Uniform Law Review, 2022, **00**, 1–12
https://doi.org/10.1093/ulr/unac025
Article

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The EU financial collateral directive: the distinguishing features of a security financial collateral arrangement?

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Abstract

The first part of this article considers whether a system-neutral meaning of a title transfer financial collateral arrangement (TTFSA) can be identified in the EU Collateral Directive. This part looks at a similar issue—it considers whether system-neutral meaning of a security financial collateral arrangement (SFCA) can be identified in the Financial Collateral Arrangement Directive. It is argued that the definition of a SFCA in the Directive is based on the assumption that there is a specific organizing principle or concept that makes it easy to clearly identify, and demarcate, SFCAs from other types of security arrangements (particularly TTFCAs). While this assumption fits well within the model of Civil law systems, which may have a clear concept of 'security right', it does not fit in well within the common law. The arguments in this article call for a careful approach in the system-neutral definition of a SFCA in the Directive.

I. The functional method and Collateral Directive

In the first article,[1] it was noted that European Union (EU) directives adopt a functional approach. First, they define legal institutions in a purposive, result-oriented way. Second, they operate on the assumption that implementing laws in Member States are functionally equivalent.[2] Third, it is presumed that concepts in directives are formulated with the assumption that they are 'system-neutral' (or not doctrinal).[3]

As observed,[4] the legal structure of the EU makes it necessary to define legal institutions in a system-neutral way since the various Member States have different doctrinal structures. As such, to define a legal institution in a doctrinal or contextual way may potentially remove it from some domestic legislative framework. However, to test this assumption, this article will explore the meaning of a security financial collateral arrangement (SFCA) in the

[1] Obiora Ezike, 'Identifying a System-Neutral Meaning of a Title Transfer Financial Collateral Arrangement in the Financial Collateral Directive' (2021) 26 Uniform Law Review 554 <https://doi.org/10.1093/ulr/unab023> last accessed 2 February 2022.
[2] Ralf Michaels, 'The Functional Method of Comparative Law' in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (OUP 2006) 377.
[3] ibid. Although Michaels does not use the word 'system-neutral', he argues that directives are not doctrinal.
[4] Ezike (n 1) 555.

Collateral Directive,[5] to identify if a stable meaning can be found that can then be used to identify functionally equivalent institutions in some systems. We will consider this question from the civil and common law traditions.[6]

In relation to the common law aspects, particularly under English law,[7] although the United Kingdom has pulled out of the EU, the comparison with English law remains relevant.[8] First, the Collateral Directive remains as retained EU law in the United Kingdom by virtue of its implementation. Therefore, any discussion on the Directive is still of relevance to understanding the UK implementing legislation. Second, the European Commission recently closed a consultation for the review of the Collateral Directive.[9] Future developments in this area may be of interest to the United Kingdom if regulatory alignment or equivalence is intended. Also, the issues raised in the article relate to broader issues dealing with the system-neutral approaches to EU law harmonization. Therefore, the issues discussed in this article still have some relevance pertaining to the EU integration exercise.

II. Title transfer financial collateral arrangements and SFCAs in the collateral directive

As discussed,[10] the Collateral Directive was therefore enacted primarily to stop Member States from recharacterizing a title transfer financial collateral arrangement (TTFCA)—that is, to legitimize the arrangement[11] and to disapply restrictions that applied to it.[12] Importantly, this core objective is dependent on the concept of a TTFCA,[13] which is defined in Article 2 of the Directive as 'an arrangement, including a repurchase agreement, under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral for the purpose of securing or otherwise covering the performance of relevant financial obligations'.

However, it is instructive to note that the Collateral Directive is structured in a way that contrasts a TTFCA from another security arrangement—that is, a SFCA. A classic example of a SFCA, in English law, is a security right, such as a charge. In civil law, a classic example will be a 'pledge'. The Directive therefore contrasts a TTFCA and a SFCA in the assumption that the arrangements are different and thus ought to be recognized by the Member States as giving rise to different legal consequences. In contrast to a TTFCA, a SFCA is defined under the Directive as 'an arrangement under which the collateral provider provides financial collateral by way of security to or in favour of the collateral taker, and where the full or

[5] Council Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements [2002] OJ L168/43 (Collateral Directive). This has been amended by: a) Directive 2009/44/ EC amending Directive 98/26/EC on Settlement Finality in payment in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims [2009] OJ L146/37); and b) Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

[6] I will consider the civil law tradition from different angles, i.e., from the perspective of both Scots property law and Dutch law. Scots property law is primarily based on civil law. This is one key characteristic which makes Scotland a 'Mixed Legal System'.

[7] I emphasize 'English law' here rather than UK law because Scots property law is based on civil law. I will use Scots property law to access the broader civil law tradition. John MacLeod, 'Thirty Years After: The Concept of Security Revisited' in Andrew Steven, Ross Anderson and John MacLeod (eds), *Nothing So Practical as a Good Theory: Festschrift For George Gretton* (Avizandum Publishing Ltd 2017) 177–193.

[8] European Union (Withdrawal) Act 2018, ss 2, 3, 6.

