share of assets for unsecured creditors) shall not apply (if it would otherwise do so) to any charge created or otherwise arising under a financial collateral arrangement.

(4) Section 178 of the Insolvency Act 1986 (power to disclaim onerous property) or, in Scotland, any rule of law having the same effect as that section, shall not apply where the collateral-provider or collateral-taker under the arrangement is being wound up, to any financial collateral arrangement.

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(5) Section 245 of the Insolvency Act 1986 (avoidance of certain floating charges) shall not apply (if it would otherwise do so) to any charge created or otherwise arising under a security financial collateral arrangement.

(6) Section 196 of the Companies Act 1985 (payment of debts out of assets subject to a floating charge (England and Wales) shall not apply (if it would otherwise do so) to any charge created or otherwise arising under a financial collateral arrangement.

#### Marginal Citations

**M19** [Section 176A](#) of the Insolvency Act 1986 was inserted by section 252 of the Enterprise Act 2002.

### **Certain Northern Ireland insolvency legislation on avoidance of contracts and floating charges not to apply to financial collateral arrangements**

**11.—(1)** In relation to winding-up proceedings of a collateral-provider or collateral-taker, Article 107 of the Insolvency (Northern Ireland) Order 1989 (avoidance of property dispositions effected after commencement of winding up) shall not apply (if it would otherwise do so)—

- (a) to any property or security interest subject to a disposition or created or otherwise arising under a financial collateral arrangement; or
- (b) to prevent a close-out netting provision taking effect in accordance with its terms.

(2) Article 74 of that Order (avoidance of share transfers, etc after winding-up resolution) shall not apply (if it would otherwise do so) to any transfer of shares under a financial collateral arrangement.

(3) Article 152 of that Order (power to disclaim onerous property) shall not apply where the collateral-provider or collateral-taker under the arrangement is being wound-up, to any financial collateral arrangement.

(4) Article 207 of that Order (avoidance of certain floating charges) shall not apply (if it would otherwise do so) to any charge created or otherwise arising under a security financial collateral arrangement.

(5) Article 205 of the Companies (Northern Ireland) Order 1986 (payment of debts out of assets subject to a floating charge) shall not apply (if it would otherwise do so) to any charge created or otherwise arising under a financial collateral arrangement.

### **Close-out netting provisions to take effect in accordance with their terms**

**12.—(1)** A close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures.

(2) Paragraph (1) shall not apply if at the time that a party to a financial collateral arrangement entered into such an arrangement or that the relevant financial obligations came into existence—

- (a) that party was aware or should have been aware that winding up proceedings or reorganisation measures had commenced in relation to the other party;
- (b) that party had notice that a meeting of creditors of the other party had been summoned under section 98 of the Insolvency Act 1986, or Article 84 of the Companies (Northern Ireland) Order 1989 or that a petition for the winding-up of the other party was pending;
- (c) that party had notice that an application for an administration order was pending or that any person had given notice of an intention to appoint an administrator; or



- (d) that party had notice that an application for an administration order was pending or that any person had given notice of an intention to appoint an administrator and liquidation of the other party to the financial collateral arrangement was immediately preceded by an administration of that party.
- (3) For the purposes of paragraph (2)—
  - (a) winding-up proceedings commence on the making of a winding-up order by the court; and
  - (b) reorganisation measures commence on the appointment of an administrator, whether by a court or otherwise.
- (4) Rules 2.85 (4)(a) and (c) and 4.90 (3)(b) of the Insolvency Rules 1986 (mutual credit and set-off) shall not apply to a close-out netting provision unless sub-paragraph (2)(a) applies.

**Financial collateral arrangements to be enforceable where collateral-taker not aware of commencement of winding-up proceedings or reorganisation measures**

**13.**—(1) Where any of the events specified in paragraph (2) occur on the day of, but after the moment of commencement of, winding-up proceedings or reorganisation measures those events, arrangements and obligations shall be legally enforceable and binding on third parties if the collateral-taker can show that he was not aware, nor should have been aware, of the commencement of such proceedings or measures.

