

# Credit Claims as Eligible Collateral for Eurosystem Credit Operations

Birgit Sauerzopf<sup>1</sup>

The introduction of a “single list” of eligible collateral common to all Eurosystem credit operations on January 1, 2007, replaced the two-tier framework in place until then. Euro area credit claims (i.e. bank loans) have become eligible for use as collateral under the single list, provided they fulfill conditions specified by the ECB. Even though credit claims are more complex than marketable securities in legal as well as administrative terms, their mobilization by Austrian banks as collateral in credit operations with the Oesterreichische Nationalbank (OeNB) has surged since the beginning of 2007. Moreover, the conditions for the cross-border use of credit claims have been adapted for the new single framework; these procedures and euro area enlargement upon Slovenia’s accession lead to the expectation that the cross-border use of credit claims by OeNB counterparties in credit operations with the OeNB will increase.

JEL classification: E5, K1

Keywords: credit claims, single list, assignment for security purposes.

## 1 Introduction

The ECB and the national central banks (NCBs) accept assets as collateral for monetary policy operations. This study takes the introduction of a “single list” of eligible collateral common to all Eurosystem credit operations as an opportunity to take a closer look at the use of credit claims as collateral. Counterparties must supply adequate collateral to the NCB conducting a credit operation<sup>2</sup> under an open market operation and or granting intraday credit.<sup>3</sup> Article 18 of the Statute of the ESCB/ECB requires all Eurosystem credit opera-

tions to be based on adequate collateral.<sup>4</sup> The single list is to be consulted on the securities eligible as collateral for euro area credit operations.

Under civil law, rights on an asset are either in rem – pertaining to the ownership of property and not based on any personal relationship – or personal. In rem collateral includes e.g. liens on tangible and intangible assets and collateral assigned for security purposes. In the event of insolvency of the debtor, in rem collateral gives the NCBs holding the collateral a preferential status vis-à-vis other creditors. Personal security includes

<sup>1</sup> The author thanks Susanne Steinacher and Thomas Wagner for their valuable comments and Renate Fatuly for her help constructing diagrams to explain the models.

<sup>2</sup> Open market operation: an operation executed on the initiative of a central bank in the financial market. Open market operations can be divided into four categories: main refinancing operations, longer-term refinancing operations, fine-tuning operations and structural operations. Reverse transactions are the main open market instrument of the Eurosystem.

<sup>3</sup> Intraday credit may be extended by central banks to even out mismatches in payment settlements and can take the form of: (1) a collateralized overdraft, or (2) a lending operation against a pledge or in a repurchase agreement (ECB, 2006).

<sup>4</sup> Article 18 of the Statute of ESCB and of the ECB: “In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may

- operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in Community or in non Community currencies, as well as precious metals;
- conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral.”

Refereed by:  
Gerhard Winkler, OeNB.

sureties, guarantees and joint and several liabilities.

Section 2 of this study outlines general aspects of monetary policy in the euro area, and changes to monetary policy operations following the extension of the single list to credit claims (debt obligations of a debtor vis-à-vis a Eurosystem counterparty) are analyzed in section 3. In a next step, the Correspondent Central Banking Model (CCBM), which is key to the cross-border use of credit claims, and the concept of the Assisting National Central Bank Model are presented. Subsequently, the concerns arising in connection with credit claims submitted as collateral are addressed in section 4 against the backdrop of the current provisions.

## 2 Implementation of the Single Monetary Policy in the Euro Area

One of the core tasks of the Eurosystem in Stage Three of Economic and Monetary Union (EMU) is the determination and implementation of the single monetary policy. The Eurosystem consists of the ECB and the NCBs of those EU Member States which have adopted the euro as the single currency in accordance with the Treaty establishing the European Community. Its decision-making bodies are the Executive Board of the ECB and the Governing Council, which in turn consists of the members of the Executive Board and of

the governors of the Eurosystem NCBs. The Governing Council has the central role of formulating the single monetary policy for the euro area and of establishing the necessary guidelines for their implementation.

By adopting an amending guideline<sup>5</sup> related to monetary policy implementation on August 31, 2006, the Governing Council introduced a single list of collateral in the monetary policy framework for the entire Eurosystem. This list now includes credit claims (i.e. bank loans to third-party debtors) as eligible collateral, meaning that counterparties of Eurosystem NCBs may submit credit claims as collateral for central bank credit. With the aims of protecting the Eurosystem from incurring losses in its monetary policy operations and of ensuring the equal treatment of counterparties, as well as of enhancing operational efficiency, underlying assets have to fulfill certain criteria.