[9] 'Targeted Consultation on the review of the Directive on financial collateral arrangements' <https://ec.europa.eu/info/consultations/finance-2021-financial-collateral-review_en> last accessed 10 March 2021.

[10] Ezike (n 1) 558.

[11] George Gretton, 'Financial Collateral and the Fundamentals of Secured Transactions' (2006) 10 Edin LR 209, 211. Gretton argues that a better name for the Directive may be the 'Repo Protection Directive'. A repo, or repurchase agreement, is an example of a TTFCA. Gretton argues that the Directive was enacted to apply a uniform rule in the European repo market by requiring Member States to recognise the terms of repos, instead of striking them down. However, other examples of a TTFCA besides repos are securities lending transactions and collateral provided as credit support within the context of derivatives.

[12] Some of the restrictions relate to publicity, some insolvency provisions, the prohibition against enforcement through appropriation, etc.

[13] This definition has been considered in an earlier article: Ezike (n 1).

qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established'. Two phrases are key to the definition of SFCA—that is, 'provides by way of security' and where the 'full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral taker'.

The difference between a TTFCA and a SFCA is not the function that they perform: they both provide collateral for the purpose of securing an obligation, as can be seen from the above definition and the detailed argument in the first article. The difference, rather, is the way in which the collateral is provided. In a TTFCA, the provision of collateral is done by a transfer of full ownership, as seen above. On the contrary, in a SFCA, the Directive states that the provision of collateral is done 'by way of security'. Importantly, the Directive further provides that in a SFCA, the collateral provider retains ownership after such provision of collateral by way of security.

The question then arises as to how to arrive at a system-neutral definition of a SFCA based on the drafting of the Directive. This question is particularly pertinent since the Directive applies to a wide range of legal systems, and the presumption is that this definition should have certain stable characteristics that mean it is able to identify a SFCA using those stable characteristics. As will be demonstrated below, because the first element above ('by way of security') provides little guidance on the meaning of a SFCA, the second requirement on ownership retention becomes useful.

III. SFCA as 'by way of security' and ownership retention

As noted, the Collateral Directive defines a SFCA as an arrangement under which the collateral provider provides financial collateral by way of security to or in favour of the collateral taker and where the full or qualified ownership remains in the collateral provider. The presence of the conjunction 'and' in the definition that links these two requirements implies that both requirements are necessary to identify a SFCA.

However, there are ambiguities that arise from separating these two elements, especially in the light of the conjunction 'and'. The inclusion of this conjunction implies that it is possible to have the two elements separately—that is, to have a provision 'by way of security' but where the full ownership does not remain with the collateral provider. This further implies that there can be provision 'by way of security', which is not a SFCA, because the collateral provider does not retain ownership. However, if retention of ownership is a necessary feature of 'by way of security', the second requirement ought to be redundant. Underlying the above analysis is the question: what does it mean to provide collateral 'by way of security' since the issue has consequences for whether the second requirement above is redundant.

1. 'By way of security' as system dependent?

The phrase 'by way of security' is not defined in the Collateral Directive. On the surface, based on the drafting of the Directive, the phrase suggests that a SFCA performs a security function. However, as earlier noted, a TTFCA is defined by the Directive in a similar way as a device that is used to secure an obligation. Thus, because the Directive treats the two devices as conceptually different, the expectation is that the phrase 'by way of security' should imply something more than a device performing a security function. However, because of the lack of detail in the Directive regarding the phrase, the second requirement on ownership retention, as will be seen below, becomes a useful guide in directly (as seen with Thomas Keijser) or indirectly (as seen with John MacLeod and George Gretton)[14] identifying what a SFCA is.

[14] Both MacLeod and Gretton write on what constitutes a security right as opposed to 'by way of security'. However, as discussed below, the phrase 'by way of security' presupposes a concept of security for which they both write on.

As discussed below, the different translations of the Directive, especially the German version, reflect some contextual uniqueness of a SFCA. As mentioned, the English version of the Directive uses the term 'by way of security' in defining a SFCA. However, this phrase is not different from the definition of a TTFCA, which is defined in a similar way. The English version of the Directive therefore makes it difficult to determine the difference between both transactions and what amounts to a SFCA.

The French and German versions also provide different definitions of a SFCA. The French version defines it thus:

> [C]ontrat de garantie financière avec constitution de sûreté', un contrat par lequel le constituant fournit au preneur, ou en faveur de celui-ci, la garantie financière sous la forme d'une sûreté, et où le constituant conserve la pleine propriété ou la propriété restreinte de cette garantie financière, ou le droit intégral à cette dernière, lorsque le droit afférent à cette sûreté est établi.

The German version, on the other hand, defines it as:

> Finanzsicherheit in Form eines beschränkten dinglichen Rechts' ist ein Sicherungsrecht an einem Finanzaktivum durch einen Sicherungsgeber, wobei das volle oder bedingte/beschränkte Eigentum oder die Inhaberschaft an der Sicherheit zum Zeitpunkt der Bestellung beim Sicherungsgeber verbleibt.