- (2) The events referred to in paragraph (1) are—
  - (a) a financial collateral arrangement coming into existence;
  - (b) a relevant financial obligation secured by a financial collateral arrangement coming into existence; or
  - (c) the delivery, transfer, holding, registering or other designation of financial collateral so as to be in the possession or under the control of the collateral-taker.
- (3) For the purposes of paragraph (1)—
  - (a) the commencement of winding-up proceedings means the making of a winding-up order by the court; and
  - (b) commencement of reorganisation measures means the appointment of an administrator, whether by a court or otherwise.

**Modification of the Insolvency Rules 1986 and the Insolvency Rules (Northern Ireland) 1991**

**14.** Where the collateral-provider or the collateral-taker under a financial collateral arrangement goes into liquidation or administration and the arrangement or a close out netting provision provides for, or the mechanism provided under the arrangement permits, either—

- (a) the debt owed by the party in liquidation or administration under the arrangement, to be assessed or paid in a currency other than sterling; or
- (b) the debt to be converted into sterling at a rate other than the official exchange rate prevailing on the date when that party went into liquidation or administration;

then rule 4.91 (liquidation), or rule 2.86 (administration) of the Insolvency Rules 1986<sup>M20</sup> (debt in foreign currency), or rule 4.097 of the Insolvency Rules (Northern Ireland) 1991<sup>M21</sup> (liquidation, debt in foreign currency), as appropriate, shall not apply unless the arrangement provides for an unreasonable exchange rate or the collateral-taker uses the mechanism provided under the arrangement to impose an unreasonable exchange rate in which case the appropriate rule shall apply.

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#### Marginal Citations

- M20** S.I. 1986/1925, amended by S.I. 2003/ 1730, S.I. 2002/1307, S.I. 2001/763, S.I. 1999/359, S.I. 1995/586, S.I. 1993/602, S.I. 1991/495, S.I. 1989/397, S.I. 1987/1919.
- M21** S.R. 1991 No. 364.

#### Modification of the Insolvency (Scotland) Rules 1986

**15.** Where the collateral-provider or the collateral-taker under a financial collateral arrangement goes into liquidation or, in the case of a partnership, sequestration and the arrangement provides for, or the mechanism provided under the arrangement permits, either—

- (a) the debt owed by the party in liquidation or sequestration under the arrangement, to be assessed or paid in a currency other than sterling; or
- (b) the debt to be converted into sterling at a rate other than the official exchange rate prevailing on the date when that party went into liquidation or sequestration;

then rules 4.16 and 4.17 of the Insolvency (Scotland) Rules 1986<sup>M22</sup> and section 49(3) of the Bankruptcy (Scotland) Act 1985 as applied by rule 4.16 (1)(c) of those rules (claims in foreign currency), as appropriate, shall not apply unless the arrangement provides for an unreasonable exchange rate or the collateral-taker uses the mechanism provided under the arrangement to impose an unreasonable exchange rate in which case the appropriate rule shall apply.

#### Marginal Citations

- M22** S.I.1986/1915, amended by S.I. 2003/2111, S.I. 2002/2709, S.I. 1999/1820, S.I. 1987/1921.

VALID FROM 26/12/2003

## PART 4

### Right of use and appropriation

#### Right of use under a security financial collateral arrangement

**16.—(1)** If a security financial collateral arrangement provides for the collateral-taker to use and dispose of any financial collateral provided under the arrangement, as if it were the owner of it, the collateral-taker may do so in accordance with the terms of the arrangement.

(2) If a collateral-taker exercises such a right of use, it is obliged to replace the original financial collateral by transferring equivalent financial collateral on or before the due date for the performance of the relevant financial obligations covered by the arrangement or, if the arrangement so provides, it may set off the value of the equivalent financial collateral against or apply it in discharge of the relevant financial obligations in accordance with the terms of the arrangement.

(3) The equivalent financial collateral which is transferred in discharge of an obligation as described in paragraph (2), shall be subject to the same terms of the security financial collateral arrangement as the original financial collateral was subject to 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.