### 2.1 General Documentation on Eurosystem Monetary Policy Instruments and Procedures

Since Slovenia's entry on January 1, 2007, the euro area has comprised Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Slovenia and Finland.<sup>6</sup> The document which is decisive for the conduct of the single monetary policy in these countries is the above-mentioned ECB guideline on monetary policy

<sup>5</sup> *Guideline of the ECB of 31 August 2006 amending Guideline ECB/2000/7 on monetary policy instruments and procedures of the Eurosystem (ECB/2006/12).*

<sup>6</sup> *The NCBs of those EU Member States which have not adopted the single currency in accordance with the Treaty retain their powers in the field of monetary policy according to national law and are thus not involved in the conduct of the single monetary policy. These Member States currently comprise Bulgaria, the Czech Republic, Denmark, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Romania, Slovakia, Sweden and the United Kingdom.*

instruments and procedures of the Eurosystem ECB/2006/12.<sup>7</sup> This guideline, which went into force two days after its adoption, comprises just four articles but an extensive annex,<sup>8</sup> which is the actual monetary policy framework and is entitled General Documentation on Eurosystem Monetary Policy Instruments and Procedures (referred to as General Documentation in brief). This annex, which the NCBs are obliged to implement, went into force on January 1, 2007. The guideline is applicable to euro area NCBs, which must implement the single monetary policy in line with its provisions. The OeNB implemented the amendment by changing the Terms and Conditions of the Oesterreichische Nationalbank Governing Monetary Policy Operations and Procedures<sup>9</sup> which have since been examined and verified by the ECB.

Because the General Documentation is the basis for the implementation of euro area monetary policy, it will be described briefly below. The document is divided into seven chapters. Chapter 1 gives an overview of the operational framework for the monetary policy of the Eurosystem. In Chapter 2, eligibility criteria for counterparties (banks) taking part in Eurosystem monetary policy operations are specified. Chapter 3 describes open market operations, while Chapter 4 presents the standing facilities<sup>10</sup> available to counterparties. Chapter 5 specifies procedures ap-

plied in the execution of monetary policy operations. In Chapter 6, the eligibility criteria for underlying assets in monetary policy operations are defined. Chapter 7 describes banks' obligation to hold minimum reserves with their NCBs.

Moreover, seven short annexes contain examples of monetary policy operations, a glossary, criteria for the selection of counterparties for Eurosystem foreign exchange intervention operations and for foreign exchange swaps<sup>11</sup> for monetary policy purposes, a presentation of the reporting framework for the money and banking statistics of the ECB, a list of the Eurosystem websites, and a description of the procedures and sanctions to be applied in the event of noncompliance with counterparty obligations.

Annex 7 – Creation of valid security over credit claims – is of particular interest, as it serves to reduce any risks of credit claims used as collateral for Eurosystem monetary policy operations. Numerous measures are cited as legal requirements to ensure that a valid security is created over a credit claim submitted as collateral. Before using a credit claim, NCBs are obliged to take various steps to verify the existence of a credit claim, including the quarterly self-certification by the counterparty to the NCB with respect to the existence of credit claims submitted. Moreover, NCBs, supervisors or external auditors must verify the procedures that counterparties use to submit the information

<sup>7</sup> OJ L 352 of 13 December 2006.

<sup>8</sup> The document is available on the ECB's website at [www.ecb.eu/pub/pdf/other/gendoc2006en.pdf](http://www.ecb.eu/pub/pdf/other/gendoc2006en.pdf)

<sup>9</sup> The amended Terms and Conditions of the Oesterreichische Nationalbank Governing Monetary Policy Operations and Procedures are available from the OeNB or at [www.oenb.at](http://www.oenb.at)

<sup>10</sup> Standing facility: a central bank facility available to counterparties at their own initiative (ECB, 2006).

<sup>11</sup> Foreign exchange swap: the simultaneous spot purchase/sale and forward sale/purchase of one currency against another (ECB, 2006).

on the existence of credit claims. Furthermore, there are provisions to ensure that the NCBs can swiftly realize the credit claims in the event of a counterparty default.

## 2.2 Key Changes since January 1, 2007

The single list of eligible collateral now serves as the basis for all Eurosystem credit operations (i.e. liquidity-providing monetary policy and intraday credit operations). In its press release of September 15, 2006, the ECB explained that it was replacing the two-tier collateral system that had been in place since the start of EMU by a single list for eligible collateral – with two distinct asset classes, marketable and nonmarketable assets – from January 1, 2007.<sup>12</sup> Marketable assets are basically securities traded on a capital market, whereas nonmarketable assets – e.g. banks' credit claims on their customers – have no comparable "market."