Unlike the English version, which uses the phrase 'by way of security', the French version uses a different terminology: '*d'une sûreté*', which loosely translates to 'security interest' or simply a security. However, like the English version, this provides little guidance, since a TTFCA also performs a security function, as already noted. Importantly, the German version, on the other hand, uses the term '*beschränkten dinglichen Rechts*', which translates to a 'limited real right'.[15] This presupposes a subordinate real right derived from ownership.

From a functional perspective, since each version of the Collateral Directive is to have the same effect in each system, regardless of the language, this implies that the German or French or English versions respectively apply in the same way in each system. While both the French and English versions provide little explanation, the German version provides that the phrase represents a 'limited real right', which is akin to a subordinate real right in civil law systems or a security interest in English law. Therefore, unlike the English version, which is wide enough to cover a TTFCA, the German phrase is suggestive of a 'limited real right' in financial collateral. Essentially, the German version, since it offers a more useful guide, can be used to understand what the English version means as the institutions are presupposed to be functionally equivalent.[16]

A 'limited real right' presupposes a property right derived from ownership. In many civil law systems, these may be a right of easement or usufruct or a security right. Under these devices, a right is created that is subordinated to the ownership right. The important question is: how can a system-neutral concept of a security right be identified, as presupposed by the Directive?

What amounts to a right in security is very controversial.[17] There is a controversy regarding the functional or formal approach in characterizing security rights and the policy

[15] Translation obtained from: George Gretton, 'Ownership and Its Objects' (2007) 71 Rabels Zeitschrift für ausländisches und internationales Privatrecht 802, 828.

[16] Under German law, there cannot be real right over incorporeals. However, an exception to this rule is security rights over incorporeals. ibid 820.

[17] There are debates about the two broad approaches (functional and formal): for example, see the old debate between Allan and Goode: David Allan, 'Security: Some Mysteries, Myths and Monstrosities' (1989) 12 Monash ULR 337; Roy Goode, 'Security: A Pragmatic Conceptualist Response' (1989) 15 Monash ULR 361.

choices regarding the suitable option to adopt. Importantly, these controversies suggest that there is no uniform rule on the concept of a security. What amounts to a security device, and the organizing principles on which this concept is based, may be dependent on each individual system. However, in all European legal systems, there is a category of devices called 'rights in security' existing in different forms. In many civil law systems, there is the right of pledge, which may be taken over both corporeal[18] and incorporeal[19] property, although Scots law, influenced by the Civilian tradition, is yet to introduce such a device for incorporeal movables, or intangible assets.[20] In civil law, there is also the *hypothec*,[21] which may be taken over immovable property.[22] In Scotland, such a security right is called a standard security.[23]

In the civil law tradition, there is a debate about what constitutes a security right.[24] In his discussion on Dutch and German law, Keijser argues that a right in security shares functional features. According to him, these features are the accessory relationship between the right of pledge and the secured debt;[25] a duty of care on the collateral taker to take care of the asset and not to deal with it in a way contrary to the security right; the right of redemption on the collateral provider to call for a return of the assets; a right to sell the collateral upon default by the collateral provider; and restrictions on the collateral taker from appropriating the assets upon default.[26]

However, MacLeod has argued that it is not fruitful to argue in terms of these effects or what the right-holder can do but, rather, the reasons why the right-holder can exercise those rights. According to him, the 'essence of the right in security. . .is its purpose'.[27] It is this purpose that brings together the many rules and the effects that govern a right in security.[28] MacLeod accepts the wider European tradition that a security right has the purpose of appropriation for security or to secure an entitlement only in order that another right will be satisfied.[29] Thus, a right in security finds its fulfilment not in itself, but towards the satisfaction of another right (debt).[30] Thus, in MacLeod's view, understanding a right in security as such explains some of the rules connected with it, such as the accessoriness principle seen above in Keijser's position. In this regard, MacLeod argues that if some value can be obtained from the secured asset without any

And there are also debates about the boundaries of the concept, what it captures and what it does not, and its requirements. On Scots law, see Gretton, 'The Concept of Security' (n 712); John MacLeod, 'Thirty Years After: The Concept of Security Revisited' in Andrew Steven, Ross Anderson and John MacLeod (eds), *Nothing So Practical as a Good Theory: Festschrift For George Gretton* (Avizandum Publishing Ltd 2017) 177.

[18] § 1204 BGB for German law; Article 3:227 of the Dutch Civil Code for Dutch Law; Article 2333 for the French Civil Code. There is also an equivalent institution in Scots and English law characterized as the pledge; for Scots law, see David Carey-Miller, *Corporeal Moveables in Scots Law* (2nd edn, W Green 2005) para 11.04-11–12; for English law, see Hugh Beale and others, *The Law of Security and Title-Based Financing* (3rd edn, Oxford University Press 2018) para 5.01-5.61.

[19] For incorporeal property such as claims or choses in action: see Article 2355 French Civil Code; Article 3:94 for Dutch Civil Code; § 1273 BGB for the German Civil Code which applies by analogy the rules applicable to the pledge of corporeal to the pledge of incorporeal property.

[20] The Scottish Law Commission recommends that a pledge be introduced for such incorporeal property. See the Scottish Law Commission *Report on Moveable Transactions*, Vol 3 (and s. 43 of the Draft Bill on Movable Transactions).