(4) If a collateral-taker has an outstanding obligation to replace the original financial collateral with equivalent financial collateral when an enforcement event occurs, that obligation may be the subject of a close-out netting provision.

#### **No requirement to apply to court to appropriate financial collateral under a security financial collateral arrangement**

17. Where a legal or equitable mortgage is the security interest created or arising under a security financial collateral arrangement on terms that include a power for the collateral-taker to appropriate the collateral, the collateral-taker may exercise that power in accordance with the terms of the security financial collateral arrangement, without any order for foreclosure from the courts.

#### **Duty to value collateral and account for any difference in value on appropriation**

18.—(1) Where a collateral-taker exercises a power contained in a security financial collateral arrangement to appropriate the financial collateral the collateral-taker must value the financial collateral in accordance with the terms of the arrangement and in any event in a commercially reasonable manner.

(2) Where a collateral-taker exercises such a power and the value of the financial collateral appropriated differs from the amount of the relevant financial obligations, then as the case may be, either—

- (a) the collateral-taker must account to the collateral-provider for the amount by which the value of the financial collateral exceeds the relevant financial obligations; or
- (b) the collateral-provider will remain liable to the collateral-taker for any amount whereby the value of the financial collateral is less than the relevant financial obligations.

VALID FROM 26/12/2003

## **PART 5**

### **Conflict of laws**

#### **Standard test regarding the applicable law to book entry securities financial collateral arrangements**

19.—(1) This regulation applies to financial collateral arrangements where book entry securities collateral is used as collateral under the arrangement and are held through one or more intermediaries.

(2) Any question relating to the matters specified in paragraph (4) of this regulation which arises in relation to book entry securities collateral which is provided under a financial collateral arrangement shall be governed by the domestic law of the country in which the relevant account is maintained.

(3) For the purposes of paragraph (2) “domestic law” excludes any rule under which, in deciding the relevant question, reference should be made to the law of another country.

(4) The matters referred to in paragraph (2) are—

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- (a) the legal nature and proprietary effects of book entry securities collateral;
- (b) the requirements for perfecting a financial collateral arrangement relating to book entry securities collateral and the transfer or passing of control or possession of book entry securities collateral under such an arrangement;
- (c) the requirements for rendering a financial collateral arrangement which relates to book entry securities collateral effective against third parties;
- (d) whether a person's title to or interest in such book entry securities collateral is overridden by or subordinated to a competing title or interest; and
- (e) the steps required for the realisation of book entry securities collateral following the occurrence of any enforcement event.

10th December 2003

*Jim Murphy*  
*Derek Twigg*  
Two of the Lords Commissioners of Her  
Majesty's Treasury

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**Changes to legislation:** The Financial Collateral Arrangements (No.2) Regulations 2003 is up to date with all changes known to be in force on or before 30 May 2024. There are changes that may be brought into force at a future date. Changes that have been made appear in the content and are referenced with annotations. (See end of Document for details)

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## EXPLANATORY NOTE

*(This note is not part of the Regulations)*

These Regulations implement the European Parliament and Council Directive [2002/47/EC](#) on financial collateral arrangements (“the Directive”). The Regulations apply to England, Wales, Scotland and Northern Ireland.

These Regulations replace the Financial Collateral Arrangements Regulations 2003 (S.I. 2003/3112) which are revoked by Regulation 2 before those Regulations were due to come into force. This revocation was due to a drafting error in the original version of the Regulations which was made and laid before Parliament.

Regulation 3 defines many of the terms used throughout the Regulations. The definition of “financial instruments” refers to “bonds and other forms of instruments giving rise to or acknowledging indebtedness if these are tradeable on the capital market”. The term “capital market” is not defined, the term is used in the Directive where it is also not defined.