The Eurosystem adopted the original two-tier collateral framework to ensure a smooth transition to the euro. The eligible assets submitted as collateral by the NCBs' counterparties in the framework of monetary policy operations were divided into two tiers to accommodate differences in financial structures between Member States at the beginning of EMU. Tier one assets consisted of marketable assets that fulfilled euro-area wide eligibility criteria, while tier two assets comprised assets deemed of particular importance at the national level, for which specific eligibility criteria were established by the respective NCBs. Tier two assets were purely "national" securities that

could only be submitted as collateral for central bank credit operations to the NCB which had put the respective security on its list of eligible securities. Hence, tier two securities were not eligible throughout the Eurosystem. The OeNB had already accepted credit claims as collateral before the introduction of the single list, albeit at conditions that differ from those applicable under the new regime.

Tier two assets that do not qualify under the eligibility criteria for the single framework under the new guideline were phased out by May 31, 2007.

No distinction is made between marketable and nonmarketable assets with regard to the quality of the assets and their eligibility for the various types of Eurosystem monetary policy operations, except that nonmarketable assets are not used by the Eurosystem for outright transactions.

Since the beginning of 2007, all assets in the *single list* eligible for Eurosystem monetary policy operations may be used on a cross-border basis throughout the euro area. Before January 1, 2007, the cross-border use of bank loans was possible only in Germany, Ireland, Spain, France, the Netherlands and Austria, as only the NCBs of these countries had put them on their lists of tier two assets.

## 3 Credit Claims as Part of the Single List

In conducting a single monetary policy, in 2006 the ECB faced the difficult task of formulating a suitable framework for the national and cross-border use of credit claims applicable

<sup>12</sup> ECB press release of September 15, 2006, at [http://www.ecb.eu/press/pr/date/2006/html/pr060915\\_1.en.html](http://www.ecb.eu/press/pr/date/2006/html/pr060915_1.en.html)

to the entire euro area. For one thing, it had to meet the “adequate collateral” requirement of Article 18 of the Statute of the ESCB, and for another, it had to ensure that credit claims could be mobilized as collateral throughout the euro area. This is difficult with regard to bank loans, as full transfer of title (assignment)<sup>13</sup> – in particular restricted transactions in rem such as assignments for security purposes or pledges – are governed by different laws in different euro area member states. Some legal systems require notification of the third-party debtor for valid mobilization, others have a public register for credit claims which have been pledged or assigned and are therefore handled differently. Moreover, not all euro area countries have a legal system that recognizes assignments for security purposes. The mobilization of bank loans on a cross-border basis might be subject to different jurisdictions in different countries, and hence to conflict-of-law regimes (reference standards). As a consequence, legal problems might have to be resolved according to laws other than that of the country of origin of the bank loan. For instance, the debtor of the bank loan to be transferred may be resident of one country, the creditor of another country; moreover, the loan agreement may have been drawn up in yet another country or the guarantor may be established in another euro area country. In view of this complex legal situation, a viable framework had to be established to limit the risk involved in these different jurisdictions as much as possible.

A particular disadvantage for the euro area-wide use of credit claims as

collateral is that there is no harmonized Community law of obligations and no Community civil law. For example, the cost of collateralization (e.g. assignment for security purposes or pledge) might rise if for every assignment or pledge a legal opinion on the collateralization procedure or on possible conflict-of-law situations has to be drawn up.

### 3.1 Criteria Governing the Mobilization of Bank Loans

Against this background, the ECB established the following eligibility criteria for nonmarketable assets in Section 6.2.2 of the Annex to Guideline ECB/2006/12 in order to establish a uniform euro area-wide legal framework for the use of such eligible assets, to the extent that this is possible. The OeNB has implemented these eligibility criteria in Article 21 of the Terms and Conditions Governing Monetary Policy Operations and Procedures; they are presented in table 1.

Let us take a closer look at the last item in table 1. Unlike the provisions applicable before January 1, 2007, under which the credit claim agreement had been governed by the law of the country of the correspondent central bank (section 3.3.1) and the third-party debtor also had to be established in the country of the correspondent central bank, the only condition applicable under the new regime is that no more than two jurisdictions apply to the transaction. This easing naturally increases the number of credit claims potentially eligible as collateral. Since January 1, 2007, counterparties have been allowed to submit bank loans under the jurisdic-

<sup>13</sup> An assignment is the transfer of a receivable from one creditor to another without changing its content. The creditor changes, whereas the claim itself and the debtor do not.