[21] See § 1113 BGB for German law; Article 2393 of the French Civil Code; Article 3:227 for the Dutch Civil Code.

[22] Sjef van Erp and Bram Akkermans (eds), *Cases, Materials and Text on Property Law* (Hart Publishing 2012) 536.

[23] See Conveyancing and Feudal Reform (Scotland) Act 1970 (as amended), s 9.

[24] For some brief historical comments on Scots law (which forms part of the Civil Law tradition), see MacLeod (n 7) 177–93. There are different positions in Scots law, some of which align more or less with the European tradition. For example, see MacLeod's comments on Forbes (in Scots law) and the similarity between Forbes and Windscheid at page 185 of MacLeod's article.

[25] This has the effect that the right ceases to exist once the secured debt is paid off.

[26] Thomas Keijser, *Financial Collateral Arrangements: The European Collateral Directive Considered from a Property and Insolvency Law Perspective* (Kluwer 2006) 97–100. Keijser also identifies other features, such as the survival of the right even when it is vested in a successor.

[27] MacLeod (n 7) 185.

[28] ibid 185,189.

[29] ibid 185–6.

[30] ibid 192.

reference to the debt, then the right is not a right in security but is more akin to a use-right defined by what the holder of the right can do rather than what the right is for.[31]

MacLeod's purposive approach, which is civil law based, is not necessarily at variance with Gretton's definition of a proper security, which was examined in detail in the first part of this article.[32] According to Gretton, a right in security refers to a 'real right in the property of another person which secures the performance of an obligation'.[33] Expanding on this definition, Gretton argues that a right in security has certain characteristics: first, the collateral in question belongs to another person other than the creditor; second, the security exists only in relation to a secured obligation—that is, it is an accessory right that follows the debt; third, when the right is realized, it produces money to fulfil a money obligation.

Importantly, a key factor for a right in security, according to Gretton, is that it creates a second (limited) real right (or right *in rem*) in the asset, in addition to the real right of ownership that the debtor retains in the asset. This means that there are two real rights (or rights *in rem*) in the asset: the subordinate real right[34] and the right of ownership.

Both Gretton and Keijser's above positions can be accommodated within the purposive approach advocated by MacLeod. MacLeod's approach finds an organizing principle around which the rules that are ascribed to a right in security (such as the publicity rules or restraint on the use of the burdened property by the collateral taker) are based. Thus, these rules are carved out by the law in reaction to the purpose of the institution, just as the rules on transfer are carved out by the law in response to the purpose served by that institution. The approach also offers some explanatory basis for why rights in security, according to Gretton, may be described as a 'real right in the property of another person' (in effect, giving rise to an additional real right).[35] Thus, the purpose of the additional real right is to secure a debt in the debtor's property.

The Collateral Directive, as earlier suggested, prescribes two requirements in identifying a SFCA: first, the collateral must be provided by way of security and, second, the collateral provider must retain ownership of the collateral. These requirements are not outwith MacLeod's purposive above approach. As noted, the purpose of a right in security is to satisfy another right. For this purpose, the right therefore merely burdens the right of the collateral provider. Since this is its key quality, it means the collateral provider necessarily retains ownership of the property. In other words, the retention of ownership requirement, in the Directive, as a separate element, is redundant.

As earlier highlighted, the conjunction 'and' in the Directive suggests that there can be provision 'by way of security' that is not a SFCA because, for example, ownership is not retained by the collateral provider. However, as the above analysis suggests, provided the secured assets are the debtor's,[36] retention of ownership by the collateral provider is a necessary feature of a right in security, allowing such rules as the accessory principle to apply. The 'and' in the Directive is therefore, as already suggested, unnecessary since provision 'by way of security' implies that ownership remains with the collateral provider, based on MacLeod's account.

MacLeod's purposive approach therefore draws a conceptual distinction between a right in security and a transfer, which accords with the distinction between a SCFA and a TTFCA, as endorsed by the Directive. According to MacLeod, satisfaction of the right is the

[31] ibid 189.
[32] Ezike (n 1) 568–70.
[33] Gretton, 'The Concept of Security' (n 17) 127.
[34] The subordinate real right or limited real right is not totally synonymous with the idea of security interest in English law. This is because, as discussed below, there are security interests in English law which operate as a transfer (that is, a legal mortgage). However, there are similarities between the two concepts.
[35] See Alisdair MacPherson, 'Registration of Companies Charges Revisited: New and Familiar Problems' (2019) 23 Edin LR 154 (footnote 40 in his article). He notes that rights in security in Scots law require the grant of a real right.
[36] A right in security may burden property belonging to another party, who may grant the security in favour of the debtor.

law's purpose in recognizing a right in security (that is, a SFCA); while, in a transfer, satisfaction of the right is the parties' purpose in employing it (TTFCA). For functional securities, particularly *fiducia cum creditore*, which is a transfer, MacLeod suggests that they are not rights in security since it is the parties who repurpose the institution in satisfaction of an obligation. Such an institution is not a right in security but a transfer, and this explains the rules that the law has designed for such devices—that is, recharacterizing such institutions as a security right. The primary reason why the law does this is because the parties (not the law) have repurposed the transaction to satisfy a debt or a right.