Regulations 4, 5, 6 and 7 prevent certain legislative provisions and common law rules which require formalities before an agreement is perfected and enforceable, from applying to financial collateral arrangements. The Directive provides that the only formality which may be required for a financial collateral arrangement to be perfected and enforceable, is that the arrangement be evidenced in writing. Legislation and rules which require signature by a particular person or entry of the arrangement in a register are therefore disapplied from financial collateral arrangements by the Regulations.

Regulations 8 and 9 prevent certain provisions of the Insolvency Act 1986 and the Insolvency (Northern Ireland) Order 1989 from applying to financial collateral arrangements. The provisions which are disapplied are those which prevent enforcement of security interests when a company or partnership is in administration proceedings or subject to a voluntary arrangement. This is because the Directive requires Member States to ensure that financial collateral arrangements are effective and enforceable even where a party to the arrangement enters reorganisation procedures such as administration.

Regulations 10 and 11 prevent certain provisions of insolvency law from applying to financial collateral arrangements so that where such arrangements are entered into or collateral is provided under such arrangements in a prescribed period prior to the commencement of winding-up proceedings, the arrangement remains enforceable once winding-up commences unlike other agreements which the company may avoid.

Regulation 12 provides that a close-out netting provision in a financial collateral arrangement is to take effect in accordance with its terms even if a party to the arrangement is being wound-up or is subject to reorganisation proceedings provided that the other party to the arrangement was not aware nor should have been aware, at the time that it entered into the arrangement, that the party was subject to winding-up proceedings or reorganisation measures. The other party may also not enforce if it had actual notice of certain steps leading to such proceedings or measures at the time when it entered into the arrangement.

Regulation 13 provides that where certain steps in concluding a financial collateral arrangement only occur on the day but after the precise moment of commencement of winding-up proceedings or reorganisation measures, those steps are binding on third parties and the arrangement is still enforceable provided that the other party to the arrangement was not aware, nor should have been aware that the proceedings or measures had commenced.

Regulations 14 and 15 provide that the specific provisions in a financial collateral arrangement regarding the currency in which obligations are to be calculated and the rate of any currency conversions will displace the rules in the Insolvency Rules 1986, the Insolvency Rules (Northern Ireland) 1991 and the Insolvency (Scotland) Rules 1986, on the calculation of debts in a

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distribution under administration in England and Wales or in a liquidation in the UK, unless the rate set through the arrangement is unreasonable.

Regulation 16 provides that where a security financial collateral arrangement provides a right of use for the collateral-taker over the collateral, that term is to be enforceable. Where a right of use is exercised the collateral-taker is obliged to replace the collateral with equivalent financial collateral, unless he sets off the value of the collateral in discharge of the relevant financial obligations in accordance with the terms of the arrangement. The equivalent financial collateral is to be subject to the same terms as the original financial collateral. Obligations arising under right of use provisions in the arrangement may be the subject of a close-out netting provision.

Regulation 17 provides that where a collateral-taker under a security financial collateral arrangement has a mortgage over the collateral provided under the arrangement it may enforce any right of appropriation of the collateral, which the arrangement provides for, without applying to the court for an order for foreclosure. The Directive requires that any right of appropriation under a financial collateral arrangement should be enforceable without the need for a court order. Regulation 18 imposes a duty on the collateral-taker, if it exercises such a right of appropriation, to value the collateral in accordance with the terms of the arrangement and in any event in a commercially reasonable manner. Where the value of the collateral differs from the amount of the relevant financial obligations the parties are obliged to account for that difference.

Regulation 19 imposes a standard test, set out in the Directive, for deciding which domestic law will apply to book entry securities which are held through one or more intermediaries and provided as collateral under a financial collateral arrangement, where there is a conflict of laws issue to be decided. The test is that the arrangement shall be governed by the domestic law of the country in which the “relevant account” (as defined in regulation 2) is maintained.

A regulatory impact assessment has been prepared in relation to these Regulations. A copy may be obtained from the Financial Stability and Regulatory Policy Team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ. A copy of the transposition note in relation to the implementation of the Directive may be obtained from the same address. Both documents are also available on the Treasury website ([www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)). Copies of both these documents have been placed in the Library of each House of Parliament.

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