Table 1

### Eligibility Criteria for Nonmarketable Assets/Credit Claims

|  |  |
|--|--|
| Type of asset:   | Credit claim   |
| Type of debtor/guarantor:  | Public sector entities, nonfinancial corporations, international or supranational institutions   |
| Place of establishment of the debtor/guarantor:  | Euro area (exception: international or supranational organizations)  |
| Currency:  | Euro   |
| Minimum size at the time of submission for use as collateral from January 1, 2007 to December 31, 2011: <sup>1</sup> | <ul style="list-style-type: none"> <li>– Domestic use: NCBs determine minimum size (in Austria: minimum size threshold of EUR 50,000 at the time of first submission)</li> <li>– Cross-border use: EUR 500,000</li> </ul>  |
| Governing laws applicable to the credit claim agreement and its mobilization:  | <p>The credit claim agreement and the agreement between the counterparty and the NCB mobilizing the credit claim as collateral (“mobilization agreement”) must both be governed by the law of a Member State belonging to the euro area.</p> <p>The total number of different governing laws that are applicable to the counterparty, the creditor, the debtor, the guarantor (if relevant), the credit claim agreement and the mobilization agreement may not exceed two.</p> |

Source: ECB.

<sup>1</sup> As from January 1, 2012, a common minimum threshold of EUR 500,000 will be applicable to all credit claims throughout the euro area.

tion of the country of the NCB conducting a credit operation, with *one* element of the transaction under the jurisdiction of another euro area country. As a case in point, an Austrian counterparty may submit a bank loan governed by Austrian law as collateral even though the third-party debtor or the guarantor is established in Italy. However, it is not possible that the counterparty (and thus the Home Central Bank – HCB) is established in country A, the credit claim agreement is governed by the law of country B and the third-party debtor (and thus the Correspondent Central Bank – CCB) is established in country C. The relevant asset is not eligible as collateral, as the jurisdictions of three countries are involved.

Whereas prior to January 1, 2007, third-party debtors were required to be enterprises and the remaining life of the Austrian credit claim submitted as collateral was not allowed to

exceed two years, this requirement was dropped in the OeNB’s Terms and Conditions Governing Monetary Policy Operations and Procedures as amended from January 1, 2007, which is in line with the intention of Guideline ECB/2006/12.<sup>14</sup> Credit claims that have become eligible under the new regime may have as their debtor a public sector entity (federal, regional or local government) or an international or supranational institution (such as the United Nations). This extension makes credit claims more attractive as collateral for central bank credit operations. However, the condition that eligible credit claims taken in by the OeNB must have a minimum residual maturity of ten days (Article 21(8) Terms and Conditions of the Oesterreichische Nationalbank Governing Monetary Policy Procedures) has remained unchanged.

<sup>14</sup> Article 21(1) and (3) of the Terms and Conditions of the Oesterreichische Nationalbank Governing Monetary Policy Operations and Procedures as amended until January 1, 2007.

To ensure that marketable and nonmarketable assets comply with the same high credit standards, a Eurosystem credit assessment framework (ECAAF) has been set up, which relies on four different credit assessment sources:<sup>15</sup> (1) NCBs' in-house credit assessment systems (ICASs), (2) external credit assessment institutions (ECAIs), (3) counterparties' internal ratings-based (IRB) systems, or (4) third-party providers' rating tools (RTs).

The OeNB offers an ICAS. Under Article 23(7) of the OeNB's Terms and Conditions Governing Monetary Policy Operations and Procedures, counterparties may select one system from among the available credit sources, which they must keep for a minimum period of one year (Article 23(7) lit. b). After this period, a

counterparty that wishes to change credit assessment sources must submit a reasoned request to the OeNB. Article 23(7) lit. f of the OeNB's Terms and Conditions Governing Monetary Policy Operations and Procedures defines the special provisions applicable to the assessment of a public sector debtors or guarantors.

### 3.2 Overview of the Legal Situation in the Case of Domestic Mobilization of Credit Claims

Although the administrative burden is higher for mobilizing a credit claim than for using securities as collateral for central bank credit, the described changes in the eligibility criteria have certainly contributed to the rise in the amount of bank loans submitted to the OeNB as collateral in exchange for central bank liquidity.

