Financial regulation: 2002 Q2

1. INTRODUCTION

Very few financial provisions were enacted in 2002 Q2.

Two Banco de España circulars were published. The first one amends the law governing the Central Credit Register (CIR), extending the use of telematic means to all communications and incorporating new techniques and treatments, in order to improve the information and access to it. In the second one, the Banco de España establishes new statistics on interest rates applied to deposits and loans vis-à-vis households and non-financial corporations, to comply with the Community information requirements in this field.

The European Central Bank (ECB) published a regulation amending the law on minimum reserve requirements in order to update its articles and adapt it to the latest Community provisions in the area.

Finally, a Community directive was published which establishes the regime applicable to financial collateral arrangements that satisfy certain requirements. Also, it aligns and simplifies the administrative formalities for financial collateral in the European Union.

2. MODIFICATION OF THE LAW GOVERNING THE CENTRAL CREDIT REGISTER

The CIR was set up by the Banco de España to receive the compulsory declarations relating to certain direct and indirect credits extended by reporting institutions to their customers. At first, the obligation to report applied to deposit money institutions, official credit entities (including the Official Credit Institute), mutual guarantee companies, the *sociedad de garantías subsidiarias* (subsidiary guarantee company) and the *sociedad mixta del segundo aval* (mixed-capital second guarantee company).

Subsequently, Banco de España Circular (CBE) 18/1983 of 30 December 1983 (1) fundamentally reformed the instructions that regulated the CIR, enabling its content to be better exploited for supervisory and statistical purposes. Among other matters, this reform extended the obligation to report to the Banco de España itself and to deposit guarantee funds, and extended the range of borrowers

(1) See "Regulación financiera: cuarto trimestre de 1983", in *Boletín económico,* Banco de España, January 1984, pp. 37-38.

and the characteristics of the credit that must be declared.

Some years later, under the powers granted to the Banco de España by Law 26/1988 of 29 July 1998 (2) on the discipline and intervention of credit institutions, CBE 7/1989 of 24 February 1989 added specialised credit institutions (mortgage loan companies, finance companies and financial lease companies) to the list of reporting institutions, leaving the basic aspects of the previous circular unchanged.

Subsequent changes in the financial system (in particular those affecting certain financial institutions) and in other economic sectors made a general revision of the CIR regulation desirable. This was carried out by means of CBE 3/1995 of 25 September 1995 (3).

Recently, the Banco de España has published *CBE 3/2002 of 25 June 2002* (BOE of 2 July 2002), which amends CBE 3/1995. It modernises the CIR, incorporating new techniques and treatments in order to enhance its quality, both as regards the quantity and quality of the information and its timeliness and the means of accessing it.

Among these modernisations, two technical ones should be noted: the use of telematic means for all communications and the coding of non-resident borrowers, in order to overcome the deficient functioning of their current coding.

In the past, data were submitted on magnetic media or through computer links, and exceptionally (with justification) declarations could be submitted on forms supplied by the Directorate Documentation and Central Credit Register. From the entry into force of the circular, the data shall be submitted by telematic transmission, in accordance with the technical specifications notified for the purpose by the Banco de España, although exceptionally, and with justification in each case, they may be sent on magnetic media, with the prior agreement of the Directorate Documentation and Central Credit Register.

The circular will enter into force on 1 November 2002, and the first declaration to be submitted by the institutions, in accordance with its provisions, shall relate to data for 30 November 2002.

(2) See "Regulación financiera: tercer trimestre de 1988", in *Boletín económico,* Banco de España, October 1988, pp. 56- 58.

(3) See "Regulación financiera: cuarto trimestre de 1995", in *Boletín económico,* Banco de España, January 1996, pp. 82-83.