However, it may be argued that the gap between a right in security and a transfer is not always clearly demarcated. There are institutions that operate as transfers, but which the law deems to exist for the purpose of the satisfaction of another right. Around this purpose, the law applies the traditional rules applicable to rights in security to such institutions. Examples of such institutions are the legal mortgage under English law or the *fiducia cum creditore* under pre-1992 Dutch law,[37] which have both been examined in detail in the first article.[38] These institutions are strictly transfers, but the law (pre-1992 Dutch and English law) treats the institution as giving rise to a security. What this implies is that there may be multiple types of transfer, with different purposes recognized by the law. It is therefore questionable if there is indeed a clear difference between the law's purpose for rights in security proper and the law's purpose for such transfers. Both institutions can be said to revolve around the same organizing principle.

The above suggests that MacLeod's purposive approach may be restrictive in terms of identifying a system-neutral meaning of a right in security. As noted above, he defines a right in security in terms of the law's purpose in recognizing the right. However, the approach begs the question: whose purpose? The law's purpose may differ from system to system (as seen in the case of the legal mortgage above), and it may be difficult to identify one single purpose that can cut across different systems. It may therefore be fruitful to discuss in terms of the law's purpose when a system-dependent approach is taken.[39]

The above analysis has implications for the Collateral Directive. As mentioned, the Directive suggests that ownership retention is a marker for a SFCA. However, as discussed above, this may not be the case, especially in the case of a legal mortgage that operates by way of transfer of 'ownership'.[40] Thus, although ownership retention may be a necessary marker for what constitutes a 'limited real right' in many civil law systems, the peculiar nature of ownership in English law and the legal mortgage means that a security right can arise even where ownership is supposedly transferred (not retained).[41]

The above analysis suggests that what amounts to 'by way of security', at the level of the Directive, is system dependent. MacLeod's purposive approach, which strongly tallies with the provisions of the Directive, may well be founded in many civil law systems where there is a clear technical demarcation between a transfer and a right in security because of the civil

[37] Erp and Akkermans (n 22) 518; Bram Akkermans, *The Principle of Numerus Clausus in European Property Law* (Intersentia 2008) 186–90. In a *fiducia cum creditore*, ownership is transferred for a security purpose. Many Civil law legal systems treat a *fiducia cum creditore* differently from a simple transfer not made for a security purpose. In Netherlands, a *fiducia cum creditore* is completely prohibited. In Belgium, it is a valid transfer but does not have any third-party effects. German law treats it like other transfers but subject to restrictions — for example, during insolvency, the arrangement is treated as a pledge, with the effect that the assets are still within the transferor's patrimony. Scots law recognises it as a valid transfer, although it is subject to the publicity requirement under Part 25, Companies Act 2006 as a charge.

[38] See particularly the pages mentioned where the argument was made that a legal mortgage and a fiducia cum creditore are equivalent institutions. Ezike (n 1) 571–82.

[39] MacLeod writes from the perspective of Scots property law, which is Civilian, therefore the above inadequacy may be justified on that basis.

[40] A legal mortgage operates by way of a transfer in English law.

[41] See the discussion in the first article, where it was argued that a legal mortgage is conceptually a transfer of full title. There is controversy about the nature of the equity of redemption regarding whether it is a personal or proprietary right. Ezike (n 1) 576–80.

law's *a priori* approach, which defines concepts in terms of specific categories. However, it is questionable if this sharp boundary operates in English law.

In English law, it is controversial whether or not there is a concept of security. If indeed there is one, this ought to have been identified, most especially in a notable text by Roy Goode and Louise Gullifer, where there is a discussion on the 'concept of security'.[42] However, both authors define a security right based on its effects, similar to Keijser, above. According to Goode and Gullifer, certain legal features need to be present to identify a security right in the Common law: first, the right ought to be a right granted by a collateral provider to a collateral taker; second, the right is by way of a grant, not by reservation; third, it is given for the purpose of securing an obligation; fourth, the asset is given by way of security, not by an outright transfer; and, fifth, the agreement restricts the debtor's right to dispose of the asset.[43] Goode and Gullifer argue that it is on these principles that English law identifies the four types of security rights—that is, the pledge,[44] the lien, the charge, and the mortgage. However, as seen below, McCormack suggests that, while these particular effects may be easy to state, they are often difficult to identify.[45]

McCormack defines a security right in English law as a right over property that is intended to ensure the performance of some obligation.[46] This definition is not different from the definition of Hugh Beale, who similarly defines a security right as a right *in rem* granted by the owner of the property to a creditor to secure an obligation defeasible upon the performance of the obligation.[47] However, these definitions define security in terms of its economic function and thus do not clearly demarcate a TTFCA and a SFCA, as earlier observed, since both perform the same economic function.