Box 1

#### Assignment for Security Purposes Defined

*Koziol and Welser (2006) provide the following explanation of assignment for security purposes: A debtor may use claims against borrowers as the basis for obtaining credit himself by assigning such claims as collateral. Assignment for security purposes is tantamount to establishing a trust for own benefit.<sup>1</sup> The assignee acquires a claim on the debtor of the assigned claim (debtor cessus, third-party debtor) under the obligation that he collect the debt and satisfy his claim only if his assignor is in default.<sup>2</sup> As the objectives of assignments for security purposes are the same as those of pledges over loan claims, the disclosure provisions applicable to pledges (liens) apply to assignments for security purposes mutatis mutandis. These disclosure requirements include notification of the debtor cessus (third-party debtor) or book entry in the accounting records of the assignor. This allows third parties who check the accounting records to determine if and when there has been a subrogation. Assignments of which third-party debtors are not notified are referred to as undisclosed assignments. Their purpose is to preclude any doubts about the economic viability of the assignor.*

<sup>1</sup> Trust is a fiduciary relationship in which rights are assigned to a trustee – a person (or institution) to whom legal title to property is entrusted to use for another's benefit – that the trustee exercises in his own name as agreed and as bound by his relationship to the trustor – an individual who establishes a trust by giving property to a trustee for the benefit of another. (Translated and paraphrased from Koziol and Welser, 2006, Vol. I, p. 218).

<sup>2</sup> However, in his relationships with third parties, the assignee has full rights to the entrusted property; these are not infringed if the assignor defaults on his debt. The assignee is entitled to assert the claim assigned to him for security purposes; within the bankruptcy proceedings, he may only assert preferential rights ("Absonderungsgläubiger"), though, pursuant to Article 10 paragraph 3 Bankruptcy Act. However, once he has reassigned his claim to the assignor for collection, he may assert rights of separation and recovery ("Aussonderungsrecht").

<sup>15</sup> All permissible credit assessment sources are available on the ECB's website ([www.ecb.eu/paym/coll/eliss/html/index.en.html](http://www.ecb.eu/paym/coll/eliss/html/index.en.html)).

Therefore, Article 22 of the OeNB's Terms and Conditions Governing Monetary Policy Operations obligates counterparties to identify claims assigned as collateral in their books. Moreover, the OeNB has the right to inform third-party debtors about collateral assignments at any time. Once the third-party debtor has gained knowledge of the assignment for security purposes, it may repay its bank loan, i.e. discharge its debt, only to the OeNB (the new creditor).

Article 30 of the OeNB's Terms and Conditions Governing Monetary Operations and Procedures provides for out-of-court realization of credit claims in the event of insolvency and in other cases in line with the unconditional preferential right of the OeNB under Article 77 of the Federal Act on the Oesterreichische Nationalbank.<sup>16</sup> In the event of default<sup>17</sup> (such as the insolvency of a counterparty), the OeNB has the right, without consulting the counterparty or involving the courts, to sell any or all of the assets assigned as collateral or pledged, or to buy the assets and to credit any amounts exceeding the loan receivables including penalty interest to the counterparty's settlement account. An out-of-court realization is more advantageous for the OeNB, as it requires no court proceedings that could incur high costs and the outcome of which may be uncertain. In the event of default, the OeNB has the right – but not the obligation – to immediately sell the credit claim assigned. It could also wait until the

third-party debtor has repaid the bank loan to the OeNB (the creditor).

### 3.3 Cross-Border Use of Credit Claims

#### 3.3.1 Correspondent Central Banking Model

The Correspondent Central Banking Model (CCBM) has been in place since Stage Three of EMU, but has rarely been used for credit claims. The CCBM serves to transfer cross-border collateral in Eurosystem monetary policy and intraday credit operations. The use of the CCBM ensures that the principle enshrined in the Annex to Guideline ECB/2006/12 that all eligible collateral – including credit claims, which are comparatively complex in legal and administrative terms – may be used on a cross-border basis. However, the cross-border use of collateral does not entitle domestic counterparties to remote access to a foreign NCB. An Austrian counterparty can conduct monetary policy transactions with no NCB other than the OeNB; it may not transact directly e.g. with the Banca d'Italia just because it wishes to use a credit claim subject to Italian law as collateral.

Under the CCBM, NCBs act as custodians (“correspondents”) for each other in respect of assets accepted in their local depository or settlement system. An ESCB agreement governs the distribution of tasks between the refinancing NCB (home NCB – HCB) and the correspondent central bank (CCB), which acts as the

<sup>16</sup> Article 77, Federal Act on the Oesterreichische Nationalbank: “The Bank shall have an unconditional preferential right to use any monies, bills of exchange or other valuables or stores of value in its possession in settlement of its own claims or as collateral for such claims.”

<sup>17</sup> Article 52 of the OeNB's Terms and Conditions Governing Monetary Policy Operations lists the events of default.