3. STATISTICS ON THE INTEREST RATES APPLIED TO DEPOSITS AND LOANS VIS-À-VIS HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS

The Statute of the European System of Central Banks and of the ECB provides that, in order to undertake the tasks of the European System of Central Banks, the ECB, assisted by the national central banks, shall collect the necessary statistical information either from the competent national authorities or directly from economic agents. By virtue thereof, and pursuant to the authorisation contained in Council Regulation (EC) No 2533/1998 of 23 November 1998 (4) concerning the collection of statistical information by the ECB, the ECB has enacted Regulation (EC) No 63/2002 of 20 December 2001 concerning statistics on interest rates applied by monetary financial institutions to deposits and loans vis-à-vis households and non-financial corporations ("the Regulation").

The Banco de España, pursuant to the Order of 12 December 1989 (5) concerning the interest rates and commissions, rules of behaviour, information to customers and advertising of credit institutions, which implemented the provisions of article 48, 2 of Law 26/1988 of 29 July 1988 on the discipline and intervention of credit institutions, has proceeded to comply with the Regulation by publishing *CBE 4/2002 of 25 June 2002* (BOE of 2 July 2002) concerning statistics on interest rates applied to deposits and loans vis-à-vis households and non-financial corporations.

To minimise the cost to credit institutions of collecting the new statistics, the Banco de España has decided to use the possibility offered by the Regulation of requesting information on interest rates from a sample of institutions whose data are considered representative of those of the population as a whole.

Accordingly, this Circular shall apply to Spanish credit institutions and the branches in Spain of foreign credit institutions ("the reporting institutions") which, as at 31 March 2002 have, as part of the registered business of their branches operating in Spain (business in Spain), euro-denominated deposits or loans vis-à-vis households (including non-profit institutions serving households) and non-financial corporations resident in Spain or in any other Member State participating in the economic and

(4) See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, p. 78.

(5) See "Regulación financiera: cuarto trimestre de 1990", in *Boletín económico,* Banco de España, January 1989, p. 35.

monetary union amounting to €500 million or more. The Banco de España may, nonetheless, require other institutions and branches with deposits or loans below this level to send the statements referred to below, whenever it considers necessary to ensure that the sample is sufficiently representative.

The reporting institutions shall submit monthly to the Banco de España (Directorate Documentation and Central Credit Register), during the first 15 days of the following month (or in Madrid on the first business day following the first 15 days of the month, if the 15th day is a non-business day in that locality), two statements, one relating to the interest rates on outstanding amounts and the other relating to new business during the relevant monthly period. The interest rate that they must declare for each category of instrument shall be the weighted arithmetic mean of their narrowly defined effective rates (NDER), which shall be deemed to be the interest rate component of the annual percentage rate of charge (APRC) defined in rule eight of Circular 8/1990 of 7 September 1990 on transparency of transactions and customer protection, i.e. without including commissions and other charges. In addition, the statement of interest rates on new business shall also specify the weighted arithmetic mean of the APRC on loans other than by overdraft.

The information in the statements required by this Circular is that laid down as compulsory in the Regulation, with just two additions: the first one corresponds to repurchase agreements, broken down between households and non-financial corporations, and the second one to the APRC applied to new business, i.e, housing loans, consumer credit and the main loan types.

To facilitate the preparation of these statements, the Circular, besides establishing general criteria, specifies those that shall apply to the main transactions conducted in Spain.

Finally, Circular 8/1990 of 7 September 1990 on the transparency of transactions and customer protection has been amended, pursuant to the Order of 12 December 1989. The present interest rate statements have been replaced by a new statement that shall be submitted by banks, savings banks (including the Spanish Confederation of Savings Banks) and the branches in Spain of foreign credit institutions, which shall include, exclusively, information on the weighted arithmetic mean of the APRC on certain euro-denominated transactions conducted in Spain with the private sector resident in Spain, which have been entered into or renewed in the previous month, to enable the Banco de España to prepare and publish the mortgage market benchmark indices.