Because of the difficulty in identifying a concept of security in English law, it has been suggested that there is 'no clear touchstone by which it can necessarily and inevitably be said that' a security interest has been created in English law.[48] This is because the particular incidences of security rights are not easily ascertainable. However, in *Re George Inglefield*,[49] the Court identified certain features of a security right in English law. According to the Court, the collateral provider in a security device will have the right to a redelivery of the assets upon payment of the debt. Second, the collateral taker is under an obligation to account for any surplus after realizing the assets. Third, the collateral taker can still go after the collateral provider where there is a shortfall after the realization of the assets.

However, these elements offer 'very little' help to the problem.[50] Some of the incidences may be replicated in transactions that are not security devices. For instance, in *Alderson v White*,[51] the Court held that 'an absolute conveyance containing nothing to show that the relation of debtor and creditor is to exist between the parties does not cease to be an absolute conveyance and merely become a mortgage merely because the vendor stipulates that he shall have a right to repurchase'. Furthermore, the presence of a right of recourse in a factoring or discount agreement does not make the transaction a charge. The fact that the transferee can make adjustments and payments to the transferor after the debts have been

[42] See Louise Gullifer (ed), *Goode and Gullifer on Legal Problems of Credit and Security* (6th edn, Sweet & Maxwell Ltd 2017) ch 2 para 1.17 titled 'Concept of Security'. The phrase 'concept of security' suggests a concept which can be found in the disparate security institutions existing in English law.

[43] ibid 1.17.

[44] Which is the functional equivalent of the Civil law pledge over tangible assets.

[45] Gerard McCormack, *Registration of Company Charges* (3rd edn, Jordan Publishing Limited 2009) 13; see also *Re Cosslett (Contractors) Ltd* (1997) 4 AllER 115, 125.

[46] McCormack (n 45) 1.

[47] Beale and others (n 18) para 4.06.

[48] *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148, 161.

[49] [1933] Ch 1.

[50] Fidelis Oditah, 'Financing Trade Credit: *Welsh Development Agency v Exfinco*' [1992] JBL 541, 546.

[51] *Alderson v White* (1858) 2 G J 97, 106.

paid by the debtors does not prevent the transaction from being by way of an outright title transfer.[52]

The above discussion on English law suggests that English law does not have a single concept of security. Rather, it has specific institutions (that is, the pledge, the lien, the charge, and the mortgage) that serve security functions. The English courts play an active part in how devices fall within these institutions. This is based on historical factors dealing with the way legal principles develop organically through the courts and the lack of *a priori* conceptualization of legal concepts. This is exacerbated by the fact that there is no legislation that provides rules on this issue.

A question arises: if there is no concept of security, on what concept or concepts are the specific security institutions in English law founded? MacLeod's purposive approach offers an answer to this. In identifying the law's purpose for a security right, MacLeod, referring to Neil MacCormick's *Institutions of Law*, distinguishes, on the one hand, between a collective action that is highly institutionalized, from which a purpose can be 'easily determined', and, on the other hand, some form of collective action, such as a spontaneous queue, which has no direct institutional framework but is still intelligible in terms of ends or purposes.[53] MacLeod, using this illustration as a metaphor, points out that Scots common law exists somewhere on the spectrum between a highly institutionalized collective action and more spontaneous activities.[54] They have clear rules about the decisions that are significant. The subjects on whom it is binding apply them with reference to the existing body of law. The rules are expanded upon to attend to the ends of the relevant area of law.[55]

English law's approach to security devices can be described as developing in a similar way to Scots common law: there are rules about the decisions that matter, as seen in the criteria set by the court in *Re George Inglefield*. Parties apply these rules with reference to existing security devices. But it is difficult to clearly identify a specific institutionalized concept(s) that brings together all of these security devices. Therefore, it is the lack of a specific organizing principle that makes it difficult to clearly demarcate transfers from security rights in English law, in the way presupposed by the Directive.

It is therefore not surprising that, in contrast to the English law approach, the approach taken by the Directive, as earlier argued, aligns more with MacLeod's highly institutionalized collective action, which resembles the *a priori* approach in the civil law, from which a clear purpose can be determined. Thus, as earlier argued, the definition of a SFCA presupposes that there is a clear conceptual demarcation between a transfer (TTFCA) and a security right (SFCA). However, as argued, this may not be the case in specific reference to a legal mortgage and *fiducia cum creditore* under Dutch law before 1992. Essentially, these discussions suggest that what amounts to 'by way of security' is system dependent. However, in the section below, Keijser's attempt to identify a system-neutral definition of security based on the two functions of recoverability and tradability will be analysed.

2. SFCA as 'no tradability' function

MacLeod's above account takes Scots law (and, broadly, the civil law) as a starting point for what amounts to a right in security (and, indirectly, a SFCA). Keijser, on the other hand, attempts to identify what distinguishes a TTFCA from a SFCA by extrapolating some broad principles without reference to any system, although he does this with reference to a TTFCA. However, as discussed below, although his definition offers some good indicators to identify a SFCA, Keijser's account is not grounded on the definition of a SFCA in the Directive.

[52] *Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd* (1979) 129 NLJ 366.