### The Correspondent Central Banking Model: An Example



Source: OeNB.

home central bank's local representative. The CCB is always the NCB of the country to whose jurisdiction the credit agreement is subject. The main task of the CCB is to settle collateralization transactions, which may take the form of an assignment, pledge or assignment for security purposes. It is assumed that the process of assignment (mobilization) of collateral is governed by the law of the CCB. The relevant provisions and procedures are detailed in Additional Terms and Conditions of NCBs applicable to their activity as CCBs. If the OeNB acts as a CCB, foreign counterparties must observe both the Terms and Conditions of their HCB and the Additional Terms and Conditions of the OeNB.<sup>18</sup> Securities submitted by counterparties are taken in custody by the CCB on behalf and for the account of the HCB. The counterparties contact the CCB via the HCB as soon as the latter signals its agreement with the cross-border transac-

tion. Every euro area country has a different procedure for realization of collateral (in insolvency proceedings or otherwise). The rapid and simple realization of collateral as provided for by Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements is not applicable to credit claims, because no harmonization has taken place in this area yet (section 4).

Chart 1 shows an example of the cross-border use by an Austrian counterparty of a credit claim under Italian jurisdiction. The Austrian counterparty pledges this "Italian" credit claim to the Banca d'Italia, as the OeNB's correspondent, according to Italian law as collateral for central bank credit from the OeNB.

Table 2 provides an overview of the different legal instruments the NCBs offer as correspondent central banks for the collateralization of bank loans.

<sup>18</sup> The Additional Terms and Conditions of the OeNB are available at the OeNB's website at [www.oenb.at/de/img/ergaenzende\\_geschaeftsbestimmungen\\_tcm14-49980.pdf](http://www.oenb.at/de/img/ergaenzende_geschaeftsbestimmungen_tcm14-49980.pdf) (in German).

Table 2

### Overview of Euro Area Collateralization Instruments

| National Central Banks                                   | Collateralization Instruments Offered       |
|--|---|
| National Bank van België/Banque Nationale de Belgique    | pledge                                      |
| Deutsche Bundesbank                                      | assignment                                  |
| Banco de España  | pledge                                      |
| Bank of Greece   | pledge                                      |
| Banque de France   | assignment                                  |
| Central Bank and Financial Services Authority of Ireland | floating charge                             |
| Banca d'Italia   | pledge                                      |
| Banque centrale du Luxembourg                            | pledge                                      |
| De Nederlandsche Bank                                    | pledge                                      |
| OeNB   | assignment for security purposes and pledge |
| Banco de Portugal  | pledge                                      |
| Suomen Pankki – Finlands Bank                            | pledge                                      |
| Banka Slovenije  | pledge and assignment                       |

Source: ECB, OeNB.

The ECB Annual Report 2006 notes that the CCBM accounted for 39.7% of the total collateral provided to the Eurosystem in 2006. Assets held in custody through the CCBM increased from EUR 353 billion at the end of 2005 to EUR 414 billion at the end of 2006. As credit claims are hardly mobilized on a cross-border basis, as already indicated, these values refer primarily to marketable securities, but they also evidence the progress in euro area financial market integration and the growing importance of the CCBM.

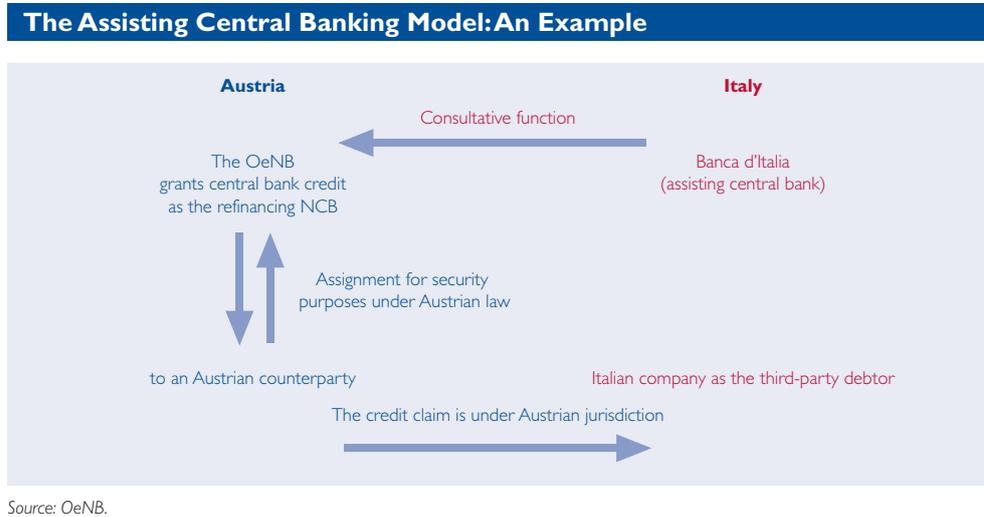
#### 3.3.2 Assisting Central Bank Model

Since January 1, 2007, euro area counterparties have been able to use the Assisting Central Bank Model in addition to the CCBM; in this model, an NCB plays the role of an assisting central bank for the refinancing NCB. This model is used when a credit claim eligible as collateral is subject to the jurisdiction of the country in which the refinancing NCB is located