The new statements shall be presented for the first time in February 2003 with data relating to January 2003. Also, in order to ensure a sufficient run of data based on the new statistics the Circular provides that before the current statistics are abolished, both shall co-exist during 2003 Q1.

4. EUROPEAN CENTRAL BANK: CHANGES TO RESERVE REQUIREMENTS

The Statute of the ESCB and of the European Central Bank (ECB) authorised the Governing Council of the latter to define the minimum reserves that the credit institutions of the Member States would be required to hold. Council Regulation (EC) No 2531/98 of 23 November 1998 (6) laid down the general principles, basic aspects and limits to the reserves, which were subsequently implemented by Regulation (EC) No 2818/98 of the ECB of 1 December 1998 (7) on the application of minimum reserves, in order that they should enter into force at the start of Stage Three of EMU.

Recently, Regulation (EC) No 690/2002 of the ECB (OJ L 106, 23.4.2002) amending Regulation (EC) No 2818/98 has been published, in order to incorporate into the provisions of the latter a number of changes, as well as the new features introduced in the latest Community legislation in this area.

First, the reference to the definition of credit institutions established in Regulation 2818/98 has been changed in order to bring electronic money institutions within its scope, and thus ensure that they are obliged to hold minimum reserves.

Second, under Regulation 2818/98, the ECB was able to exempt from reserve requirements, on a non-discriminatory basis, institutions subject to winding-up proceedings. This provision has now been widened to establish as a general rule that, without being under any obligation to submit any request, an institution shall be exempt from reserve requirements from the start of the maintenance period within which its authorisation is withdrawn or renounced, or within which a decision to submit the institution to winding-up proceedings is taken by a judicial

(6) See "Financial regulation: fourth quarter 1998", in Economic bulletin, *Banco de España,* January 1999, pp. 76-77.

(7) See previous footnote.

authority or any other competent authority of a participating Member State.

Third, the new Regulation expressly states that institutions shall be required to include any liabilities they may have vis-à-vis a branch of the same entity, or vis-à-vis the head office or registered office of the same entity, which are located outside participating Member States.

Finally, the formula for calculating the remuneration of holdings of required reserves has been changed slightly, to take into account the fact that the Eurosystem may, on occasions, conduct main refinancing operations with different maturities simultaneously.

The changes to the reserve requirements entered into force in the Member States in May 2002.

5. DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON FINANCIAL COLLATERAL ARRANGEMENTS

Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems was a decisive step in the establishment of a solid legal framework for payment and securities settlement systems. In its Communication of 11 May 1999 to the European Parliament and the Council on financial services, entitled "Implementing the framework for financial markets: action plan", the Commission, after consulting market experts and national authorities, undertook to prepare new legislative proposals on financial collateral, to move forward from Directive 98/26/EC.

Recently, Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (OJ L 168, 27.6.2002) has been published The Directive establishes, within the European legal context, a Community regime applicable to financial collateral arrangements (8) that satisfy certain requirements and to financial collateral in accordance with the conditions set out in the Directive.

This Directive applies to financial collateral once it has been provided and if that provision can be evidenced in writing. The evidencing of the provision of financial collateral must allow for the identification of the financial collateral to which it applies. For this purpose, it is sufficient to prove that the book entry securities collateral has been credited to, or forms a credit in, the relevant account and that the cash collateral has been credited to, or forms a credit in, a designated account. The financial collateral to be provided must consist of cash or financial instruments (9).

Member States may exclude from the scope of this Directive financial collateral consisting of the collateral provider's own shares, shares in affiliated undertakings and shares in undertakings whose exclusive purpose is to own means of production that are essential for the collateral provider's business or to own real property.