[53] MacLeod (n 7) 188. His view is influenced by MacCormick's theory on legal institutions. See footnotes 50 and 51 in MacLeod's article; Neil MacCormick, *Institutions of Law: An Essay in Legal Theory* (Oxford University Press 2007) 13–16, 834.

[54] MacLeod (n 8) 188.

[55] ibid.

As seen in the first article,[56] Keijser argues that financial collateral performs two functions, —that is, recovery and tradability functions.[57] First, it performs a recovery function for recourse purposes. In this regard, it is an asset that may be used in the event that the collateral provider defaults. Keijser further argues that financial collateral also performs a tradability function. In this sense, it can be used for further trading.[58] Keijser argues that it is the tradability function that distinguishes a TTFCA from a security right. Therefore, security interests (SFCA) only have a recovery function. The secured party cannot dispose of the secured assets except when a default has occurred.[59]

It is important to note that Keijser's position is based on his broad perspective of how financial collateral operates in the financial market. He seems to take the above qualities as common and the distinguishing features of a SFCA and a TTFCA.[60] Thus, his analysis suggests that the above distinguishing features may broadly be used to identify the difference between a TTFCA and a SFCA. Therefore, his account is substantially based on market practice rather than being exclusively centred on the Directive.

As Keijser suggests, because it is only a TTFCA that performs a tradability function (that is, a right to use the assets), this means that a SFCA is an arrangement that does not perform a tradability function: only a TTFCA performs that function. By implication, a SFCA is an arrangement that is not a TTFCA or, rather, an arrangement that performs only a recovery function. However, it cannot be defined on the basis that it is an arrangement that simply performs a recovery function since both a TTFCA and a SFCA perform a recovery function. The suggestion here is that a SFCA is defined by Keijser negatively as an arrangement that is not a TTFCA.

The tradability function is deemed to arise because the arrangement is a transfer, and it is this feature that distinguishes a TTFCA from a SFCA. This point is endorsed by the Collateral Directive, which differentiates both a TTFCA and a SFCA on the basis that, in a SFCA, ownership remains with the collateral taker. This is the reason why the tradability function does not arise in a SFCA. Therefore, although Keijser's account on tradability is mainly focused on a TTFCA, his analysis also shows—though indirectly like MacLeod's, above—the importance of the second requirement in the Directive on ownership retention to a SFCA. The second requirement will thus appear to be a key requirement in identifying a SFCA.

As noted, the effect of Keijser's analysis is to provide a negative definition of a SFCA. The pitfall in this is that it does not provide any positive content. However, Keijser's definition, as well as the scope of application of the Collateral Directive, is helpful in identifying a SFCA. First, the Directive applies only to interest in financial collateral, which is intangible

[56] Ezike (n 2) 560.

[57] Recovery function means that the financial collateral is used by the collateral taker to safeguard against the collateral provider's default. Primarily, TTFCAs are used for 'recourse' reasons. On the other hand, the tradability function primarily refers to the right of the collateral taker to use the collateral. In legal terms, the right refers generally to the unlimited right of the collateral taker to dispose of the collateral or create a further security right for his own benefit in the collateral. See Keijser (n 26) 16–9; Philip Wood, *Comparative Law of Security Interest and Title Finance* (2nd edn, Sweet & Maxwell Ltd 2007) 673–5, 684; Joanna Benjamin, *Interests in Securities: A Proprietary Law Analysis of the International Securities Markets* (Oxford University Press 2000) para 6.10-13; Edward Murray, 'Financial Collateral and the Financial Markets' in Frederique Dahan (ed), *Research Handbook on Secured Financing in Commercial Transactions* (Edward Elgar 2015) 158, 163. Erica Johansson, 'Reuse of Financial Collateral Revisited' in Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues* (Hart Publishing 2010) 153.

[58] Keijser (n 26) 16–18.

[59] It is important to note that under Article 5 of the Collateral Directive, a right of use may be associated with a SFCA. One of the implications of this right is that a collateral taker is vested with the general right to dispose of the collateral during the subsistence of the arrangement. There are debates, both in English law and Civil law, about how this aligns with the residual rights (described as the equity of redemption in English law) of a debtor in a security right. See the detailed discussion on both the English and Civil law aspects in Keijser (n 26), chapter IV. The analysis in this article does not cover this provision in the Collateral Directive or the issues that might arise in conceptualising the right of use within a SFCA.

[60] This analysis is contained in chapter two of his book on how financial collateral work in the financial markets.

property in English law or *incorporeals moveables* in civil law systems. This restricts the scope of the type of devices that apply to such objects. In most system, a secured creditor may take a pledge or a charge, therefore excluding quasi-security devices such as a personal guarantee. Second, a SFCA, as Keijser opines, performs only a recovery function. One objection to this view is that a device, such as a personal guarantee, performs a recovery function and may thus be characterized as a SFCA. However, this may not matter within the context of Keijser's analysis. As noted, the Directive applies only to arrangements dealing with the 'provision' of financial collateral. Therefore, the object of the arrangement is financial collateral, which must be provided by way of a grant or a transfer to the collateral taker. Although a personal guarantee gives the creditor an additional right against the guarantor in respect of the secured obligation, there is no provision (by way of a grant) of financial collateral, and neither does it relate to an interest in collateral. It is merely an unsecured promise to perform an obligation where the debtor fails to act. Consequently, Keijser's recovery functions may be helpful in identifying a SFCA because of the external parameters regarding the legal acts to constitute a SFCA in the Directive.