and the debtor or the guarantor of this claim is located in another country. In such a case, the NCB of the latter country assists the refinancing NCB as a contact or consultant and provides its support in the collateralization of the central bank credit. This could be especially important if the collateral is to be realized.

The following example shows the involvement of an assisting central bank: In a reverse transaction, an Austrian counterparty submits a credit claim for collateralization purposes to the OeNB. This credit claim is subject to Austrian law and is a claim on a company registered in Italy. The only cross-border link in this case is the Italian third-party debtor. In this example, the Banca d'Italia plays the assisting central bank role. As both the credit agreement and the collateralization procedure (e.g. assignment for security purposes) are governed by Austrian law, the probability that a conflict-of-law standard under international private law<sup>19</sup> be-

<sup>19</sup> International private law (IPR) pertains to conflict-of-law regimes; its provisions are conflict-of-law rules (= reference standards). The underlying notion is that a conflict arises as to which of the national legal systems involved in a cross-border case is in fact applicable. IPR solves this problem by determining the applicable legal system (Schwimann, 1999).



comes applicable is decidedly lower than in the case of the CCBM. Here, it is unlikely that legal issues arise that require a response under the Italian legal system. Hence, this model will be easier to apply in practice than the CCBM.

Chart 2 illustrates the example of the cross-border mobilization of a credit claim using the assisting central bank model. It should be added that in this case there is no link between the Banca d'Italia and the third-party debtor, an Italian company.

#### 4 Summary and Outlook

As the EU has only a very restricted competence for the harmonization of private law issues, it began to issue directives on the settlement of transactions with financial instruments and their use as collateral for transactions only fairly recently. Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in pay-

ment and securities settlement systems represented a first important harmonization step.<sup>20</sup> Pursuant to Article 9(1) of this directive, the rights of the NCBs and the ECB to collateral security provided to them are not affected by insolvency proceedings against the counterparty which submitted the collateral to the respective NCB. This provision entitles the NCBs to a preferential right to satisfaction in the event that the counterparty becomes insolvent.<sup>21</sup>

Once Directive 98/26/EC had been issued, the development to harmonize financial law issues gained momentum, leading to the adoption of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.<sup>22</sup> The aim of this directive is to harmonize the financial collateral arrangements and to allow for rapid and unbureaucratic realization of specific financial instruments. The directive does not explicitly deal with the use of credit claims as eligi-

<sup>20</sup> OJ L 166 of 11 June 1998.

<sup>21</sup> *Right of separation and recovery.*

<sup>22</sup> OJ L 168 of 27 June 2002.

ble collateral, which is why the legal provisions governing collateralization and the enforcement of credit claims may differ from country to country.

As Ludwigs (2006) notes, the harmonization of obligations through EU Directives spans a steadily growing number of individual issues. Up to now, the Community legislature has pursued a selective approach by adopting directives on specific agreements<sup>23</sup> or marketing techniques,<sup>24</sup> in particular pertaining to consumer contract law, where the need for harmonization was determined to be especially pressing. The lack of an overarching concept integrating each of the Community harmonization measures has attracted criticism for some time now. In response, the European Parliament has called for greater harmonization of civil law. Because the principles of conferral and subsidiarity apply in the EU, no general solution for civil law issues as a whole could be found yet.

The provision on which the principle of conferral is based is to be found in Article 5 of the Treaty (establishing the European Community): “The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein.” Accordingly, the Community’s competence extends only to those areas explicitly conferred upon its bodies in the Treaty. As a matter of principle, this rules out activities by the

Community only the basis of the objectives and tasks of the Treaty alone. As the Community treaties do not provide for EU-wide harmonization of the law of obligations and of civil law, the European Commission cannot of its own accord undertake any large-scale harmonization.