Another requirement for the Directive to apply is that the collateral taker and the collateral provider must each belong to one of the following categories:

a) A public authority, including public sector bodies of Member States charged with or intervening in the management of public debt, and public sector bodies of Member States authorised to hold accounts for customers.

b) A central bank, the European Central Bank, the Bank for International Settlements, a multilateral development bank as defined in Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, the International Monetary Fund and the European Investment Bank.

c) A financial institution subject to prudential supervision including: a credit institution, an investment firm, a financial institution, an insur-

(8) For the purpose of this Directive, "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. Also, "title transfer financial collateral arrangement" means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations, and "security financial collateral arrangement" means 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.

(9) In this Directive, "financial instruments" are deemed to be shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital market, and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment), including units in collective investment undertakings, money market instruments and claims relating to or rights in or in respect of any of the foregoing.

ance undertaking, an undertaking for collective investment in transferable securities (UCITS) and an UCITS management company.

d) A central counterparty, settlement agent or clearing house, as defined in Directive 98/26/EC, including similar institutions regulated under national law acting in the futures, options and derivatives markets to the extent not covered by that Directive, and a person, other than a natural person, who acts in a trust or representative capacity on behalf of any one or more persons that includes any bondholders or holders of other forms of securitised debt.

e) A person other than a natural person, including unincorporated firms and partnerships.

In order to improve the legal certainty of financial collateral arrangements, Member States should ensure that certain provisions of insolvency law do not apply to such arrangements, in particular, those that would inhibit the effective realisation of financial collateral or cast doubt on the validity of current techniques such as bilateral close-out netting, the provision of additional collateral in the form of top-up collateral and substitution of collateral.

The Directive seeks to limit the administrative burdens for parties using financial collateral so that the only perfection requirement which national law may impose in respect of financial collateral should be that 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 of a person acting on the collateral taker's behalf while not excluding collateral techniques where the collateral provider is allowed to substitute collateral or to withdraw excess collateral. The Member States shall not require that the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement, or the provision of financial collateral under a financial collateral arrangement, be made dependent on the performance of any formal act. If they make use of this option Member States shall inform the Commission which shall inform the other Member States thereof.

The simplification of the use of financial collateral through the limitation of administrative burdens promotes the efficiency of the cross-border operations of the ECB and the national central banks of Member States participating in the economic and monetary union, necessary for the implementation of the common monetary policy. Furthermore, the provision of limited protection of financial collateral arrangements from some rules of insolvency law in addition supports the wider aspect of the common monetary policy, where the participants in the money market balance the overall amount of liquidity in the market among themselves, by cross-border transactions backed by collateral.

The Directive protects the enforceability of bilateral close-out netting, not only as an enforcement mechanism for title transfer financial collateral arrangements including repurchase agreements but more widely, where close-out netting forms part of a financial collateral arrangement. Sound risk management practices commonly used in the financial market should be protected by enabling participants to manage and reduce their credit exposures arising from all kinds of financial transactions on a net basis, where the credit exposure is calculated by combining the estimated current exposures under all outstanding transactions with a counterparty, setting off reciprocal items to produce a single aggregated amount that is compared with the current value of the collateral.

The Directive provides for rapid and non-formalistic enforcement procedures in order to safeguard financial stability and limit contagion effects in case of a default of a party to a financial collateral arrangement. However, the Directive balances the latter objectives with the protection of the collateral provider and third parties by explicitly confirming the possibility for Member States to keep or introduce in their national legislation an a posteriori control which the Courts can exercise in relation to the realisation or valuation of financial collateral and the calculation of the relevant financial obligations. Such control should allow for the judicial authorities to verify that the realisation or valuation has been conducted in a commercially reasonable manner. It also provides for a right of use in case of security financial collateral arrangements, which increases liquidity in the financial market stemming from such reuse of "pledged" securities. This reuse however should be without prejudice to national legislation about separation of assets and unfair treatment of creditors.

Finally, the Commission shall present a report to the European Parliament and the Council on the application of this Directive not later than 27 December 2006, accompanied where appropriate by proposals for its revision.

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 27 December 2003 at the latest, and shall forthwith inform the Commission thereof.

4.07.2002.