Additionally, Keijser's analysis also requires a consideration of whether an arrangement performs a tradability function—which is a function performed by a TTFCA. As noted above, the scope of Collateral Directive (that is, provision of financial collateral) helps to narrow the choice of devices that may apply where the device does not perform a tradability function. In many civil law systems, this leaves an option of a pledge. In English law, this will be a mortgage or charge, which are all security rights in respect of incorporeal moveables or intangible property. As mentioned, applying Keijser's two functions aids in the identification of the institution in question.

However, it may be argued that, since Keijser's account does not give us a positive content to work with, it is dependent on the system to provide such a positive content. Thus, because Keijser's account only indicates what a SFCA is not, a system invariably can only evaluate its own institutions against these conditions to determine if any device satisfies the threshold. Ultimately, any institution that falls within this category must be one provided by the system and is system-dependent. The system plays an active role in the definition of the positive part of such an institution.

Two observations can be expressed regarding this: on one hand, it will seem that what amounts to 'by way of security' is system dependent. However, this observation may be facile since, as suggested, there are indications from the foregoing discussions that there are indeed functional similarities in how systems approach the issue. Thus, a comparative functional approach requires, as Keijser does, that we look specifically at the practical effects of the phrase 'by way of security' to identify the key institutions in Member States. Obviously, asking such questions directs attention towards practical effects of the right/concepts, which appear to be equivalent in most systems: first, both Keijser and Goode agree that a security right is accessory: it follows the principal obligation. Although systems will normally describe this effect using different terminologies, what that presupposes is that the security rights are not outright transfers. Second, both Goode and Keijser also seem to agree that the collateral provider has a right to redeem the collateral. As a corollary of this right, this implies that the collateral taker cannot deal with the assets. Do these functional similarities suggest that a system-neutral meaning of a SFCA can be identified?

Two counter-arguments can be made. First, if institutions are defined by their specific effects, nothing stops us from using not just effects that are similar, but those effects that are different in arriving at a system-neutral meaning. For example, MacLeod notes that, even within legal systems, different types of security devices may have different effects. For example, the holder of a pledge in civil law is entitled to possess before the debtor's default but cannot realize the asset after default. This contrasts with the holder of a standard security over immoveable property or heritable property, in Scots law, who has no right to possess prior to default, but has the right to sale after default. Although these differences relate to

effects within one legal system (Scots property law), obviously, major differences are bound to arise when the comparison is between effects in relation to security devices across different legal systems. Therefore, if specific institutions give rise to both differences and similarities, there is the question of whether a system-neutral idea of a SFCA can be identified in terms of just those effects that are similar.

The argument may also be made that defining what amounts to 'by way of security' in terms of the contents of the right may be 'radically over-inclusive'.[61] This is because there are limited rights or rights lesser than ownership, such as the right of servitude, that are accessory but are not security rights or interests. Similarly, there are arrangements that vest on a party a right to ask for redelivery, such as an owner's right in a usufruct, which is not a security right. It is therefore questionable if these specific contents provide any indications as to what the phrase 'by way of security' means.

The above point re-echoes MacLeod's argument that, instead of asking what the right-holder can do, it is better to ask why that person can do those things. It is in asking this question that we can understand the purpose that brings those specific incidents together. As the above discussions demonstrate, these principles/purpose will apparently differ from system to system, as demonstrated most especially with reference to a legal mortgage or a *fiducia cum creditore* in some civil law systems, which, as we saw earlier in this article and the first article, contrasts with the presupposition in the Collateral Directive (arguably influenced by the civil law approach) that there is a conceptual distinction between a transfer and a security right.

IV. Conclusion

The key argument in the article is that the definition of a SFCA in the Collateral Directive is not really system neutral. The two criteria used to define a SFCA are based on the presupposition that there is a conceptual distinction between a SFCA and a TTFCA. However, as the above discussion demonstrates, this conceptual demarcation is not always clear, as there are institutions that lie somewhere on the spectrum between these two devices. Although the exercise carried out in this article can be criticized as being too focused on the wordings of the Directive, the article highlights the difficulties, and risks, that may be encountered in harmonizing legal concepts across systems on the supposed assumption that concepts can somewhat be defined in a system-neutral way. There may be some validity in this assumption of system neutrality, as seen above in the similarity regarding the effects of a security right across systems, which feeds into the meaning of a SFCA. However, careful attention must be paid not to overstep these similarities or to be too focused on the similarities and therefore overlook that the differences also play a significant role.

Acknowledgements

This work is derived from my PhD dissertation submitted to the University of Glasgow. I am grateful to my supervisors Prof Andreas Rahmatian, Prof Iain MacNeil, Dr John MacLeod (now at the University of Edinburgh) and the anonymous reviewer. My discussions with Dr MacLeod were very helpful in refining some of the ideas in this article. All errors are mine.

[61] MacLeod (n 7) 185.