With regard to credit claims, the European Commission proposes an extension of the scope of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements to include certain credit claims that have been eligible as collateral for Eurosystem credit operations from January 1, 2007.<sup>25</sup> Currently, this directive covers only cash collateral (i.e. holdings on accounts), but not banknotes or financial instruments such as stocks and equivalent securities. However, implementing the proposed amendment gives rise to numerous questions, as the creation of valid security (e.g. through assignment for security purposes) is subject to different provisions in different countries. It will not be simple to introduce a uniform procedure across the EU. Principally, the European Commission considers that the extension of the scope of Directive 2002/47/EC will increase the liquidity of EU financial markets and is therefore open to further developments in this direction. The introduction on January 1, 2007, of the single list for eligible collateral common to

<sup>23</sup> See Council Directive 90/314/EEC on package travel, package holidays and package tours (OJ L 158 of 23 June 1990), or Directive 1999/44/EC of the European Parliament and of the Council on certain aspects of the sale of consumer goods and associated guarantees (OJ L 171 of 7 July 1999).

<sup>24</sup> See Directive 85/577/EEC Council Directive 85/577/EEC to protect the consumer in respect of contracts negotiated away from business premises (OJ L 372 of 31 December 1985) or Directive 97/7/EC of the European Parliament and of the Council on the protection of consumers in respect of distance contracts (OJ L 144 of 4 June 1997).

<sup>25</sup> See <http://europa.eu/rapid>, reference IR/07/22, of 9 January 2007. The report of the European Commission is available at [http://ec.europa.eu/internal\\_market/financial-markets/collateral/index\\_en.htm](http://ec.europa.eu/internal_market/financial-markets/collateral/index_en.htm)

all Eurosystem credit operations represented an important step toward this aim.

Since that date, euro area counterparties have been able to submit credit claims (bank loans) to the NCBs as collateral for central bank credit as long as the securities used meet the underlying eligibility criteria. By introducing the single list, the ECB has substantially extended the range of credit claims eligible as collateral for central bank credit. In the single list, for example, credit claims that have links to a second country – e.g. because the third-party debtor or the guarantor is established abroad –

may be deemed eligible. Since uniform conditions apply throughout the euro area, it is likely that both the national and the cross-border use of credit claims as collateral for central bank credit will increase. By introducing the single list, the ECB has contributed to raising the efficiency and strengthening the integration of euro area financial markets. It will be especially interesting to observe whether counterparties' tendency to restructure their collateral accounts to include more credit claims will grow and how much of a liquidity-enhancing effect the strategic optimization of their collateral will have.

## References

- ECB. 1992.** Protocol on the Statute of the European System of Central Banks and of the European Central Bank (Statute of the ESCB). Official Journal.
- ECB. 2006.** The Implementation of Monetary Policy in the Euro Area: General Documentation on Eurosystem Monetary Policy Instruments and Procedures. Frankfurt/Main. September.
- ECB. 2006.** Guideline of the European Central Bank of 1 August 2006 amending Guideline ECB/2000/7 on Monetary Policy Instruments and Procedures of the Eurosystem (ECB/2006/12). Official Journal.
- ECB. 2007.** Annual Report 2006. Frankfurt/Main.
- Financial Market Authority (FMA) and OeNB. 2004.** Techniken der Kreditrisikominderung. Guidelines on Credit Risk. Vienna.
- Koziol, H. and R. Welser. 2006.** Grundriss des bürgerlichen Rechts. Band I und II. Vienna: Manz.
- Löber, K. 2006.** The Developing EU Legal Framework for Clearing and Settlement of Financial Instruments. In: Legal Working Paper Series 1. Frankfurt/Main: ECB.
- Ludwigs, M. 2006.** Europarecht. Heft 3. Harmonisierung des Schuldvertragsrechts in Europa – Zur Reichweite der gemeinschaftsrechtlichen Zuständigkeit für eine Europäisierung des Privatrechts. Bonn.
- OeNB. 2006.** Federal Act on the Oesterreichische Nationalbank 1984. May 17, 2006. Vienna.
- OeNB. 2007.** Additional Terms and Conditions of Oesterreichische Nationalbank (OeNB), when acting as Correspondent Central Bank (CCB). As at January 1, 2007. Vienna.
- OeNB. 2007.** Terms and Conditions of the Oesterreichische Nationalbank Governing Monetary Policy Operations and Procedures. January 1, 2007. Vienna.
- Smits, R. 1999.** Kommentar zum EU-/EG-Vertrag. Art. 102a–136a EG-V. In: Groeben-Thiesing-Ehlermann (ed.). Vol. 3. 5<sup>th</sup> edition. Baden-Baden: Nomos Verlagsgesellschaft.
- Schwimmann, M. 1999.** Internationales Privatrecht. Vienna: Manz.
- Thun-Hohenstein, C., F. Cede and G. Hafner. 2005.** Europarecht. 5<sup>th</sup> edition. Vienna: Manz.